
CONTEMPORARY LEGAL THINKING

**BRIEFING NOTE ON THE NEW
AUTOMOTIVE FRANCHISE
REGULATIONS**

V.S.GEORGE
— LAWYERS —

T: (02) 9150 6991 M: 0404 077 078

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Introduction

The recent release of the *Competition and Consumer (Industry Codes – Franchising) Amendment (New Vehicle Dealership Agreements) Regulations 2020* introduces for the first time industry specific legislation for the automotive industry within the Franchising Code of Conduct. Many of the provisions introduced are designed to address the power imbalances that exist in commercial arrangements between dealers and distributors.

In this briefing note we have provided an explanation of the changes and analysis and evaluation of the new provisions.

Although the new provisions are not contained in a separate mandatory Code of Conduct, it is contained in a separate Part of the Franchising Code of Conduct. Therefore, dealers continue to benefit from many of the

existing protections in the Franchising Code of Conduct as well as the industry specific provisions in Part 5.

In this briefing note, we have used the phrase *Franchising Code* in relation to the Franchising Code of Conduct and the phrase *Automotive Code* in relation to Part 5 that contains the industry specific provisions.

As you are aware, the firm's Principal, Vinesh George, has 15 years' experience advising clients in the automotive industry and more than 20 years in the legal profession. The firm represents the legal interests of franchised new car dealers in Australia. Its clientele includes many established dealers, dealer councils and industry associations.

We hope you enjoy this Briefing Note.



Vinesh George,
Principal,
V.S. George Lawyers

Summary of Key Changes

Key Changes	Explanation	Analysis: Did dealers achieve what they wanted?	Result
Notification obligations (cl 47, 48)	<p>Distributors and dealers are required to notify each other in writing as to what they intend to do upon the expiry of the existing agreement.</p> <p>If the term of the agreement is 12 months or more, distributors and dealers are required to provide at least 12 months' notice.</p> <p>If the term is 6 months or more, then at least 6 months' notice is required.</p> <p>If the term is less than 6 months, then at least 1 months' notice is required.</p>	<p>Dealers wanted an increase in the minimum notification period and hoped for a minimum 12 month notice coupled with a minimum agreement term of 5 years.</p>	STALEMATE
Reasons requirement (cl 47, 48)	<p>In non-renewal notices, distributors and dealers are required to provide reasons for their intention to either not extend their agreement, or not enter into a new agreement.</p>	<p>Dealers wanted an end to 'no fault' non-renewal notices.</p>	WIN
Obligation to manage winding down of agreement (cl 49)	<p>If either the distributor or dealer provides a notice of intention to either not extend the agreement, or not enter into a new agreement, then the parties must agree to a written plan to manage the winding down of the dealership and cooperate to reduce the dealer's stock over the remaining term of the agreement.</p>	<p>Dealers wanted a mandatory buy back of stock on commercially reasonable terms.</p>	STALEMATE
Requirements regarding Significant Capital Expenditure (cl 50)	<p>Distributors cannot require dealers to undertake Significant Capital Expenditure during the term of the dealer agreement. Unlike clause 30 of the Franchising Code (which, as specified by the Regulations, no longer applies in relation to a new vehicle dealership agreement), the fact that a distributor considers it necessary for the dealer to undertake capital investment is no longer a valid reason.</p>	<p>Dealers wanted the ability to freely consent to any expenditure they undertook so they could be sure to recoup their investment.</p>	WIN



Summary of Key Changes (cont.)

Key Changes	Explanation	Analysis: Did dealers achieve what they wanted?	Result
<p>Information and discussion about capital expenditure (cl 51)</p>	<p>Previously, distributors could require dealers to undertake significant capital expenditure during the term of their dealer agreement. The only requirement was to provide a written statement justifying the expenditure.</p> <p>Now, the written statement justifying the expenditure must be disclosed in the disclosure document prior to entering into a new agreement or extending the term of a dealer agreement.</p> <p>The distributor and dealer are required to discuss the expenditure before entering into, renewing or extending the term / scope of the agreement.</p> <p>Discussion must include the circumstances in which the dealer is likely to recoup their expenditure. The dealer's geographical location must also be taken into account. In other words, a metropolitan dealer may be treated differently to a regional dealer.</p>	<p>Dealers wanted to ensure a likely return on investment from their capital expenditure.</p>	<p>WIN</p>
<p>Multi-franchisee dispute resolution (cl 52)</p>	<p>Where a distributor has entered into franchise agreements with 2 or more dealers, and 2 or more of those dealers have a dispute of the same nature with the distributor, they may ask the distributor to deal with them jointly in the dispute.</p>	<p>Dealers wanted a mandatory requirement on distributors to resolve disputes collectively with multiple dealers.</p>	<p>STALEMATE</p>

New definitions inserted into Franchising Code

Explanation of the changes made:

The following definitions were inserted into subclause 4(1) of Schedule 1:

“new light goods vehicle” means a new vehicle of the kind referred to in clause 4.5.5 of the *Vehicle Standard (Australian Design Rule – Definitions and Vehicle Categories) 2005*.

Note: A **light goods vehicle** according to clause 4.5.5 of the *Vehicle Standard (Australian Design Rule – Definitions and Vehicle Categories) 2005* is defined as “a **goods vehicle** with a ‘Gross Vehicle Mass’ not exceeding 3.5 tonnes. For comparison purposes, a Ram 1500 truck has a gross weight of approximately 3 tonnes and would, therefore, qualify as a light goods vehicle.

Note: A **goods vehicle** is a motor vehicle constructed primarily for the carriage of goods and having at least 4 wheels; or 3 wheels and a ‘Gross Vehicle Mass’ exceeding 1.0 tonne. A motorcycle, for example, would not qualify as a goods vehicle.

“new passenger vehicle” means a new vehicle of a kind referred to in clause 4.3 of the *Vehicle Standard (Australian Design Rule – Definitions and Vehicle Categories) 2005*.

Note: A **passenger vehicle** according to clause 4.3 of the *Vehicle Standard (Australian Design Rule – Definitions and Vehicle Categories) 2005* includes passenger cars, forward-control passenger vehicles and off-road passenger vehicles. An omnibus (defined as having more than 9 seating positions) is not included in this definition. See legislation for further details.

“new vehicle” has the same meaning as in the *Motor Vehicle Standards Act 1989*.

“new vehicle dealership agreement” means a motor vehicle dealership agreement relating to a motor vehicle dealership that predominantly deals in new passenger vehicles or new light goods vehicles (or both).

“significant capital expenditure”:

- (a) in relation to a franchise agreement other than a new vehicle dealership agreement – has a meaning affected by clause 30(2); and
- (b) in relation to a new vehicle dealership agreement – has a meaning affected by subclause 50(2).

Application:

New definitions inserted into the Franchising Code came into effect from 1 June 2020.

Analysis and Evaluation of the change:

The definitions that have been added are designed for clarity rather than for the purpose of correcting the imbalance of power between dealers and distributors, as the other changes do.

The choice of the word “deals” in the definition of “new vehicle dealership agreement” possibly indicates an intention to expand the scope of arrangements covered by the Franchising Code. While there has been some speculation that regulators intended to cover agency agreements here, it is not made explicit. Whether or not the term “deals” extends to agency agreements is a matter that will in all likelihood require a court determination. In other words, a dealer may need to litigate against a distributor that is attempting to circumvent the Franchising Code through the agency distribution model.

As mentioned above, the definition of “new vehicle dealership agreement” means a motor vehicle dealership agreement relating to a motor vehicle dealership that predominantly deals in new passenger vehicles or new light goods vehicles (or both). We believe the purpose of adding the definitions of “new passenger vehicles” and “new light goods vehicles” is to narrow the scope of the application of the new Regulations to those dealerships predominantly dealing in cars and small trucks.

The Franchising Code continues to cover a broad range of other vehicles such as motorcycles, tractors, motorised farm machinery, motorised construction machinery, aircraft and motor boats.

Notification Obligations

Explanation of the change made:

Distributors (per clause 47) and dealers (per clause 48) are now required to notify each other in writing as to their intentions on the expiry of an existing agreement. If the term of the agreement is 12 months or more, distributors and dealers are required to provide at least 12 months' notice. If the term is 6 months or more, then at least 6 months' notice is required. If the term is less than 6 months, then at least 1 months' notice is required.

Application:

The requirements of clause 47 replace clause 18 – end of term arrangements for new vehicle dealership agreements entered into on or after 1 June 2020, or renewed or extended after this date. Clause 18 still applies to agreements entered into prior to 1 June 2020.

The requirements of clause 48 are only applicable to new vehicle dealership agreements entered into on or after 1 June 2020, or renewed or extended after this date.

Penalty for non-compliance:

Breach of clause 47 by a distributor will result in a civil penalty of 300 penalty units (\$63,000, increasing to \$66,600 from 1 July 2020). Breach of clause 48 by a dealer does not result in a penalty under the Regulations.

Note: Currently, 1 penalty unit = \$210. From 1 July 2020, 1 penalty unit = \$222.

Analysis and Evaluation of the change:

Previously, if a distributor intended to extend or enter into a new agreement, it had to provide dealers with the maximum notification of 6 months. Now, however, if the term of the agreement is 12 months or longer, 12 months' notice is required.

Furthermore, distributors (and dealers) now have the additional obligation to notify franchisees (and franchisors) if they do not intend to either extend or enter into a new agreement. In practice, distributors were issuing non-renewal notices despite no explicit requirement for them to do so.

While the notification obligations imposed on distributors is a positive development, the requirement for dealers to abide by notification obligations is confusing, burdensome and unnecessary. The changes give rise to the prospect of contradictory notices being exchanged between dealer and distributor. One notice may indicate an intention to enter into a new dealer agreement while the other may indicate an intention to renew the existing dealer agreement. Dealers must now also plan well in advance if it intends to not renew its representation of a brand. This is why we describe the changes as a stalemate.

To reflect dealer expectations, the clause 47 notification obligation should have been a minimum of 12 months. Additionally, it should have been supported by the Regulations enacting dealers' calls for longer term dealer agreements. A minimum term of 5 years with an automatic renewal of 5 years at the dealer's election is certainly not unreasonable given the significant investment made by dealers and the fact that other industries offer agreements spanning 20 years.

Notices of intention has also been an area of dispute. In one case, the court suggested that a notice of intention involved a hypothetical future possibility which a party is not bound to take. This is an area that could have been clarified in the Regulations.

No-Fault Termination - Reasons Requirement

Explanation of the change made:

If distributors (per s 47(5)) or dealers (per s 48(4)) provide a notice that they do not intend to either extend their agreement or enter into a new agreement, the notice must include the reasons for their intention i.e non-renewal notices now require reasons.

Application:

The requirements of clause 47 replace clause 18 – end of term arrangements for new vehicle dealership agreements entered into on or after 1 June 2020, or renewed or extended after this date. Clause 18 still applies to agreements entered into prior to 1 June 2020.

The requirements of clause 48 are only applicable to new vehicle dealership agreements entered into on or after 1 June 2020, or renewed or extended after this date.

Penalty for non-compliance:

Breach of clause 47 by a distributor will result in a civil penalty of 300 penalty units (\$63,000, increasing to \$66,600 from 1 July 2020). Breach of clause 48 by a dealer does not result in a penalty under the Regulations.

Note: Currently, 1 penalty unit = \$210. From 1 July 2020, 1 penalty unit = \$222.

Analysis and Evaluation of the change:

The requirement for distributors to provide reasons for a non-renewal is good news for dealers and will make it somewhat easier to challenge distributors if their reasons are unjustified and/or they are not acting in good faith. This is why we describe the change as a win for dealers. That said, the Automotive Code also requires dealers to provide reasons if they choose not to renew.

A possible disadvantage of the requirement for dealers to provide reasons is that they may also be subject to legal challenge by distributors. This is new legal territory for dealers.

It is, therefore, important that dealer notices are drafted carefully to avoid litigation. For example, representations made by a dealer when entering into a dealer agreement that it would build a new facility but who does not build a new facility may need to be addressed in the reasons for deciding not to renew.

This change is largely in line with dealers' expectations and will hopefully put an end to no-fault non-renewals. However, it would have been preferable if dealers did not also have to provide reasons for non-renewal notices as it is currently not an area of dispute between dealers and distributors.

Obligation to manage winding down of agreement

Explanation of the change made:

If either the distributor or dealer provides a notice of their intention to either not extend the agreement, or not enter into a new agreement, then new clause 49 requires that the parties agree to a written plan to manage the winding down of the dealership and cooperate to reduce the dealer's stock over the remaining term of the agreement.

Application:

Clause 49 applies only to new vehicle dealership agreements entered into on or after 1 June 2020, or agreements that renewed or extended after 1 June 2020.

Penalty for non-compliance:

None.

Analysis and Evaluation of the change:

As most dealer agreements contain a plan to manage the winding down of the dealership and to reduce stock, clause 49 appears unnecessary. In such cases, both parties have already agreed to the plan in the dealer agreement. However, it generally favours the distributor.

Some distributors set out their buy back plans as part of supplemental documentation such as bulletins and standards. The legal effect of these documents is questionable. However, the point that appears to have been missed is that the terms of any buy back of vehicles and parts should be on commercially reasonable terms. For this reason, we describe the changes as a stalemate, rather than a win for dealers.

Requirements regarding Significant Capital Expenditure

Explanation of the change made:

Under new clause 50, distributors cannot require dealers to undertake significant capital expenditure during the term of the dealer agreement unlike clause 30.

The fact that a distributor considers it necessary for the dealer to undertake capital investment during the term of the dealer agreement is no longer a valid reason under clause 50. It must be disclosed prior to entering into the dealer agreement or prior to renewing a dealer agreement.

Application:

Clause 50 applies to new vehicle dealership agreements if the disclosure document for the agreement was created, or most recently updated, before the commencement date, and the agreement is entered into, renewed or extended on or after the creation or updating of the disclosure document.

Clause 30 continues to apply to new vehicle dealership agreements entered into, renewed or extended before 1 June 2020, and also where the disclosure document for the agreement was created, or most recently updated, before 1 June 2020, and the agreement is entered into, renewed or extended after this date.

Penalty for non-compliance:

None.

Analysis and Evaluation of the change:

Clause 50 is an important win for dealers. Under the operation of clause 30, many dealers were required to make significant expenditures during the term of their dealer agreement. In theory, requests for capital expenditure must now be disclosed prior to entering into a new dealer agreement or renewing a dealer agreement. This change is welcomed as it is broadly in line with dealer expectations.

Information and discussion about Capital Expenditure

Explanation of the change made:

New clause 51 requires that distributors' disclosure documents must include as much information as practicable about any expenditure they require the dealer to undertake, including: (a) the rationale for expenditure, (b) the amount, timing and nature of expenditure, (c) the anticipated outcomes and benefits of expenditure; and (d) the expected risks associated with expenditure.

The distributor and dealer are required to discuss the expenditure before entering into, renewing or extending the term/scope of the agreement. Discussion must include the circumstances in which the dealer is likely to recoup their expenditure. The dealer's geographical location should be taken into account.

Application:

Clause 51 applies in relation to a disclosure document that is created or updated on or after 1 June 2020 and that is for a new vehicle dealership agreement entered into, renewed or extended after the creation or updating of the disclosure document.

Penalty for non-compliance:

None.

Analysis and Evaluation of the change:

Dealers should now be in a position to discuss capital expenditure requirements prior to entering into or renewing a dealer agreement. The discussion and representations made by the distributor should be minuted as soon as possible after it occurs as it may become important evidence if the reasoning, rationale and anticipated outcomes and benefits do not materialise. This is why we describe the changes as a win for dealers.

Multi-franchisee dispute resolution

Explanation of the change made:

Where a distributor has entered into franchise agreements with 2 or more dealers, and 2 or more of those dealers have a dispute of the same nature with the distributor, clause 52 enables them to ask the distributor to deal with them jointly in the dispute.

Application:

Clause 52 applies to a new vehicle dealership agreement that is entered into, renewed or extended before, on or after 1 June 2020.

Penalty for non-compliance:

None.

Analysis and Evaluation of the change:

For dealers, the insertion of clause 52 is a step in the right direction. The ability of dealers to resolve common disputes collectively does assist in strengthening their negotiating position. While the disadvantage of clause 52 is that it appears that distributors are not obligated to participate in this process. To be more effective, we believe clause 52 should have mandated distributor compliance with the dealers' request.

Key Issues not addressed by the amendments

Unfair Contract Terms to be extended to dealers:

Unfair Contract Terms (UCT) legislation originally applied to consumers but has recently been extended to also cover small businesses. As most dealerships do not qualify as a small business under UCT legislation, they are afforded no protection under the law. However, dealers are just as deserving of UCT protection as consumers and small businesses, particularly given their unequal negotiating position with distributors makes it difficult for them to effectively advocate for the removal of unfair terms. The Automotive Code was a missed opportunity to incorporate UCT legislation. The Regulations could have prohibited clauses that are particularly harmful to dealers, such as clauses that set unrealistic or arbitrary performance targets and unilateral changes to the dealer agreement or dealer standards. However, the Regulations failed to mention let alone address the issue of UCT.

Security of tenure:

The Regulations failed to address the security of tenure concerns that dealers experience due to short term dealer agreements. The AADA advocated for a minimum 5 year term, or a link between the term of the agreement and capital investment. A more ambitious target may be to seek automatic renewal terms as exist in lease agreements or long-term contracts at the election of the dealer.

Fair and transparent target setting:

Dealer performance targets cause a number of issues for dealers. Targets can be arbitrary and unrealistic, based on faulty research that dealers are not aware of. Failing to meet unfair targets can mean termination of the dealer agreement, even where the dealer is performing well. In our view, the issue of unfair performance targets was a missed opportunity to regulate conduct in the automotive industry. At our Sydney breakfast briefing in December 2019, a retired Federal Court Judge agreed with us that unfair targets could amount to misleading and deceptive conduct.

Warranty Obligations:

In the automotive industry, dealers are required to fulfil distributors' statutory warranty obligations. In theory, any statutory warranty work completed by dealers should be compensated by distributors. However, in practice, distributors regularly reject statutory warranty claims for minor non-conformities with their processes. Furthermore, distributors engage in practices like the extrapolation of warranty clawbacks in order to avoid the cost of conducting a full audit. Unfortunately, the Regulations did not extend to the issue of warranty obligations.

Industry Standard for Compensation:

The recent exit of the Holden brand from Australia has highlighted the need for a compensation system that ensures dealers are treated fairly when a distributor exits the country or drastically alters the way it operates. The compensation offered to Holden dealers has been criticised as inadequate and validates the need for regulatory intervention rather than reliance on the distributor's good will. The new Regulations were a missed opportunity to provide a framework for fair and adequate compensation.

Whether an agency agreement is covered by the Franchising Code:

Concerns have been brewing in the automotive industry for some time now about a possible widespread change from the franchise model of distribution to an agency model. The Regulations do not provide a clear answer as to whether an agency model would be captured by the Franchising Code or not. Yet again, we believe the new Regulations were a missed opportunity to clarify this issue.

Prohibition of Unfair Conduct:

The Regulations were also a missed chance to include in the Automotive Code prohibitions such as unfair conduct similar to those contained in the *Motor Dealers and Repairers Act 2013 (NSW)* which prohibits specific conduct by distributors that is unfair and detrimental to dealers.

Conclusion

The regulatory changes do cover some key areas for dealers, such as setting out reasons for a non-renewal rather than permitting no-fault non-renewals with no reasons. It also introduces for the first time, industry specific provisions within the Franchising Code of Conduct. This provides a basis and platform on which to build the years ahead. Dealers and industry associations such as the AADA should be congratulated on achieving these additional industry specific provisions.

We look forward to advising dealers and industry bodies as to the implementation of the changes and taking advantage of the additional protections provided by the Automotive Code.



V.S.GEORGE
— LAWYERS —

T: (02) 9150 6991 M: 0404 077 078