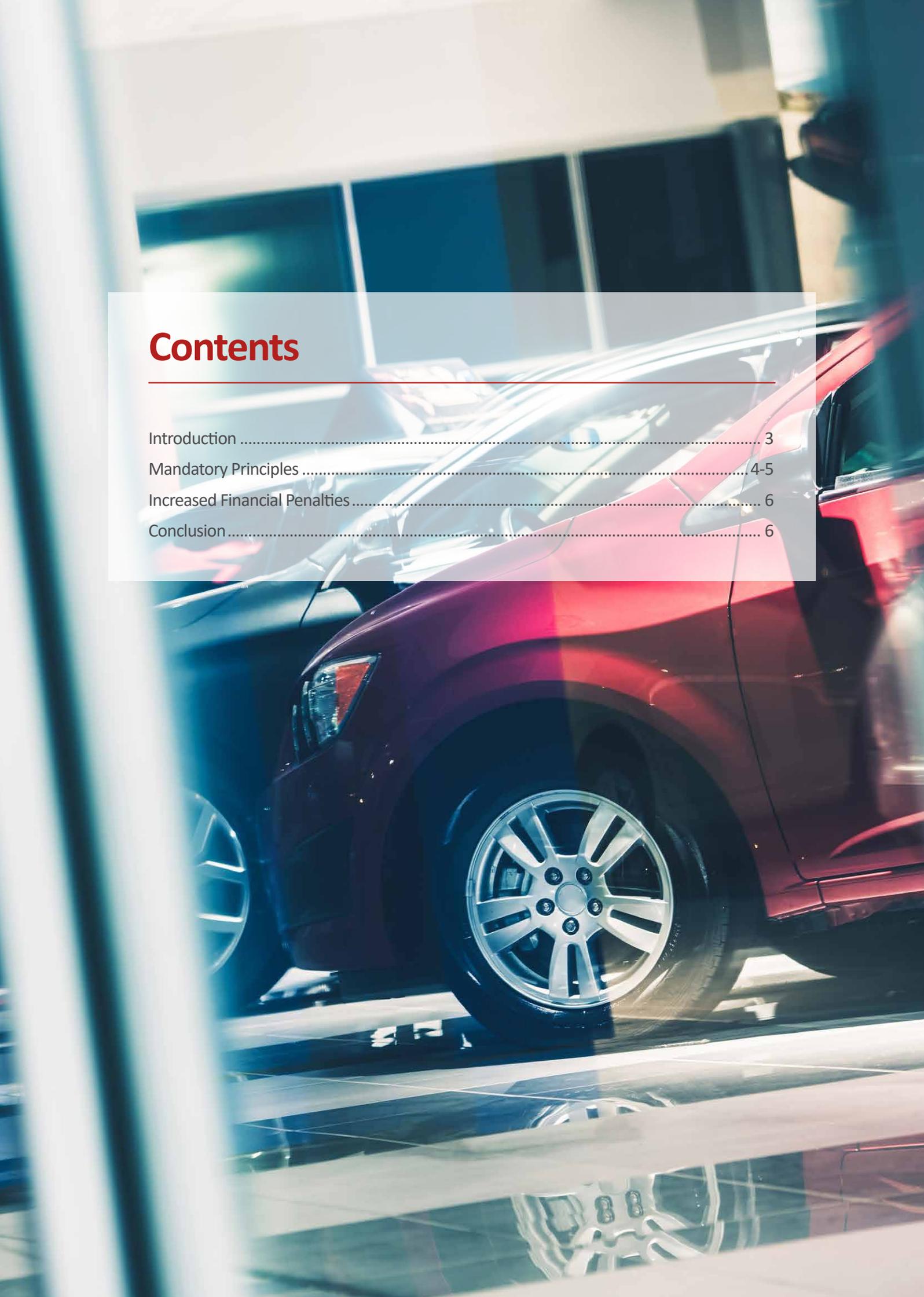

CONTEMPORARY LEGAL THINKING

**BRIEFING NOTE:
GOVERNMENT REFORMS DRIVE
DEALERS TOWARDS A FAIRER
FUTURE**

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GOVERNMENT REFORMS DRIVE DEALERS TOWARDS A FAIRER FUTURE

Introduction

On 12 March 2021, the Morrison Government announced that it would be making landmark reforms to the automotive industry in response to “*the growing power imbalance*” between Dealers and distributors.

Although a date was not specified, The Government committed to making the following reforms to the Franchising Code:

1. Making the voluntary best practice principles for new car dealership agreements mandatory.
2. Increasing penalties under the Franchising Code to up to \$10 million for “*wilful, egregious and systemic breaches*” of the Code, such as unilateral contract changes, poor compensation and renegeing on warranties.
3. Explicitly recognising that Dealers operating under an agency agreement are protected under the Franchising Code.

The specifics of implementation of those reforms are yet to be released by the Government.



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GOVERNMENT REFORMS DRIVE DEALERS TOWARDS A FAIRER FUTURE

Mandatory Principles

The recent example of General Motors' abrupt withdrawal of the Holden brand from Australia and their subsequent failure to work in a cooperative manner with Dealers is illustrative of the general inadequacy of reliance on distributors' good faith and voluntary principles. Voluntary principles can sometimes have the positive effect of promoting ethical business practices, however, they are significantly inhibited by their inability to create an environment of compliance and accountability.

MANDATORY PRINCIPLES FOR NEW CAR DEALERSHIP AGREEMENTS	
Principle 1	Franchisors should include provisions in new dealership agreements that provide for fair and reasonable compensation for franchisees in the event of early termination resulting from: <ul style="list-style-type: none">• withdrawal from the Australian market;• rationalisation of their networks; or• changes to their distribution models.
Principle 2	Franchisors should not include provisions that exclude compensation in new dealership agreements.
Principle 3	The 'fair and reasonable compensation' as referred to in Principle 1 should include appropriate allowances for the loss a franchisee may incur, which can include: <ul style="list-style-type: none">• lost profit from direct and indirect revenue;• unrecovered expenditure and unamortised capital expenditure when requested by the franchisor;• loss of opportunity in selling established goodwill;• wind up costs.
Principle 4	When an agreement is entered into it should provide franchisees a fair and reasonable time to secure a return on investments that have been required by franchisors as part of the agreement.
Principle 5	Agreements should include reasonable provisions for franchisors to compensate or buy back new vehicle inventory, parts and special tools, in the event of: <ul style="list-style-type: none">• non-renewal;• withdrawal from the Australian market;• rationalisation of their networks; or• changes to their distribution models.
Principle 6	Agreements should include provision for timely commercial settlement and dispute resolution.

Mandatory Principles (cont.)

Dealer Compensation

Principles 1, 2, 3 and 5 of the mandatory principles relate to the inclusion of provisions for compensation in Dealer agreements.

Principles 1 and 3 relate to the provision of “*fair and reasonable compensation*” for Dealers that have had an early termination as a result of their distributor withdrawing from the Australian market, rationalising their network or changing their distribution model.

Principle 5 requires that “*reasonable provisions*” be included in Dealer agreements so that distributors can compensate Dealers or “...*buy back new vehicle inventory, parts and special tools*” in the event of non-renewal, market withdrawal, network rationalisation or changes to the distribution model.

Principle 2 explicitly precludes distributors from including provisions that exclude compensation in new dealership agreements.

The necessity and rationale for mandating “*fair and reasonable*” compensation for Dealers was evident in the unfair compensation offered by GM Holden to its 185 Dealers. The recently released Senate report on the *Regulation of the relationship between car manufacturers and car Dealers in Australia* provided countless examples of submissions that were concerned about the adequacy of compensation offered by GM Holden. Of particular concern was the submission by an anonymous Dealer, who noted the wide disparity between the compensation offered by GM Holden, and the value of KPMG’s independently determined compensation of the true amount owed to Dealers. The concept of “*fair and reasonable*” compensation creates an independent standard with which to evaluate the compensation being offered by distributors. While determining what is “*fair and reasonable*” may present practical difficulty, having this enforceable standard can help prevent the excess abuses of distributors who significantly and unfairly under-compensate Dealers.

Fair and reasonable time to secure a return on investment

Principle 4 requires distributors to provide Dealers with “*fair and reasonable*” time to secure a return on the investments they have made in accordance with their Dealer agreement. As Dealers expend significant sums of money complying with dealership facility requirements, it can take many years for them to recoup their investment. Short term Dealer agreements place enormous pressure on Dealers to meet what are often unreasonable demands from distributors, or else face the ever-present threat of non-renewal. Principle 4 provides an important safeguard against Dealer exploitation and will require distributors to reconsider the length of the terms they set for their Dealer agreements.

Provisions for timely commercial settlement and dispute resolution

Principle 6 states that agreements should include provisions for timely commercial settlement and dispute resolution. Given the difficulty that Dealers and distributors have in resolving disputes and settling matters in an efficient manner, having provisions in place in a Dealer agreement will assist in helping both parties cooperate in finding a solution without resorting to litigation. Nevertheless, given that principle 6 has only vague specifications, it is unclear how current practice will evolve as a result of the need to have “*timely commercial settlement*”.

GOVERNMENT REFORMS DRIVE DEALERS TOWARDS A FAIRER FUTURE

Increased Financial Penalties

The decision to increase penalties for a breach of the Franchising Code to a maximum of \$10 million is a welcome and necessary change. In its response to the *Fairness in Franchising Report* released in 2019, the Government had previously committed to doubling penalties from 300 penalty units (\$66,600 from 1 July 2020) to 600 penalty units (\$133,200) for breaches of the Franchising Code.

However, given the substantial wealth and revenue of overseas multinational distributors, such penalties were deemed too small to have a deterring effect on poor corporate practices. It is hoped that the radical increase in financial penalties is sufficient to deter distributors from engaging in unethical practices.

Conclusion

The Government's reforms of the automotive franchising sector are welcome as they continue to level the playing field. Dealers can look forward to future reforms, which will continue to foster healthy business relations between distributors and Dealers.



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