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Alto Group

31 October 2008

The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Committee Secretary

As the Chairman of the Alto Group of Companies, I wish to provide a submission to the Parliamentary Joint Committee on Corporations and Financial Services' Enquiry into the Franchising Code of Conduct. I have been made aware of the Committee's hearings through the MTAA, and I have also read a copy of the submission made to the Committee by Mr Bob Gardini and I make this submission to provide some additional material to you in support of the call for the inclusion of a mandatory Duty of Good Faith in the Franchising Code of Conduct.

I established the Alto Group in the 1960's in Sydney. Currently, six Alto Group companies are licensed motor dealers in NSW, between them operating a total of 20 motor vehicle and motor cycle franchises.

In 1983 I operated Ford franchises on the Pacific Highway at both Artarmon and Gordon in Sydney and was also President of the Motor Traders Association of NSW. I was approached by [REDACTED] the managing director of [REDACTED] Australia to take on [REDACTED] franchises at our Artarmon and Gordon locations. These franchises were not highly sought-after at that time, but because of my high personal regard for [REDACTED] I agreed. We proceeded on a hand shake, and I established these two dealerships.

In 1989 I was forwarded a dealer agreement to sign which I signed because we had been operating the dealerships successfully for 6 years, and the relationship was good.



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In the early 1990's █████ changed the dealer margin structure they paid to their franchisees. In order to qualify for the previous level of dealer margin, we were required to significantly upgrade the dealership premises. Alto Group first rebuilt the Artarmon dealership at a cost of about \$8 million, and this new facility was opened in late 1999.

The Gordon redevelopment was complicated by the age and construction of the existing facility. It would have been prohibitively expensive to renovate this site, so I suggested to █████ that we construct a new facility on a new site within our Prime Market Area (PMA). They wouldn't agree, and put the dealership on review and issued a termination notice. After months of disputation and negotiation and considerable legal expense, we finally agreed on a new facility at Pennant Hills Road, Pennant Hills which I then proceeded to construct at a total cost of \$11.5 million excluding the land value. This new dealership opened in 2003.

We continued to operate both dealerships, rebuilding the Pennant Hills market area from start-up, which takes several years to do and in the process creating one of the top dealerships in Australia. Then in 2006, █████ met my son Anthony and advised him that █████ wanted to acquire our two franchises in order to restructure the Sydney market. They said they would pay a fair price for the businesses, and either buy or rent the facilities from us, whatever we wanted. They then handed Anthony documents giving 12 months notice of termination of the franchises to, as they said, get the discussions going. When asked what would happen if we didn't want to sell, they replied the franchises would be terminated anyway.

█████ did make us an insignificant offer, which I rejected as being extremely low, and in this period I got the feeling that █████ thought they could acquire the Alto businesses without having to pay any compensation, notwithstanding our efforts over 23 years to develop these businesses into successful and valuable assets. We faced the real prospect of seeing █████ take these businesses over for nothing by letting the termination notices expire.

So we engaged lawyers and commenced proceedings in the NSW Industrial Relations Commission, while █████ sought declarations in the Victorian Supreme Court. There were several mediation sessions under notices issued pursuant to the Franchising Code, as well as litigation in NSW and Victoria. The NSW Industrial Relations Commission ruled the matter was not within its jurisdiction, and the matter was set for hearing in the Victorian Supreme Court. Finally a settlement was agreed, prior to the hearing. Its terms are confidential, but resulted in Alto ceasing to be a █████ dealer at both Artarmon and Pennant Hills.

In the twelve months prior to this, Alto spent well over \$1 million in legal costs in order to protect the businesses we had spent 23 years building. We were not in breach of our agreements, and had invested significant capital to build dealership facilities to █████ requirements. All this apparently meant nothing when █████ decided to take back the businesses for itself and operate them as factory stores.

We were lucky in reaching a settlement, in that we had the resources to pay for the level of legal representation necessary to resolve the dispute, resources which would be out of reach of many dealers. We were also lucky that proceedings were in Victoria, where the implied Duty to act in Good Faith is accepted as part of franchise agreements, particularly because the Trade Practices Act was not available to us in our dispute. Without the significant resources of the Alto Group behind us, and in another jurisdiction, we would have faced the loss of these businesses without compensation.

The point I want to emphasise is that, in a franchise relationship in the motor industry it doesn't matter how big or experienced the dealer is, the franchisor always holds the whip hand. They dictate the terms of the dealer agreement, they usually retain the right to vary those terms unilaterally, and they can issue termination notices without the dealer being in breach. The dealer has to trust that this will not happen, or at least not before he has had the opportunity to make a return on his investment.

My experience over many years is that the franchisors, with all their resources, engage top-tier legal advice. Unless a dealer has the significant resources to enable them to match that level of representation, they are disadvantaged. The franchisors prepare their standard franchise agreement, often without any input or discussion with dealers. This agreement is then given to the dealers to sign on a take it or leave it basis

If you seek to negotiate the terms, as we invariably do, I can almost guarantee you will get one of two responses; either "this is our standard agreement and we can't agree to variations for any individual dealer", or "this is the agreement that was approved by the Dealer Council, and we won't vary it."

The use of Dealer Council's by franchisors is a continuing concern. Membership of these councils is usually by invitation from the franchisor, enabling them to stack the council with dealers who are more likely to be compliant to the wishes of the franchisor, such as a dealer holding only a single franchise so who is financially dependant on that franchise. Rather than being a forum to present dealer's issues to the franchisor, the dealer council becomes a rubber stamp to approve the franchisor's proposals for change, including new dealer agreements. The franchisor then seeks to use this "approval" to discourage any further negotiation by individual dealers.

Another ongoing concern is renewal of dealer agreements. It used to be the case that dealer agreements, if for a term, would be automatically renewed on expiration, unless a dealer was being terminated for cause, or by agreement. It is now much more common for renewals to be at the discretion of the franchisor, with no guarantee at all that a franchise will be renewed on expiry. This is often coupled with a clause that states that, on termination or expiration of the agreement the dealer is not entitled to any compensation for goodwill. This gives the franchisor significant power over the franchisee at renewal time, which can be used to gain agreement for the franchisee to expend considerable money to "upgrade" their facilities. If the dealer doesn't agree to this then the franchise will not be renewed.

Another way franchisors exert pressure on dealers is the setting of targets. Often these are set by the franchisor without consultation, and are based on the franchisor's forecast of its market share for the year. The targets then must be met by the dealer or he will be in breach of his agreement. Once set, targets are rarely reviewed to take account of actual results or changing market conditions, because the franchisor will have provided them to its parent overseas, who allocates manufactured units based on them. When the vehicles arrive in Australia the franchisor will force them onto the dealers so they can report back to head office that they have achieved target. The dealer is left with too much stock, which puts pressure on margins. If the dealer refuses to accept this stock he opens himself up to retribution. Typically this is either loss of bonus for failing to achieve the (unrealistic) target, or the dealer finds that scarce stock, which he wants to order because it can be sold with good margin, is allocated to the participating dealers rather than him. I have experienced both of these results.

Another way this is done is that, as the year end approaches the franchisor will itself register new vehicles, and pressure the dealers to also register new vehicles they have not yet sold, to gain market share and fulfill their factory targets. These market share results are deceptive as the industry market share figures are based on new vehicles registered, rather than vehicles sold. It also means the dealer now has a stock of registered vehicles, which it then must sell as second hand. This not only reduces the dealer's margin on these cars, but it adversely affects the new vehicle prices because customers now have the choice of a new full price vehicle, or a second hand vehicle with full warranty, no kilometers, and at a reduced price. Obviously in this situation new car prices are affected.

I use these examples of what I have experienced as a dealer over recent years to illustrate my point that, in a motor vehicle franchise, the franchisor holds the whip hand. These examples are not exhaustive, but I trust they convey this point clearly to you. Dealers need the protection of a clear Duty of Good Faith for both dealer and franchisor to help redress this imbalance, and this is best done by legislation, rather than having to rely on the lottery of whether such a Duty will be implied by a court, which of course only assists if you litigate. By legislating this Duty into franchise agreements it should enable the franchise relationship to be reset on a more equal footing, and should enable fairer resolution of disputes whether or not that dispute ends up in court.

I trust that these comments will be of some assistance to the Committee in its enquiry.

Yours faithfully



George Altomonte
Chairman
Alto Group of Companies