

NATIONAL COMPETITION POLICY

REVIEW OF MOTOR CAR TRADERS ACT 1986 AND ATTENDANT REGULATIONS



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NATIONAL COMPETITION POLICY
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AND ATTENDANT REGULATIONS

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OVERVIEW

RECOMMENDATIONS

Consumer rights and remedies established under the *Motor Car Traders Act* 1986 should be retained, and the licensing of motor car traders should continue.

While not necessary on the grounds of promoting competition, the eligibility criteria relating to fitness to be licensed on probity grounds could be rationalised. Two specific recommendations are made on this point. As these issues are under consideration in the broader context of proposals to re-organise business licensing processes in establishing a Victorian Civil and Administrative Tribunal, it has otherwise been deemed appropriate to defer to that process.

While the overall conclusion of the review is that the regulatory requirements imposed on the industry have negligible impact on competitive rivalry and are justified in terms of the public benefits they generate, the review has identified some areas where regulatory objectives could be achieved with less regulation.

The recommendations are that:

1. The eligibility criterion for a trader to have 'suitable premises' be replaced by a criterion that a trader have all relevant planning approvals for any premises at which the trader carries on business, or proposes to carry on business, as a motor car trader.
2. The eligibility criterion for a trader to carry on a motor trading business 'efficiently' should be removed.
3. The potential for unwarranted claims on the Motor Car Traders' Guarantee Fund should be reduced by:
 - ensuring that a financier cannot claim in relation to a trader's failure to cancel a security interest where the debtor was a motor car trader;
 - ensuring that a financier cannot claim where a vehicle has been repossessed from a trader's premises and sold at a loss; and
 - specifying the provisions in relation to which a claim can be made for loss incurred from the failure of a trader 'to comply with [the] Act' as sections 36 (prohibition on consignment selling), 38 (prohibition on odometer tampering), 43(3) (disposal of a trade-in vehicle during the cooling-off period), s54(1) (traders' obligations with respect to warranties), and s56(2) (special conditions purporting to limit or modify warranty obligations).

EXECUTIVE SUMMARY

The review examines the scope for reform of the *Motor Car Traders Act 1986* and Motor Car Traders Regulations 1987 under National Competition Policy. It follows the steps established in the Victorian Government's *Guidelines for the Review of Legislative Restrictions on Competition (The Guidelines)*.

Historically regulatory mechanisms have been viewed as necessary in the motor trading industry to protect the public interest in this important sector of the consumer market. Legislation governing motor car traders was first enacted in Victoria in 1973 and has undergone significant amendment twice in the last ten years. The most recent review conducted in 1994, and the amendments proposed as a result, involved a consideration of competition issues in the industry.

COMPETITION AND THE LEGISLATION

The review finds that there are strong competitive pressures in the motor trading industry in the markets for both new and used cars and that competitive pressures would not be significantly enhanced if the basic regulatory scheme were removed or altered.

Nonetheless, screening of participants in the industry through the licensing requirement and compliance with conduct requirements in particular may have some marginal effect on traders' cost levels. As a result, a review of the objectives of the legislation, alternative means for achieving them and an assessment of the benefits and costs of retaining particular requirements where viable alternatives do not exist was undertaken.

The review identifies the major objective of the legislation as one of addressing market failure due to information asymmetry inherent in the nature of motor vehicle transactions. This information asymmetry reflects the fact that motor vehicles are infrequently purchased, technically complex and expensive items which are essentially experience goods. The legislation attempts to address this problem primarily by improving consumers' bargaining position by both correcting, and compensating for, information asymmetry through a number of avenues. Other related objectives include effective disciplining of traders and allowing recovery of losses as a result of dishonest trader conduct.

IMPROVING BUYERS' BARGAINING POSITION

The review finds the requirement for information disclosure and standardised documentation by traders to be minimally burdensome and essential for promoting informed and efficient transactions in the marketplace. The information required is generally readily available to traders and would often be recorded in some form in any case. The benefits in terms of improved functioning of the market clearly outweigh the costs.

A mandatory warranty provides buyers with some assurance of vehicle reliability at the time of sale and prevents misrepresentation on the part of traders with respect to quality. The review finds the mandatory warranty an efficient means for improving buyers' bargaining position with respect to this important product attribute and price negotiating point. The potential for traders to supply warranties voluntarily is examined as are other means for obtaining information on product quality such as independent third party testing by the RACV. The review finds that these options do provide key information to buyers but suffer from a number of drawbacks which render them ineffective as a general means for improving buyers' bargaining position in the used car market.

The review finds that a short cooling-off period and opportunity for buyers to rescind a sale, within a limited timeframe and under limited circumstances, provides a deterrent to unconscionable conduct by traders. Traders can largely avoid the costs associated with these provisions by ensuring that they treat buyers in a fair and appropriate manner in organising transactions. This clearly improves buyers' bargaining position in negotiating a motor vehicle purchase.

DISCIPLINE AND REDRESS

The review finds that the objective of efficiently disciplining traders is largely achieved through record keeping requirements and the licensing of traders.

Record-keeping requirements regarding the dealings book, display notice, cooling off waivers and agreement of sale contracts pose minimal costs to traders in return for significant public benefits in terms of providing evidence for dispute resolution, the disciplining of traders if required and, in some instances, the tracking of stolen vehicles.

Loss of a licence or right to trade represents an effective deterrent to breaches of the Act reducing the need for disciplinary action. Alternatives to licensing examined are not considered as effective for achieving the disciplinary objective, either in terms of deterrence or enforcement. Case-by-case investigation and prosecution is too costly, time-consuming and narrowly-focused a strategy. Difficulties with other alternatives include: the costs, uncertainty and delays associated with consumers pursuing legal action; insufficient industry association coverage to allow effective self-regulation; and increased monitoring costs and the potential for significant losses to occur before a business behaving inappropriately is detected and disciplined under a negative licensing scheme.

LOSS RECOVERY

Although not a principal reason for licensing of traders, a further benefit of licensing is its underwriting of the Motor Car Traders' Guarantee Fund. This mechanism provides a 'safety net' to ensure that buyers' losses as a result of certain trader actions can be recovered.

In considering alternatives to the current guarantee fund, the review concludes that alternative options such as insurance would likely be more costly than existing arrangements, potentially result in more disputation and may involve longer delays in payment without clear potential benefits in terms of increased competition.

PART ONE BACKGROUND

1. THE INDUSTRY

The trade of new and used cars and related goods and services, such as repairs is a major industry in Victoria. According to the latest ABS (1994) figures available, car retailing in Victoria alone in 1991-92 employed around 10,900 persons with a turnover of almost \$4.8 billion. (Figures provided by the VACC for 1996 indicate that employment has changed little at about 10,500 persons). These figures accounted for the bulk of activity in the total motor vehicle retailing industry which also includes motorcycle dealing and trailer and caravan dealing.

Motor vehicle retailing as a whole accounted for about 17% of all retail turnover in Victoria in that year. Apart from its significance in terms of total retailing activity, the motor trading industry is also linked to other important sectors of the economy notably vehicle and component manufacturing and service industries such as repairs, insurance and finance.

Approximately 2,000 motor car traders are licensed in Victoria at any one time. In 1996-97 licensees numbered 2,061 up 94 from the previous year. There is a significant turnover of licences, with new businesses tending to operate in the premises used by previous traders.

The industry comprises a variety of retail companies, manufacturers, financiers and wholesale companies. The specialised wholesale sector is relatively small, while financiers do not trade motor cars as part of their ordinary business but do trade cars for the purposes of selling, letting or hiring them on instalment terms, under hire-purchase agreements or to take or enforce securities over cars.

Trading in new and used vehicles can involve a complicated set of transactions arising mainly from agency arrangements in the wholesale and retail financing of stock. As indicated above, traders may deal in various sectors of the industry, including for example, wholesaling used vehicles to the trade and selling to the public, or wrecking but on occasion selling a vehicle to the public. Many dealings include arranging the provision of finance to the buyer.

At the retail end of the market, dealers might trade in new and used cars or specialise in one sector only. As well as selling to the public, traders deal with each other both individually and at auction. Auctioneers dispose of vehicles on consignment at public auction as well as by private treaty and by wholesaling to the trade.

1.1 NEW VEHICLE TRADE

According to the VACC, there were approximately 380 specialist new car traders as at March 1997.

New vehicles are distributed in two main ways:

- a manufacturer or importer supplies a wholesale distributor who in turn supplies dealers; or
- a manufacturer or importer distributes vehicles directly to dealers.

The new vehicle sector of the industry in particular has a heavy concentration of franchisees. Under the franchise system, manufacturers and importers have a significant degree of control. This market segment is also dominated by relatively large establishments. A long term trend in both Australia and overseas suggests that further rationalisation is occurring with dealerships becoming larger and fewer in number.

About 50% of new vehicle sales are to private users. Private enterprises purchase around 40% of new cars while public sector organisations purchase the remaining 10%. The bulk of cars bought by fleet buyers are in the 'upper medium' class. This sector is dominated by the larger locally produced cars such as the Holden Commodore and Ford Falcon.

1.2 USED VEHICLE TRADE

In contrast to the new vehicle sector, the used vehicles sector is characterised by small enterprises, with the exception of new car dealers who re-sell trade-in vehicles either to the public or to the trade. These dealers tend to handle higher priced used vehicle stock.

This sector also comprises a significant private market of transactions arranged between individuals and not involving a licensed trader. These transactions account for approximately 50% of used car sales although in metropolitan areas the figure is even higher.

Another avenue for the sale of used vehicles exists through selling on consignment at public auction.

2. THE LEGISLATION IN OUTLINE

2.1 REGULATION OF INDUSTRY PARTICIPATION

Under the *Motor Car Traders Act* it is an offence to carry on the business of trading in motor cars without holding a motor car trader's licence.

The Act defines a motor car trader as any person who carries on the business of trading in motor cars, except those doing so in the capacity of employee or those involved in a number of motor car trading transactions which it excludes from the definition (see Section 2.3).

An application for a licence may be made by an individual who is at least eighteen years of age or by a partnership or body corporate. Applications by partnerships and bodies corporate must provide specified details for each partner and each director.

An applicant (including a partnership or body corporate) is ineligible to be licensed if the applicant:

- is disqualified under the Act or an act in another state from holding a licence;
- is an undischarged bankrupt or insolvent under administration;
- lacks sufficient financial resources or suitable premises to conduct the business of trading in motor cars;
- does not have sufficient knowledge of the Act to carry on a motor car trading business;
- has been convicted of a serious offence (involving fraud or dishonesty, violence or drug trafficking in Victoria or elsewhere punishable by imprisonment for 3 months or more) within the past 10 years;
- has had a claim admitted against the Guarantee Fund;
- would not maintain effective control of the business; or
- is not likely to carry on the business honestly, fairly or efficiently or is not a fit and proper person to be a licensee.

In assessing whether an applicant is a fit and proper person, the Licensing Authority may consider charges pending in relation to a serious offence or whether the applicant is an associate of a person or body corporate who has been convicted of a serious offence within the last ten years.

Licences are automatically cancelled if a licensee fails to meet a subset of the criteria listed above, namely being bankrupt or wound up; being convicted of a serious offence in Victoria or elsewhere (unless the Authority grants permission to continue trading); or being disqualified from holding a licence. Unless permission is granted by the Authority, licences may also be cancelled 30 days after a claim has been admitted against the Guarantee Fund in relation to the licensee.

A licensee's failure to meet the remaining criteria listed above may also be grounds for disciplinary action. In addition to cancelling or suspending licences, the Authority has available to it a range of less severe disciplinary measures including reprimands, fines, or imposing conditions or requirements on licences.

The Authority may grant permission for an applicant (or existing licensee) to be licensed, involved in managing, or otherwise be employed in a customer service capacity by a motor car trading business despite failing to meet the criteria relating to the Guarantee Fund claims and criminal convictions. It may also authorise licensed traders to conduct sales at public auction. It is an offence to do so without such authorisation.

Once the provision introduced by the *Motor Car Traders (Amendment) Act 1996* is proclaimed, the current licensing system involving annual renewal and scrutiny of licences will be replaced by a perpetual licence. On payment of an annual fee, the perpetual licence allows licensees to continue trading indefinitely unless a reason is established to the contrary.

2.2 CONDUCT REQUIREMENTS

The Act contains a number of requirements affecting business conduct and contractual relations between sellers and buyers of motor vehicles. Apart from two key provisions which apply to the sale of any used vehicle whether by a trader or private individual, most requirements relate only to the sale of used cars between traders and consumers. However a number of these requirements do not apply if the sale is at public auction.

The key requirements are:

- Any person, whether a trader or private seller, is prohibited from tampering with, or falsely representing the accuracy of, an odometer reading of a used vehicle. Traders must record the odometer reading at the time of purchase, display it on the car and state it in the agreement of sale.
- All registered cars (whether registration is suspended or not) and regardless of age, distance travelled, or price must be sold with a current roadworthy certificate (ie issued within 30 days prior to sale). This requirement applies to both motor car traders and private sellers but does not apply to vehicles sold on consignment at public auction or if the buyer is a motor car trader, financier, or manufacturer.

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- Consignment selling by traders is prohibited unless it is on behalf of a financier, manufacturer, other licensed motor car trader, or unless the sale is at a public auction.
 - Traders' advertisements for used cars must contain certain identifying details of the trader and vehicles offered for sale.
 - Traders must ensure the cancellation of any security interest in used cars offered for sale.
 - All motor car traders must keep a dealings book on the premises outlining key identifying details of motor cars purchased, sold or exchanged.
 - Traders must attach display notices on used cars containing key identifying details of the vehicle such as distance travelled, cash price (except when offered or displayed for sale at public auction), year of manufacture and first registration, engine number and registration number (if any).
 - Traders must supply buyers with an agreement for the sale of a new or used car at the time of purchase. These agreements must include the terms and conditions prescribed for each unless the trader is dealing with another trader, a financier or a manufacturer. If additional conditions are included in the agreement they must not derogate from the prescribed terms and conditions.
 - Traders must supply a non-waivable statutory warranty of 3 months or distance of 5,000 kilometres (whichever occurs first) against defects, not excluded by notice, for used cars which are less than 10 years old *and* which have travelled less than 160,000 kilometres. The warranty does not apply to vehicles sold at public auction. Special conditions purporting to limit or modify warranty obligations are void under the Act. For vehicles not subject to warranty by virtue of age and/or distance travelled, traders are required to attach a notice stating that the vehicle is sold without any obligation under the Act to repair or make good any defect which the car may have.
 - For used car sales traders must observe a cooling-off period of three clear business days to allow buyers (other than motor car traders or bodies corporate) to re-consider and terminate the agreement if desired. During this period, a trader must not sell or dispose of a trade-in vehicle provided by the buyer as part payment for the motor car. The cooling-off period does not apply to vehicles purchased at public auction or where the purchaser signs a prescribed waiver form. If a buyer terminates an agreement during the cooling-off period, the trader must refund all monies paid except \$100 or 1% of the purchase price under the agreement (whichever is greater) and return any vehicle provided by the buyer as part payment under the terms of the agreement.

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- Buyers may apply to the Magistrates Court or Credit Tribunal within three months of purchase for rescission of an agreement of sale on certain grounds. These include false representation in relation to an odometer reading, the agreement of sale not containing the prescribed particulars, or the car being substantially different from the car represented in the display notice. These buyers may not make a claim against the Guarantee Fund until the application for an order for rescission has been heard and determined.
 - Traders may not employ in a customer service capacity persons who fail to meet certain criteria.
 - It is an offence to aid or abet persons who are not licensed motor car traders to carry on the business of trading in motor cars.

2.3 COVERAGE OF REGULATION

The Act (s. 3(3)) exempts the following transactions from the definition of 'trading in motor cars' and hence the need to be licensed as a motor car trader:

- Any person buying from, selling to, or exchanging motor cars with a licensed motor car trader, financier or manufacturer.
- Any person selling, buying, or exchanging with their employee or with an employee of a related company.
- Financiers selling, by public auction or tender, cars that have been repossessed or surrendered (by persons who are not motor car traders).
- Private sale by financiers of repossessed cars to buyers introduced by persons from whom the cars were re-possessed.
- Any person selling cars to a person who has hired or leased the car for a continuous period of at least three months immediately prior to sale.
- Buying or selling at public auction ex-government cars or cars owned by a company (not a licensed motor car trader) in liquidation.

Private sellers of used cars are exempt from the Act's requirement to be licensed or to meet conduct requirements contained in the legislation other than those prohibiting odometer tampering and requiring used vehicles to be sold with a current roadworthiness certificate.

Regulation 6 also exempts the following sales at public auction from the requirement to be licensed or to meet the conduct requirements contained in the Act:

- Motor cars formerly owned or used by a Municipality (including the cities of Melbourne and Geelong).

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- Motor cars owned by executors or administrators of estates of deceased persons.
 - Motor cars owned and sold by insurers which, at the time of auction, are so damaged that the cost of repairs would be more than \$2,000 or more than the value of the car.

2.4 MOTOR CAR TRADERS GUARANTEE FUND

The Act establishes a Motor Car Traders' Guarantee Fund.

The Fund primarily receives revenue from licence fees as well as fines imposed under the Act and any interest earned through investment of monies held by the Fund. The Fund is used to meet the costs of administering the regulatory scheme and to pay claims to consumers for certain losses incurred as a result of motor car traders' actions. The Guarantee Fund acts as an avenue of last resort for loss recovery to any person (other than a motor car trader, financier, manufacturer or related company) who may make a claim against the Fund for losses incurred as a result of a motor car trader failing to:

- comply with the Act;
- transfer good title to the car;
- comply with an agreement to pay the purchase price to a person who sold a car to the trader or to remit all, or part, of the purchase price to another person;
- pay transfer fees, registration fees or stamp duty on a new or unregistered car or to provide a roadworthiness certificate or other document required to enable the car to be registered;
- remit money paid to the trader as a premium or purchase price for an insurance policy or warranty to the person who was to provide the insurance or warranty; or
- satisfy a court order, order of the Small Claims Tribunal, or order made by the Authority for a licensee to pay compensation (up to \$5,000) to persons losing money arising from the licensee's trading in motor cars.

The Fund grants claims only to buyers who have incurred a loss as the result of dealing with a licensed trader or where, on reasonable grounds, the buyer thought the seller was a licensed trader. The Regulations establish the maximum claim that may be paid out of the Fund to any one person in relation to one matter. This maximum amount is currently \$20,000. Maximum limits are set in order to protect the viability of the Fund.

PART TWO EFFECT OF THE REGULATION ON COMPETITION

3. COMPETITION IN THE INDUSTRY

Reflecting competitive conditions in the industry, traders in both the new and used vehicle sectors face an ongoing threat of losing market share and making financial losses if they are unable to compete effectively with other suppliers of vehicles. Competitive rivalry in the industry is also demonstrated through innovations and improvements to vehicle quality and sales packages, significant levels of advertising, and competition between manufacturers and traders on price, vehicle options and customer service.

3.1 NEW VEHICLE TRADE

This sector of the market is characterised by franchise systems where importers and manufacturers have a significant degree of control. In this environment it is difficult for a new trader to enter the market. Vehicle distributors control the number of retailers by controlling the number of franchises. There is a high demand for these and potential traders generally must wait for a franchise to become available and then convince the manufacturer or importer that they should be granted the franchise.

As a result of these marketing arrangements, a significant degree of competitive rivalry occurs between vehicle manufacturers for market share. At the dealership level, new cars are sold in a fixed range of models with extensive manufacturers' warranties and increasingly specialised maintenance and warranty services. Products and services offered by dealers of a given make of car are undifferentiated as franchisees are generally required to carry the full product range and provide comprehensive services.

Apart from competition between makes and models which occurs largely at the manufacturer level, the extent to which manufacturers' recommendations are followed may work to blunt price competition at the dealership level. However the existence of a large number of dealer franchises, particularly for the more popular makes of vehicles, restricts the ability of any one dealer to take advantage of market power.

There is scope for competition between the franchisees of one manufacturer through avenues such as marginal price discounting which is delivered via upward adjustment of trade-in valuations, absorption of delivery and statutory costs or by providing value-added options at no or less cost to the buyer. Franchisees also compete on the basis of the quality of customer service provided.

Rivalry in the motor vehicle industry has increased significantly in Australia over recent years due to improved technology, reductions in tariffs and other government assistance which have introduced new competition to the industry. A positive effect of this has been improved quality and reliability of vehicles, initially through the need for locally produced vehicles to compete with better quality imported cars. Consumers have also benefited from increased choice as the variety of makes and models of vehicles available has expanded significantly. Other benefits include more models incorporating features once reserved for luxury class vehicles such as power steering, ABS brakes, CD players and so on, and extended warranty periods which may also include free servicing for a set period of time or free roadside assistance.

The Australian market for new vehicles is described as a 'mature' one where the rate of new car purchases per capita has been falling since the late seventies to 1995 (Industry Commission, 1996, p. 25). In a shrinking market, competitive pressures are enhanced as participants try to secure market share. In this type of environment, consumers are likely to continue to benefit. Manufacturers will maintain a greater demonstrated commitment to the quality of their product through extended warranty periods and longer servicing intervals. Dealers will increasingly recognise the importance of providing a high level of service incorporating features such as extended opening times, innovative vehicle purchasing plans, provision of loan cars during servicing and so on. These changes reflect the need for dealers to establish long term relationships with clients in order to secure after sale servicing of vehicles and to encourage a repeat purchase of a new or used car in future.

3.2 USED VEHICLE TRADE

In contrast to the new vehicle sector, the used car market is characterised by a significant number of smaller firms where the bulk of competition occurs at the dealer level. Barriers to entry in this sector are relatively low. Exiting the industry is also easy when compared to the new vehicle sector as there are no manufacturers or importers interested in controlling outlets. The major barrier to a potential trader is financing of stock.

Reflecting low entry and exit barriers there is a considerable turnover of businesses in the used car market with new businesses often operating from existing premises.

In addition to the discipline imposed on existing licensed traders from the potential entry of new businesses, competition in the industry is enhanced by the existence of a substantial private market which accounts for about 50% of sales and through sales at public auction. The private used car market in particular represents a significant source of potential substitutes for used vehicles sold by licensed traders.

The new vehicle sector also represents a source of potential rivalry to used car traders as many new vehicle traders sell used vehicles and as some degree of substitution by consumers of new vehicles for used (and vice versa) also appears to occur. Recent increases in small vehicle sales of cars such as the Charade, Festiva and Excel may be drawing some purchasers from the used car market to the new, although these increases may also reflect a change in consumer preferences for smaller vehicles. The Victorian Automobile Chamber of Commerce (VACC) has indicated that a trend of shifting consumer preferences towards new cars rather than used has been observed.

4. ROLE OF REGULATION

It is often presumed that a licensing requirement represents a barrier to entry to an industry. In the motor car trading industry this presumption is challenged for two main reasons.

Firstly, the licensing system is an 'open' one. Provided that applicants meet the licensing criteria, there is no ceiling on the total number of licences that may be granted. This significantly reduces the licensing requirement's potential for raising entry barriers particularly in contrast to 'closed' licensing systems which set an upper limit to the total number of licensees or industry participants.

Secondly, the costs imposed by the licensing fee and conduct requirements contained in the legislation are likely to be insignificant when compared to marketplace factors such as the scale of investment required to establish a sustainable motor car trading business and potential obstacles to trade such as the need to operate within the franchise structure in the new vehicle sector.

A simple formula for assessing the extent to which regulatory costs contribute to entry barriers is provided by Norman. Norman (1997, p.36) states that there is no effect on barriers to entry if these costs represent less than 2% of the sales turnover of an average trader.

According to the ABS (1997), the average annual sales turnover of a motor vehicle retail establishment is \$4.5 million. The current application and licence fees for licensed motor car traders are \$681 and \$866. The sum of the application and licence fees (\$1,547) as a percentage of average annual sales turnover produces a figure of 0.03%. While this figure does not incorporate an estimate of the costs associated with meeting the conduct requirements contained in the Act, it is clear that the impact of the licensing requirement is effectively zero. Furthermore there is significant leeway to remain below the threshold of 2% even if the costs of meeting conduct requirements were estimated and incorporated in the calculation. This is particularly so because the cost represented by the application fee should be spread over the lifetime of the business which will generally be longer than one year.

This exercise demonstrates that, from a competition policy point of view, the legislative requirements imposed on the motor trading industry are more likely to be of interest because of the opportunity costs and uncertainty they may raise for potential traders rather than for their effects on barriers to entry.

As a result of these costs, which may ultimately raise prices paid by consumers, there is a need to examine the regulatory system in place to assess whether the costs of achieving its objectives are justified by its benefits. This includes a consideration of whether alternatives to existing legislative arrangements could achieve these benefits at lower cost. The general impact of the regulatory requirements on the industry are outlined below and discussed further throughout the report.

The licensing fee is currently \$866 per annum per place of business with a one-off application fee of \$681. The fee is set at a level consistent with achieving 'cost recovery' from the industry. This is a more transparent and equitable way of funding the costs of a regulatory system than through consolidated revenue. While buyers of vehicles ultimately benefit from the regulatory arrangements in place, it is more efficient to collect the costs of the system through an annual levy on traders (who can pass these costs on) rather than imposing a levy on individual buyers of vehicles. Licence fee revenue covers both the costs of administering the regulatory scheme and maintaining the Guarantee Fund.

On the assumption that few people seeking a licence would have a criminal record or be bankrupt, the licensing criteria creating the most uncertainty for potential traders are those relating to financial viability of the applicant, requirement for 'suitable premises' and the 'fit and proper' person test or assessment of the likelihood that the person will not carry on the business in an honest, fair or efficient manner. (See Chapter 10).

Of the conduct requirements contained in the legislation, the requirement for traders to provide a non-waivable statutory warranty for used cars of a certain age and distance travelled is likely to pose the most significant cost on business.

The main impact of the Guarantee Fund on traders arises through the need to fund it. In general this raises the level of licence fee payable although currently little licence fee revenue is earmarked for the Fund as significant reserves exist. While a guarantee fund is virtually unthinkable without a licensing system to screen applicants and make continued activity in the industry provisional in order to limit the number of claims made, maintenance of the Fund is not the primary reason for licensing motor car traders.

Apart from the effects of the regulatory system on traders, the report considers the role regulation plays in traders' ability to compete on price with a significant private market in the sale of used cars. As regulatory requirements do not apply to the private market, sales may be skewed away from traders to the private market. (Although, if working well and providing their intended benefits, regulatory requirements may in fact shift sales from the private to the trader market).

In assessing all of these issues the report notes that other factors such as exchange rate fluctuations; the strategic business plans of multinational car companies and Commonwealth regulation in areas such as tariffs and assistance, sales tax, safety requirements and environmental standards impact significantly on the nature of competition in the motor trading industry. In this context the effects of the requirements contained in the legislation under review have far less impact on the overall motor car trading environment than might be the case if they applied in isolation. This suggests that their removal or amendment would likely result in little change to trading conditions in the industry overall.

PART THREE ALTERNATIVE MEANS FOR ACHIEVING OBJECTIVES

5. OBJECTIVES OF THE LEGISLATION

The broad aim of the legislation is to address a market failure due to information asymmetry inherent in the nature of motor car trading transactions. Buyers lack information with which to assess either the 'quality' of competing sellers or the safety, quality and reliability of the motor vehicles themselves, particularly in the case of used vehicles. Sellers who possess this information may not have an incentive to reveal it to buyers. This information asymmetry is compounded by the cost and complexity of the product and, in general, a lack of expertise on the part of buyers. This, in part, reflects the fact that cars are infrequently purchased and essentially experience goods.

This information asymmetry does not allow the market to achieve socially optimal outcomes. As Akerlof (1970) described, in markets where consumers cannot judge quality poor quality goods can drive out superior quality goods as it is difficult for sellers to command a price premium for such superior goods.

In addition to failing to reflect a broad range of price/quality combinations, this type of marketplace offers considerable potential for fraud and deception of buyers because they are susceptible to being misled by sellers. This can encourage transient and unethical operators to enter the industry particularly when barriers to entry are low, as is the case in the used car market. Without some remedy to prevent the consequences of information asymmetry, there is a potential for 'rip offs' to occur which impose costs on the buyers involved but also have a broader negative impact of generally reducing public confidence in the market.

The legislation aims to deal with the problems associated with information asymmetry by including measures broadly intended to:

- improve buyers' bargaining position by both correcting and compensating for information asymmetry;
- provide efficient disciplining of dishonest traders; and
- allow losses due to dishonest trader conduct to be recovered.

6. LINKS BETWEEN OBJECTIVES AND RESTRICTIONS

6.1 IMPROVING BUYERS' BARGAINING POSITION

A number of conduct requirements contained in the legislation are directed at improving buyers' bargaining position. These can be grouped into three broad categories according to provisions directed at:

- ensuring that information held by sellers and relevant to a purchasing decision is disclosed to buyers;
- providing an assurance to buyers that the vehicle being purchased meets legal requirements for registration and has clear title;
- preventing misrepresentation by sellers regarding quality of the vehicle by providing some assurance of reliability at the time of sale; and
- deterring unfair and unconscionable conduct by traders in negotiating contracts.

Information disclosure

These requirements work directly at addressing the problem of information asymmetry by facilitating informed decision making by buyers.

To ensure that buyers do not have misleading information even prior to inspecting a vehicle at a dealership, the regulations require advertisements by traders to include three key pieces of information: the trader's licence (LMCT) number; the registration number of the vehicle or engine number if the vehicle is unregistered; and the cash price of the car, including dealer charges.

Provision of this minimal and easily obtained information prevents traders enticing buyers to their dealerships by advertising desirable vehicles at value for money prices which do not exist or which, on arrival at the dealership, 'have just been sold'. A requirement to include an LMCT number in the advertisement indicates to buyers the conditions of sale with respect to regulatory obligations. It also prevents traders posing as private sellers in order to sell vehicles without meeting the regulatory requirements to provide information and assurances to buyers.

At the dealership, buyers' bargaining position is improved by the requirement for traders to affix window display notices containing essential information on all used vehicles for sale. This provides buyers with the minimum amount of information necessary to sensibly negotiate over the vehicle. Display notices must contain identifying details of the current and previous owner of the car, distance travelled, cash price (except for vehicles displayed at public auction), year of first registration and registration number if applicable, engine number and year of manufacture, and whether the vehicle is subject to warranty.

Similarly, a notice describing defects, and a reasonable estimate of their cost of repair or making good (that the trader is not required to repair under warranty) must at all times be attached to the car and a copy must be signed and delivered to the buyer at the time of sale.

The agreement of sale used to complete a transaction contains prescribed particulars to ensure that the contract does not unduly favour one party to the transaction at the expense of the other. The required particulars on the sale of a new car are minimal and include only identifying details of the employee who negotiated the agreement on behalf of the trader, the trader's licence number, a description of the vehicle sufficient to identify it, the engine number, price and other charges and the manner in which these are to be paid.

The agreement for the sale of a used car requires these details as well as information relating to the registration number, odometer reading including whether the trader believes it to be true, that the agreement is subject to approval of finance in cases where this applies, conditions relating to trade-in if relevant, and termination conditions. Both types of agreement may include additional conditions negotiated by the parties to the transaction, provided that they do not reduce the rights conferred by the Act.

Legal requirements

The requirement for traders to ensure cancellation of any security interest in a used car provides the buyer with an assurance that the vehicle will not be re-possessed. Importantly it protects the previous owner from being pursued by a financier for a debt which the trader should have discharged. This is relevant for buyers who have a vehicle they wish to trade-in as part payment for another vehicle.

The legislation requires all sellers of registered used cars to provide a current roadworthy certificate issued within 30 days of sale. The roadworthy certificate indicates to buyers that the vehicle satisfies the legal requirement for minimum levels of safety contained in the *Road Safety Act 1986* and that it is suitable for registration. This provides buyers with a basic assurance that the vehicle once purchased can be used immediately without undergoing unanticipated repairs to bring it to the standard required for registration.

Misrepresentation relating to product quality

The legislation requires traders to supply a mandatory statutory warranty covering three months or 5,000 kilometres (whichever occurs first) for used vehicles which are less than 10 years old *and* have travelled less than 160,000 kilometres. The warranty is intended to clarify the notions of 'merchantable quality' and 'fitness for purpose' contained in general legislation such as the *Trade Practices Act 1974* and the *Goods Act 1958* in relation to used motor vehicles.

Provision of a warranty improves buyers' bargaining position by providing them with some degree of confidence in the reliability of the vehicle for which they are negotiating. In effect, the warranty requires traders to supply vehicles that resemble the representations they make regarding quality. These representations are made through mechanisms such as the vehicle's generally 'polished-up' appearance and through discussions with the buyer.

The warranty acts as a proxy for information on vehicle quality by providing buyers with some assurance that the vehicle is of reasonable condition given its age and distance travelled *at the time of sale*. It is not intended to provide an assurance, or information on, the vehicle's likely condition at some time in future and hence only applies for a limited period. This is considered a sufficient time for defects existing at the time of sale to become apparent and be repaired and also limits the number of defects which may have been caused or exacerbated by the owner's treatment. The trader is not responsible for repairs of such defects. Nor is the trader responsible for repair of defects in the tyres, battery or prescribed accessories which include items such as: audio equipment; body hardware or rear window demisters which are not standard to the car; light globes and sealed beam lights.

The statutory warranty represents a minimum warranty that traders must provide on certain used vehicles. Traders may offer extended warranties or warranties on vehicles where the statutory warranty does not apply if they wish to do so. The statutory warranty applies only to newer used vehicles in recognition of the fact that at some cut off point, reflecting age and/or distance travelled, the costs of providing an assurance that the vehicle is not unreliable are excessive, even if the warranty period is brief.

The warranty requirement was changed during the last review of the Act in 1994 following consultation between the Office of Fair Trading (OFTBA), the Victorian Automobile Chamber of Commerce (VACC) and the Royal Automobile Association of Victoria (RACV). It simplified the requirement from a two-tier system where vehicles sold for more than \$3,000 were covered by a warranty of two months or maximum distance of 3,000 kilometres, and those sold for more than \$6,000 were covered by a warranty for 3 months or 5,000 kilometres.

In theory a potential moral hazard problem may arise with respect to warranties. In practice however the inconvenience associated with returning a vehicle to the trader for repairs during the warranty period, the absence of the vehicle during repairs and the uncertainty associated with the time frame involved in repairs is likely to counter any tendency for the bulk of buyers to significantly alter the checks and assurances they would normally seek in relation to a vehicle's quality before deciding to buy.

Unconscionable conduct

To counteract a disadvantage that buyers may have relative to sellers through a lack of experience or information in negotiating commercial transactions and to improve buyers' bargaining position by counteracting pressure sales tactics, the Act incorporates two provisions designed to deter unconscionable conduct by traders. These are the cooling-off period and the rescission provision.

A three day cooling-off period for used car sales is primarily designed to remedy an information asymmetry which exists with regard to the contract and pressure selling which can result in a purchaser entering an agreement where, on cool consideration, it is apparent that she or he will be unable to discharge it. It counters consumer ignorance of contractual terms and problems that may be associated with buyers having little opportunity to carefully read or assimilate all details of a contract presented to them at point of sale. For buyers who are more confident about their purchase, and who wish to take immediate delivery of the vehicle, the cooling-off period may be waived at the buyer's option using a prescribed form.

The cooling-off period provides buyers with a second chance to study the terms of the contract of sale and to seek independent advice on any terms which may be of concern or which are not clearly understood. In many cases it allows buyers to organise finance and cancel an agreement if suitable finance cannot be found. While it is likely that the bulk of buyers organise finance prior to purchase, some may commit themselves to a purchase that is beyond their budget. This may occur when encouraged by a trader who emphasises that a better vehicle can be purchased with minimal additional finance. Traders have an incentive to upsell for higher revenue and often also have an incentive to upsell in order to arrange additional or larger finance packages which will earn higher commissions.

The cooling-off period imposes costs on traders by delaying the finalisation of transactions which can result in the trader holding stock or having delayed access to payment. However these costs are recovered to some extent as buyers who terminate an agreement of sale during the cooling-off period are required to pay \$100 or 1% of the purchase price (whichever is greater). Due to the financial penalty involved in cancelling sales, it is unlikely that many buyers would enter into contracts with the prior intent of cancelling, but rather would use the option as an 'insurance' reserved for unanticipated or exceptional circumstances only.

These factors would reduce the costs associated with providing a cooling-off period. In addition, traders, by virtue of experience in judging potential customers and their needs, can contain such costs to a degree by delaying finalisation of contracts or not applying high pressure sales tactics.

The Act allows buyers to apply for rescission of a sale within three months in certain limited cases. These include where a false representation has been made in relation to an odometer reading; the agreement of sale does not contain the prescribed particulars; or the motor car is substantially different from that described in the window notice that was attached to the vehicle. This provision is specifically directed at preventing unconscionable conduct as it essentially provides a remedy for fraudulent practices on the part of the trader. Importantly rescission may be exercised at the buyer's option so that a contract which benefits the buyer, despite these concerns, is not automatically cancelled.

Rescission proceedings are rare and to a large extent within the control of traders as the provision essentially covers instances of false representation.

Both the cooling-off period for used car sales and the rescission provision improve buyers' bargaining position by providing an incentive for traders to act honestly and responsibly in sales negotiations in order to reduce the extent to which buyers exercise these options after an agreement of sale has been made. They also have the advantage of curbing the consequences of unconscionable conduct. This reduces reliance on costly dispute resolution mechanisms to compensate buyers for its effects or reliance on the Fund for recovery of losses arising from such actions.

6.2 DISCIPLINING TRADERS

Another objective of the legislation is to provide an efficient means for disciplining dishonest traders and those not complying with regulatory requirements. This is primarily achieved through the licensing of traders and record-keeping requirements. Other conduct requirements contained in the legislation such as a ban on consignment selling and the provision allowing rescission of contracts in certain limited instances (discussed above) support this objective.

The licensing requirement assists in meeting this objective in two main ways. It allows for more effective monitoring of industry participants and it provides a credible deterrent to dishonest conduct through the imposition of penalties, suspension of right to trade, or in cases of more serious misconduct, loss of the right to trade.

Assessments conducted before licences are granted are designed to limit the possibility of dishonest dealings by excluding persons who, on the basis of past conduct, have demonstrated a likelihood that they will behave in an inappropriate manner. This is the purpose of licensing criteria such as a serious offences test and ensuring that unlicensed persons do not have effective control of a business. Importantly, these criteria do not automatically exclude such persons from the industry. The legislation provides the Licensing Authority with a capacity to impose conditions on licences granted. This gives the legislation additional flexibility in this regard. (See Chapter 10).

By establishing a paper trail of essential information, record keeping requirements provide key information for dispute resolution, the disciplining of traders if required, and the tracking of stolen vehicles in some cases. These requirements include maintaining a dealings book, requiring display notices on vehicles, cooling-off waivers and sale contracts.

Some conduct provisions are intended to reduce opportunities for dishonest dealings and hence the need for disciplining traders. Consignment selling is prohibited as it offers broad opportunities for fraud on vendors by allowing the possibility for traders to misrepresent the sale price of a vehicle to the owner or by allowing the possibility that sales proceeds will not be forwarded to the owner. A major objection to consignment selling is that it allows traders to effectively rely on the public to finance their stock. An earlier review of the Act (1985, p. 63) noted that traders in financial difficulties had resorted to consignment selling as a means to keep trading. Inevitably however many ceased trading and a number of losses had to be reimbursed from the Fund.

The provision allowing rescission of a contract in certain defined circumstances also provides a remedy for dishonesty on the part of the trader and restores the parties to the positions that existed prior to sale.

6.3 LOSS RECOVERY

It is clear that losses are sustained by buyers of motor cars due to dishonesty or incompetence on the part of traders. About \$195,000 was paid from the Guarantee Fund in 1995-96 representing 35 claims. During the years 1990-91 through to 1993-94 total claim value per annum was considerably higher peaking at around \$1.0 million in 1992-93. This amount represented 368 claims. Due to the nature of information asymmetries in the market, it is also clear that buyers have very limited means for preventing these losses.

The regulatory provisions contained in the Act are primarily directed at minimising loss rather than compensating for it after the event. By regulating the behaviour of the party directly responsible for causing, or not causing a loss, the licensing system and associated conduct requirements are a direct means for proactively reducing the possibility of loss to buyers. Nonetheless losses do occur and the legislation establishes a Guarantee Fund to assist persons in recovering losses arising from traders not complying with the Act's requirements. In this context, the Guarantee Fund acts as a 'safety net' in a limited subset of cases where losses occur despite mechanisms established to prevent them. It is a Fund of last resort available only when other avenues for seeking compensation have been exhausted.

Like any insurance scheme, there is a potential moral hazard problem associated with maintaining a Guarantee Fund. In theory its existence may reduce incentives for buyers to do their utmost to ensure they do not suffer loss arising from a motor vehicle transaction they engage in. At its extreme, this might result in buyers purchasing the first vehicle they find within their budget without assuring themselves that the trader is reputable and that the vehicle is essentially sound in the knowledge that if any loss were to occur, it would be covered by the Fund.

This problem is limited by a number of factors. Pre-purchase consumer awareness of the Fund is low and it functions only as an avenue of last resort. A person seeking compensation through the Fund would incur the monetary costs and inconvenience associated with trying to negotiate a favourable outcome with the trader in the first instance, dealing with disputes processes, and finally making application for compensation from the Fund. In the meantime the consumer must make do with an inappropriate vehicle which might be unserviceable. Finally the Fund provides compensation only on limited grounds so a reckless consumer could not simply assume a refund of any loss incurred. Taking these considerations into account, it is clear that few buyers would be significantly less cautious than they would otherwise be in purchasing a vehicle simply due to the existence of the Guarantee Fund. This in part would reflect the large sums of money involved.

A moral hazard problem is likely to be more significant amongst traders. Traders who are responsible for creating losses do not bear the full costs of compensating buyers hence their incentives to prevent losses to the extent possible are reduced. The result is that more frequent losses may occur (see Section 9.5).

7. ALTERNATIVE APPROACHES: IMPROVING BUYERS' BARGAINING POSITION

7.1 ALTERNATIVES TO STATUTORY WARRANTY

Used cars are expensive items, second only in terms of financial outlay to the purchase of a home for most people. Yet purchase carries an unavoidable and inherent risk that the vehicle will represent poor value for money in the sense that it will be less reliable and more expensive to maintain than would have reasonably been expected based on the vehicle's appearance, age, history and price.

In this type of situation buyers may end up paying more for a vehicle than they would have been willing to pay if they had known it was not reliable. This results in a resource misallocation. In the current regulatory environment the statutory warranty acts as a proxy for information to buyers that the vehicle is of reasonable condition given its age and distance travelled.

Reliance on market forces and general laws

The potential effects on buyer information and decisions of removing the statutory warranty needs to be examined.

Under this option buyers will likely rely on a number of sources to better inform themselves of a vehicle's value. These are likely to include:

- increased search;
- obtaining third party assessments and independent third party testing of the vehicle by the RACV; and
- warranties voluntarily provided by traders.

In cases where buyers have, despite these sources, nonetheless purchased a vehicle that is defective they will have to rely on warranties of 'merchantable quality' and 'fitness for purpose' contained in general legislation to enforce a minimum level of reliability.

The degree to which buyers will have to rely on their own search and third party testing as sources of information will reflect the extent to which warranties are voluntarily provided by traders and the quality of those warranties.

The extent to which warranties will voluntarily be provided by traders will likely vary according to the segment of the market they are in. Vehicles (and traders) may be usefully classified into a prestige or 'high end', a 'mid-range' and a 'low end' of the market. The bulk of vehicles and buyers are likely to fall in the 'mid-range' segment while fewer vehicles and buyers will be included in the 'high end' which includes prestige and more expensive vehicles or the 'low end' which accounts for the poorest quality vehicles many of which are, to some extent, defective or unreliable.

Traders in the 'high end' will dispose of low quality trade-ins through the trade and will likely supply all remaining used vehicles with warranty. In this part of the market the trader uses the warranty as a marketing tool in a way similar to the new vehicle market. In general the warranty poses little cost to the trader as few claims will be made. It is used to signal both the trader's and the vehicle make and model's quality. Buyers in this market are entitled to assume minimum risk when purchasing.

In the 'low end' of the market all vehicles are defective or unreliable to varying degrees. This part of the market is most likely to include those vehicles not currently covered by the statutory warranty. In this environment the costs of providing warranty are likely to be prohibitive and the trader is likely to offer a discount rather than offer to repair a defect if discovered by a potential buyer. Buyers in this part of the market are likely to be aware that they must accept a risk on quality or value for money if such low priced vehicles are to be available to them at all.

In the 'mid range', some traders will provide warranty. This is likely to apply to those vehicles that appear to be better quality on the basis that the high costs of providing warranty on some vehicles which are returned for repair will be offset by the price premium charged on other vehicles where the warranty results in low repair costs. As the quality of vehicles falls, the extent to which warranties are provided will also fall or their coverage will be less comprehensive. For these lower quality vehicles, traders are more likely to repair defects discovered by a potential purchaser or offer a price discount rather than supply a warranty. This reflects the increased risk and cost associated with providing warranty on these vehicles. Buyers in this part of the market have the most significant difficulty in assessing value for money, and are those targeted by the current requirement for statutory warranty.

While neither the trader or buyer have full information about a particular vehicle's quality, the trader has an information advantage over the buyer by virtue of having the vehicle in their possession with time to inspect it for defects and through general trading experience which provides the seller with 'general picture' information on how the particular vehicle compares against others of its make, model and age and against used vehicles on sale in general.

The trader may set the price of the vehicle on the basis of its appearance, a superficial inspection and the average price of average quality vehicles of that type. If the buyer pays this price and subsequently discovers a serious defect (whether the trader was aware of it or not), the buyer suffers a loss presuming that their willingness to pay for the vehicle with a defect would have been lower. The trader on the other hand obtains a surplus having sold a poorer quality vehicle at a higher price than would have been achieved if the buyer had been better informed about its quality.

Under this scenario if a warranty is supplied, the buyer still pays an average (too high) price for a poor quality vehicle but at least, through repairs of existing defects after sale, acquires an average quality car. In contrast, without a warranty the possibility that buyers will incur a loss is more likely. To reduce this possibility buyers will spend more time and resources acquiring information about all vehicles being considered. This might involve spending more time than would have been the case if a warranty were provided in activities such as inspecting a broader range of vehicles; seeking out opinions of other vehicle users or specialist motor magazines for indications of a particular make and model's reliability; and acquiring general information such as that provided by government, and motoring and credit organisations about minimising loss when acquiring a used car. This general information may be supplemented by acquiring specific information with respect to a particular vehicle through independent third party testing such as that provided by the RACV.

However, relative to the current environment requiring mandatory statutory warranties, substitution of these sources of information for information previously indicated or provided by warranty increases the transactions costs of trading a used car for both buyers and dealers due to the time, monetary outlay and inconvenience involved. Yet these increased costs may not necessarily result in a correspondingly significant improvement in a buyer's stock of information or bargaining power and hence may not contribute significantly to producing more efficient outcomes.

This is due to a number of reasons including uncertainty over the condition of the vehicle after the trader has purported to address problems identified in the test or uncertainty over the adequacy of a discount which may be negotiated in the place of repairing problems.

Apart from the shortcomings of third party testing as a mechanism for informing buyers, potential problems relating to voluntary warranties supplied by traders or reliance on warranties contained in general law should also be highlighted.

For warranties voluntarily provided by the trader, or commercial warranties supplied by independent third parties, the problem of information asymmetry associated with the purchase of the vehicle also applies to the purchase of the warranty. Without careful presentation and the opportunity for proper scrutiny of such a warranty at the point of sale, buyers could be significantly disadvantaged in negotiations over its purchase. Having incomplete information about the vehicle, the buyer will not know whether the warranty is required and could be convinced that it is superfluous by the seller, or conversely may be convinced to buy a warranty that provides little coverage in order for the trader to earn a commission. It is also difficult for buyers to compare the terms of different commercial warranties for one vehicle or across traders.

Providing the trader with control over what will be covered by warranty can result in the buyer purchasing a warranty that is of little value due to its exclusions. Commercial warranties generally require buyers to observe strict service dates, use specified parts and so on in order for the warranty to be honoured. In contrast, coverage of defects under the statutory warranty is more specific. Some accessories are excluded under the regulations as are defects listed in the display notice on the vehicle, provided that a reasonable estimate of the cost of repair or making good is provided by the trader.

Different interpretations of warranty obligations by consumers and traders can result in costs and disputation. This would be expected to increase if general legislative provisions of 'merchantable quality' and 'fitness of purpose' or commercial warranties provided the new standards in a market with no statutory warranty.

Part V, Division 2 of the *Trade Practices Act 1974* deals with 'Conditions and Warranties in Consumer Transactions'. Sections 71(1) and 71(2) outline the implied warranties of 'merchantable quality' and 'fitness for purpose':

71.(1) *Where a corporation supplies (otherwise than by way of sale by auction) goods to a consumer in the course of a business, there is an implied condition that the goods supplied under the contract for the supply of the goods are of merchantable quality*

(2) *Where a corporation supplies (otherwise than by way of sale by auction) goods to a consumer in the course of a business and the consumer, expressly, or by implication, makes known to the corporation or to the person by whom any antecedent negotiations are conducted any particular purpose for which the goods are being acquired, there is an implied condition that the goods supplied under the contract for the supply of the goods are reasonably fit for that purpose, whether or not that is the purpose for which such goods are commonly supplied ...*

Section 66(2) provides an interpretation of the meaning of 'merchantable quality':

Goods of any kind are of merchantable quality within the meaning of this Division if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect having regard to any description applied to them, the price (if relevant) and all the other relevant circumstances.

In what appears to be the most recent survey of public knowledge of these rights by the Trade Practices Commission (or its successor), a survey conducted in 1989 found that public awareness of these implied warranties was very low. Moreover even if consumers are aware of these rights, many are unlikely to have a clear idea of their scope or fully understand their implications and therefore will be unlikely to seek to have them observed. This partly reflects the uncertainty associated with case-by-case court interpretations of what these terms mean in practice. While mechanisms such as consumer education campaigns may improve consumers' awareness of these implied warranties, they would not necessarily remove the uncertainty associated with their interpretation.

As the vague nature of these warranties suggests that traders will be reluctant to voluntarily acknowledge their obligations under them, some mechanism would likely be required to ensure that third party or voluntary trader provision of warranties would not result in such persons exploiting the commercial benefits of providing warranty while avoiding the costs of meeting their obligations.

The likely effect of these factors would be a reduction in disputes settled between the trader and buyer involved in the transaction and increased usage of dispute resolution processes involving independent third parties and higher cost.

Removal of the statutory warranty may also result in a consumer loss through reduced choice if traders do not provide warranties to a similar degree as currently occurs. Currently buyers of used vehicles that are less than ten years old and have travelled less than 160,000 kilometres may choose between two sources of supply with different trading conditions — a trader market which provides some assurance of vehicle reliability and a higher risk, but lower priced private market.

Some consumers value the assurance on product quality provided through warranty and are willing to pay for the reduced risk of purchasing in the trader market. These buyers will prefer to purchase in the trader market provided that the price premium paid in this market does not exceed the value buyers place on this assurance and other advantages of buying in the trader sector, such as easy disposal of existing vehicles. At least 50% of buyers prefer to purchase in the trader sector and are willing to pay the price premium that may be associated with doing so.

While current mandatory warranty arrangements benefit these buyers, those people who are less 'risk-averse', better able to judge vehicle quality themselves, or who are not interested in the trader repairing faults under warranty (eg. because they prefer to repair the vehicle themselves) may be penalised if they purchase from a trader. This would include enthusiasts who purchase vehicles for the purposes of restoration for example. These buyers are penalised because they must pay for a mandatory warranty which they do not value. While this is of concern, removal of the warranty to prevent this occurring would not be justified for a number of reasons.

Firstly, any price premium paid by these, or indeed other buyers, in the trader segment relative to the private used car market would reflect not only the requirement for traders to supply warranty and meet other regulatory requirements but also a range of other overhead costs such as rent, wages and labour on-costs which traders must pay. Such operating costs would be reflected in a price differential between the two market segments regardless of whether the warranty were imposed or removed as private sellers do not have similar cost structures. Hence some difference in prices between the two market segments would likely remain. Removal of the mandatory warranty would therefore result in a loss to buyers who prefer to buy under conditions of warranty (presuming the scope and coverage of voluntary warranties is not as broad) without an offsetting benefit to other buyers.

Secondly, buyers who prefer not to pay for the assurances provided by warranty have available to them both the private and auction markets for used cars as alternate sources of supply. Removal of the mandatory warranty in the trader segment would benefit these buyers by increasing the options available to them that meet their preferred trading conditions but would do so at the cost of reducing, or possibly removing, the lower risk market conditions preferred by other buyers who value the warranty.

Given the scale of expenditure involved in purchasing a vehicle and the complexity of the product itself, it is likely that more 'risk-averse' buyers would account for a larger proportion of purchasers. Further, retaining the preferred trading conditions of these buyers does not remove options for less risk-averse buyers who may still access the private or auction markets. These factors suggest that removal of the mandatory warranty would likely benefit few at the expense of a larger number of buyers.

The shortcomings of the options of voluntary warranties, increased information search and RACV testing that the bulk of buyers would have to rely on in the place of a mandatory warranty for improving their bargaining position and determining their willingness to pay for a particular vehicle can result in a significant waste of time, money and resources. In addition, the mechanisms may not be particularly effective and buyers may, despite their efforts to inform themselves, end up incurring significant losses if the vehicle purchased is defective. In contrast, a requirement for traders to supply a mandatory warranty on certain used vehicles represents a simpler and more efficient means for ensuring an informed marketplace in terms of product quality.

For these reasons, removal of the mandatory warranty is not suitable as a widespread and general means to improve the bargaining position of all buyers of used cars. Provision of a mandatory warranty or guarantee counteracts the effects of uncertainty associated with quality. While it is true that some traders will provide warranties voluntarily it is possible that they will cover only a sparse subset of vehicles and buyers.

In contrast, the mandatory warranty ensures that buyers who most require the additional information the warranty provides are covered. At the same time traders are still free to use extended warranties as a further signal of quality or as a marketing tool if they wish to do so.

Statutory warranty on sales by all sellers

It might be argued that it is unreasonable to require traders to provide a warranty on newer used vehicles when these vehicles can be purchased in the private market at a lower price (partly reflecting the absence of a warranty) and when many buyers are willing to take a risk on quality in return for a lower price.

However, traders are always subject to implied warranties of 'merchantable quality' and 'fitness for purpose' not imposed on private sellers. This would be the case even if the mandatory statutory warranty for vehicles less than 10 years of age which have travelled less than 160,000 kilometres were removed. The warranty imposed by the *Motor Car Traders Act* can therefore be regarded as an attempt to codify these less specific protections rather than a new requirement in itself. It improves enforceability of the implied warranties and thereby reduces costs associated with disputation and legal processes.

This reason for applying a statutory mandatory warranty in the trader sector of the used car market does not apply in the private market.

From an economy-wide perspective, it is most efficient if vehicles are brought to their optimal level of safety or quality by the party (seller or buyer) who can do so at least cost. By virtue of greater experience and exposure to motor vehicles, it is likely that in general traders have an advantage in reducing risk because they are more likely to identify a defect in a vehicle, understand its implications in terms of safety or performance and costs of repair, and possess knowledge of how the vehicle compares to others on the basis of safety, risk and quality.

While private sellers have some knowledge of the specific history and defects of their vehicle they do not have the general knowledge and experience held by traders by virtue of their expertise in trading vehicles. This suggests that while information asymmetry will always occur between the seller and buyer of a vehicle, it is likely to be greater and more significant in transactions involving traders. Similarly, in general, the costs of avoiding loss differ more significantly between a trader and buyer than a private seller and buyer.

In the absence of warranty, it is more likely that losses due to defective or unreliable vehicles will be incurred by buyers rather than traders in general. By virtue of trading a large number of vehicles, traders' low returns on some vehicles would on average be offset by higher than average returns on other vehicles so that the overall return to traders would be balanced between excessive profits and substantial losses. In contrast a purchaser buying one car does not have an opportunity to spread or average losses if these are incurred. A private seller is in a similar position.

For example, a used vehicle of a particular make, model and vintage will attract an average price for an average vehicle of that type established in the market. If a private seller's vehicle is above average, a loss is incurred by the seller if she or he cannot signal the higher quality and the average price is achieved. Traders, on the other hand would incur a similar loss on above average vehicles, again assuming they could not signal better quality, but would extract a gain on vehicles that are below average yet achieve the average price if the buyer cannot ascertain the difference in quality. If a trader sells a greater proportion of below-average than above-average vehicles, the losses incurred on some vehicles by achieving a price that does not reflect their better quality will be more than offset by the gains made on the poorer quality vehicles which do achieve the average price.

In summary, the private market is one where the information asymmetry between buyers and sellers is less significant than in the trader market. In general, both parties in a private transaction will rely on information sources such as the results of third party testing to negotiate over price. Price negotiations based on this type of information can be clearly understood by both parties and the buyer is able to extract some value from the costs and resources spent in acquiring additional information.

In contrast, a trader generally has a considerable advantage in terms of information held about the specific vehicle, general conditions in the used car market and expertise in negotiating sales of cars. In this situation, the trader is in a position where he or she can price in a way that reduces the pay off to the buyer for incurring the costs of obtaining additional information. In these situations the buyer would incur a loss through obtaining little value for the resources spent on obtaining information as well as the loss associated with purchasing a defective vehicle.

Statutory warranty at buyer's option (mandatory dual pricing)

A middle course between compelling traders to provide a statutory warranty on all vehicles below a certain age and distance travelled and the other extreme of not requiring a statutory warranty at all is one which compels traders to offer a warranty at a stated price and allows buyers to choose whether they will purchase it. This would result in a market where dual prices for vehicles arise — one inclusive of statutory warranty, the other not.

The Discussion Paper released by the Office in September 1994 as part of the most recent general review of the Act gave some prominence to this idea.

This option would require window display notices to state both 'with warranty' and 'no warranty' prices. Agreements of sale would have to indicate whether the 'warranty' or 'no warranty' option had been chosen and the price agreed. A requirement to provide buyers with copies of these documents would also be required. Advertisements would have to specify both prices.

The main apparent advantage of this option is that traders could offer vehicles at 'no warranty' prices lower than the 'with warranty' prices they currently charge. This assumes that sellers will not simply use current prices 'with warranty' as the starting point for 'no warranty' prices.

This option would also provide buyers with access to a relatively simple standard warranty if they were willing to pay for it. The difference between the 'with warranty' and 'no warranty' price should provide buyers with some indication of the risk involved in forgoing the warranty.

However this option has three main disadvantages.

Firstly, traders may inflate the 'with warranty' price to deter consumers from buying the vehicle under these conditions with the result that few vehicles are supplied with some assurance of reliability at time of sale. This has implications for achieving the legislation's objective of improving buyers' bargaining position.

Secondly, documentation requirements would increase which would raise traders' costs to a degree, for instance by requiring the inclusion of two prices in advertisements.

Thirdly and most significantly, there is potential for misunderstanding and confusion for both buyers and traders as to whether negotiated prices did, or did not, include warranty. This could increase costly disputation and reduce buyer confidence in the industry.

Importantly, while this option may appear a reasonable approach in theory, it was rejected by both industry and consumer representative groups (Victorian Automobile Chamber of Commerce, Royal Automobile Club of Victoria, Consumer Credit Legal Service and Victorian Motor Wholesale and Auction Association) on practical grounds during consultations associated with the 1994-95 review of the Act. A revised mandatory statutory warranty system was preferred.

Given the preference of these key industry and consumer groups for the current warranty system over the option of mandatory dual pricing, and the fact that the revised and simplified warranty requirement has only been in place since March 1997, it appears sensible to leave the current system unchanged for a reasonable amount of time. This would allow an assessment of the current system's effectiveness to be made before it is replaced with another warranty system.

7.2 ALTERNATIVES TO THE COOLING-OFF PERIOD

Reliance on general contract law

Removal of the cooling-off provision may reduce traders' costs by allowing transactions to be finalised sooner. This would eliminate costs associated with cooling-off such as holding stock and trade-ins during the three day period and committing staff resources to transactions that result in no financial return to the trader.

However removal of this provision would not meet the legislation's objective of deterring unconscionable conduct and improving buyers' bargaining position. Its removal would also conflict with the legislation's objective of minimising losses due to dishonest trader conduct. Use of the cooling-off provision can avert the costs associated with recovering losses later.

The cooling-off provision requires traders to take into account the consequences of actions such as pressure selling through the knowledge that the sale may be cancelled during the cooling-off period. This is likely to more effectively deter inappropriate trader behaviour than the possibility of legal action under general legislative provisions as this involves greater uncertainty of penalty and lengthy delays.

The provision gives traders an incentive to take care in negotiating sales and in encouraging people to purchase more expensive vehicles and finance packages. By doing so, traders can largely avoid the possibility of cancelled sales and any costs that may be associated with the cooling-off provision.

Cooling-off period on sales of used cars by all sellers

The principal reasons for using a cooling-off provision as a mechanism to improve buyers' bargaining position in the trader market do not exist in the private market for used cars.

In the trader market, it is easier for buyers to sign agreements for vehicles beyond the budget they had originally set themselves through encouragement from the dealer. This is more likely to occur in the trader than private market because buyers can be shown a range of 'better' vehicles than the one they had originally come to see. A presentation of finance packages on the part of the trader can convince the buyer that the vehicle is affordable.

In the private market the sellers' role in buyers entering into contracts beyond their means is significantly reduced because only one vehicle is offered for sale, finance packages are not offered and the seller generally expects a full cash payment for the vehicle at the time it changes hands.

7.3 ALTERNATIVES TO STANDARD DOCUMENTATION OF INFORMATION

Market provision of information

It might be argued that traders should not be subject to regulation which specifies what information must be provided to buyers and that it is the buyer's responsibility to obtain information relevant to a purchasing decision in order to promote their best interests. This assumes that all buyers have equal and easy access to information and that information can be obtained at relatively low cost.

While it is reasonable to expect consumers to inform themselves, there are cases where information can be more efficiently provided through seller disclosure. The information the legislation requires sellers to disclose is already held by traders or can easily and cheaply be acquired. As traders are unlikely to supply all information that might be relevant to the buyer, but which might not advantage the trader, information disclosure laws are required to ensure that essential information for the purchaser's buying decision is provided.

Standard documentation in agreements of sale ensures that contracts do not unduly favour the trader. Removal of this requirement could significantly adversely affect buyers' bargaining position through a change to contract provisions. This is significant as contracts are generally presented to buyers as a 'fait accompli' at the time of sale. It would also make it more difficult for buyers to compare the conditions of sale of vehicles by one trader or across traders, reducing buyers' ability to choose the package (vehicle and contract conditions) that best meets their needs.

Documentation and contracts associated with sale can be a source of fair trading problems and compliant if they unduly favour one party over the other or if they do not simplify and make complex legal provisions more comprehensible and useful. The requirements for standard terms and conditions in an agreement of sale are a simple, efficient and low cost means for addressing these potential problems.

Apply standard documentation of information to all sellers

From a buyer's point of view, the requirement for standard documentation of information in the trader market and absence of this requirement in the private market is unlikely to represent a key distinguishing feature between the two market segments. Hence it is not likely to be an important factor for deciding to purchase in one market rather than the other. Nonetheless the option of applying these requirements to private sellers in order to bring that market into line with the trader segment should be considered.

Generally private sales of motor cars do not involve written contracts and may only involve a simple receipt for monies paid. For trade sales, on the other hand, contracts of sale would be used even if there were no regulatory requirements relating to them. Therefore, in the case of trade sales, the legislation does not impose a new requirement on sellers but merely requires that contracts include a number of specified items. In contrast, if this requirement were to apply to private sellers, it would represent a new requirement for which there appears to be no need given that written agreements of sale are not generally entered into at all in this part of the market.

The key reason the legislation requires traders to place window notices on used vehicles offered for sale is to provide potential buyers with contact details of the last owner of the vehicle as well as identifying details of the vehicle. Clearly in a private sale this is unnecessary. For traders, window notices also happen to be a more efficient means of providing basic information to a large number of buyers on a large number of cars than doing so verbally. Again there is not a comparable situation in a private sale.

It is clear that both the regulatory requirement for certain terms to be included in the agreement of sale and the requirement for window display notices are redundant in the private segment of the used car market.

7.4 REMOVE PROHIBITION ON CONSIGNMENT SELLING

The prohibition on consignment selling might appear a high cost means of achieving the objective of improving buyers' bargaining position because it prevents an alternative form of selling. Some traders and/or sellers of vehicles may prefer to sell on consignment.

However any losses that may be associated with prohibiting sales on consignment at dealerships are minimised because a consignment selling route exists through public auction and is available to any buyer and any trader who seeks authorisation to conduct such sales.

Removing the prohibition on consignment selling would therefore make it more difficult to achieve the regulation's objective of improving buyers' bargaining position without significantly improving the position of those preferring the, already existing, option of selling on consignment.

7.5 ALTERNATIVES TO RESCISSION

Removal of this provision would require those buyers who have discovered a loss as a result of fraudulent practices by traders to rely on general legislative provisions to recover that loss. These provisions relate to misrepresentation and unconscionable conduct but, due to their vague nature, create uncertainty and are difficult to access as a source of remedy.

In contrast the existing rescission provision clarifies those rights by specifically outlining cases in which the buyer may apply to a Magistrate's Court or the Credit Tribunal within three months for rescission of a sale. This provision is an addition to any other legal right a buyer may have to rescind a sale and is designed to restore the parties to their positions prior to sale.

Removal of the rescission provision would probably make it more difficult for buyers to be compensated for the consequences of fraudulent conduct by traders. Apart from the losses that would be incurred by consumers, the incentive for traders to behave in an appropriate manner would be reduced. This implies that the legislation's objective of improving buyers' bargaining position would be more difficult to achieve.

8. ALTERNATIVE APPROACHES: DISCIPLINE

8.1 ALTERNATIVES TO LICENSING

Deregulation

Consumers general lack of confidence and past, and some continued, experience with malpractice in the industry suggests that the industry as a whole could not be completely deregulated.

In addition, there is no reason to believe that informational and bargaining inequalities that have existed in the past between buyers and sellers no longer exist. Market forces alone in motor vehicle trading would not produce efficient outcomes or operate in the public interest. Furthermore the potential for consumer loss arising out of market failure in this market is significant given the number of transactions involved, the significance of the purchase for most buyers and the large sums of money involved.

Consumer information and education strategies

Consumer information and education strategies are already pursued by a number of organisations such as the Office of Fair Trading, the RACV and consumer credit bodies through publications such as *Car Deals*, seminars or other avenues. These strategies can improve buyers' information and promote improved dealings in motor vehicle transactions thereby reducing reliance on disciplinary measures.

While information and education of buyers plays an important role in achieving the legislation's objectives, particularly if well publicised and widely accessible, it cannot address all the problems that arise due to information asymmetry in the market. This is for two main reasons. Firstly, some buyers will not be reached through such programs. Secondly, the information provides buyers only with a general understanding of potential problem areas in transacting for a motor vehicle. While this understanding is important for alerting buyers to possible inappropriate conduct on the part of traders, it is insufficient for disciplining such traders. Over time, such traders may acquire a poor reputation and be penalised by losing market share as a result. However this may take considerable time with resulting damage to a significant number of buyers and the industry's reputation in the interim.

Therefore, while these efforts when successful, can lower the occurrence of unfair trading, disputation and calls on the compensation fund, they cannot be used in isolation to ensure that traders deal with buyers in an appropriate manner thereby reducing the need for disciplinary action against traders.

Voluntary industry code or industry self-regulation

This option, generally based on a voluntary code of practice or conduct, involves industry setting its own rules and standards and applying sanctions. Voluntary schemes are binding only on members of the trade association and rely on industry initiative and commitment to be effective. Under this option primary responsibility for conduct within the industry lies with industry itself. This generally requires industry to have an incentive or commercial benefit from upholding the standards and reputations of members and sufficient commonality of interest to deter non-compliance. This is because compliance relies on the desire of participants to uphold the reputation of the industry and the desire to avoid the sanction of peers.

The benefits of voluntary schemes for consumers are that they can increase consumer confidence in dealing with the trade. These schemes also incorporate industry expertise, reflect market realities and can generally be modified more quickly than government-based regulation in response to changing circumstances and needs.

The disadvantages are that such schemes may not cover all participants in the industry but only those that are members of the industry association. Under limited coverage, the public benefits that could potentially be achieved by self-regulation would be limited. Based on figures provided by the VACC, its coverage of specialist new car traders is 85% while its coverage of specialist used car traders is only about 20%. While the organisation's coverage of the new vehicle sector is impressive, the low coverage of used car traders is particularly significant because the bulk of regulatory measures under current arrangements relate to used car sales.

Another shortcoming of these schemes is that they often do not incorporate enforcement actions or effective sanctions. For instance, expulsion from the industry association as a penalty might not represent an effective deterrent against breaches of the code, particularly if commercial survival or success does not rely heavily on being a member of the association. Lack of effective sanctions can arise because of a conflict of interest as non-compliance with the scheme can adversely affect the image of the whole industry. Another concern may be a lack of independence, whether real or perceived, in assessing disputes.

The transfer of government regulation to industry may not always mean less regulation. In addition, without adequate monitoring, self regulatory schemes can act for the benefit of the industry rather than the public benefit. If the scheme works well and membership is highly valued, existing members may set very high standards in order to protect the asset they have created in terms of reputation and quality. Barriers to entry may arise and result in the abuse of market power.

The potential failings of voluntary self regulation suggest that a combined approach of government and industry-based regulation may be preferable.

Co-regulation

Under an industry self-regulation scheme a proportion of businesses would operate outside its requirements and enforcement activity because such associations rarely have 100% coverage of an industry. In these cases there may be a role for government in providing a mandatory means of coverage for all market participants and in enforcing legal sanctions. This option would result in both industry and government regulation of traders' behaviour.

A co-regulation option usually involves formulation of a code of practice by an industry organisation in consultation with government and consumers. Breaches are usually made enforceable by:

- incorporating the code of practice by reference into regulations and creating penalties for breaches; or
- establishing broad performance-based regulations with the code of practice having deemed to comply status.

By incorporating breaches in legislation, this option has a greater potential than industry self-regulation for actually altering trading behaviour. At the same time it retains the advantages of an industry code such as flexibility and the ability to respond quickly to changing conditions.

Co-regulation approaches vary. An industry body could be responsible for detailed administration of the code including complaint handling, monitoring and discipline, and public promotion and research. Or a strengthened form might involve the incorporation of specific principles or objectives in legislation which dictate what a code must achieve. This might also specify requirements that must be met by potential traders such as absence of criminal convictions and may establish a supervisory body including representatives of industry, government and consumers.

As government involvement in these schemes increases through mechanisms such as performing a supervisory role or acting as an avenue for appeal on consumer/trader disputes the potential for, and costs of, overlap and duplication of functions needs to be considered. In addition considerable time and resources may be expended in developing a system that results in little overall change to the existing regulatory structure, apart from shifting responsibility for regulation more heavily to industry and away from government.

Such costs may offset the benefits of increasing industry expertise and responsiveness in the regulatory arrangements in this way. This is particularly the case if these benefits can be incorporated in government-based regulation at lower cost through mechanisms such as more effective communication and consultation with industry and by (as is the case) including industry representatives in the panel established as the Licensing Authority.

Negative licensing

This option would allow anyone willing to establish a motor trading business to do so without any prior checks on their suitability. However those who demonstrate through their behaviour that they are not complying with appropriate standards of conduct can be excluded from the industry.

This main advantage of this option is that it does not raise costs for potential entrants to the industry.

However as unscrupulous traders are excluded from the industry only after misconduct is detected, this option raises the possibility that buyers will incur serious harm and that overall confidence in the industry may be adversely affected before inappropriate behaviour is detected and the offending trader is disciplined or excluded from the industry. Given the nature of the product, this is likely to be a serious drawback as it may take some time for problems associated with inappropriate behaviour to manifest themselves and for these to be detected and dealt with.

A second advantage of this option is that administration costs may be lower as there is no requirement for probity checks or processing of licences. However to provide a credible threat that inappropriate conduct will be detected and penalised, monitoring and enforcement costs would increase. These costs are likely to be high if the scheme is to be effective for penalising misconduct and deterring future breaches.

These monitoring and enforcement costs, particularly when added to the risk of harm associated with the delay in disciplining misconduct, would likely exceed the savings made on licensing administration costs.

Conclusion

Motor vehicles are particularly important in contemporary life and represent a major investment for many people hence it is essential that their trade is conducted in a fair and efficient way. The reputation of the motor trading industry as a whole and consumer confidence in it can be damaged by the malpractices and dishonest actions of a few businesses or traders. This behaviour can have serious negative impacts such as increasing search costs for consumers and driving quality out of the market. Effective disciplining of traders is essential for ensuring, as far as practicable, that the industry is reputable.

The licensing system that is in place asks little more than for traders to behave in an honest and fair manner. In doing so it helps ensure that honest industry participants do not suffer the negative consequences of competition from dishonest traders. All of the other options considered would be less effective for disciplining traders and would provide less incentive for traders to behave appropriately. This reflects the fact that an industry participant would not wish to lose his or her licence — a valuable asset representing the right to trade. Through prior checking the licensing system also reduces, to some degree, the likelihood that disciplinary action will be required and provides for easier identification and tracking of those responsible for misconduct if it does occur.

9. ALTERNATIVE APPROACHES: LOSS RECOVERY

9.1 MARKET MECHANISMS AND THE GENERAL LAW

An option for recovering losses that inevitably occur in the industry is to rely on general legislation such as the *Fair Trading Act*, rather than industry-specific legislation and an industry compensation fund. However, reliance on this mechanism has a number of significant disadvantages.

In order to be effective, redress must be speedy, not too costly and representative. Delays cause frustration and costs to all parties by, for example, delaying repairs to a faulty vehicle or through a long drawn out case catching media attention and reflecting poorly on a trader or the industry as a whole. Reliance on general legislative provisions does not meet these criteria. This avenue of redress is both costly and time consuming.

The cost and delays associated with this option are particularly relevant because motor trade disputes can involve relatively small amounts of money. In these cases, recourse to usual legal procedures can be too costly to justify the value of what is at stake in making the complaint.

In addition, it is difficult to obtain a conviction under general legislation. Therefore this option is both ineffective as a means for recovering loss and as a means for deterring malpractice and loss. Factors such as ignorance, and fear also minimise the potential for action by consumers. Some consumers may not seek redress through a court due to the need for legal representation or because they are intimidated by legal processes and consider them complex. For others the protections of such legislation are in practice diminished because they are not even aware of their existence.

These problems reflect the difficulties and uncertainties associated with enforcing rights conferred by vague notions such as 'fitness for purpose' and 'merchantable quality'. Specific product legislation for complex items such as motor vehicles can more clearly define these rights and provide a more efficient and useful remedy or avenue for redress. The need to overcome these problems and clarify the rights and obligations of parties to a motor trade transaction were in fact reasons for introducing product specific legislation in this area.

Another market-based mechanism which may reduce reliance on licence fee revenue to support the Fund is to increase the proportion of Fund monies attributable to penalties and fines imposed under the legislation. The appeal of this option is that traders who are behaving inappropriately bear the costs of supporting compensation mechanisms established under the Act while reputable traders are not penalised through potential licence fee increases. Higher fees and penalties should also have a greater deterrence effect on inappropriate behaviour.

However, this option is not necessarily less restrictive than one largely based on licence fee revenue to support the Fund nor is it necessarily more effective at reducing misconduct and hence the potential for claims. In order to effectively deter misconduct, a strategy based on penalties must involve two elements. Firstly, to act as an appropriate penalty and deterrent, fines must be of a suitable magnitude reflecting the seriousness of the misbehaviour being penalised and the potential for gain by the trader in taking such action. Secondly, penalties must be applied sufficiently frequently for those being monitored to consider it a reasonable probability that misconduct will be discovered and penalised. This implies that monitoring costs could be high given the level of inspection required for penalties to be credible. Further, costs associated with proving misconduct could be considerable given that significantly high penalties and fines could not be imposed without sufficient information and proof to justify them.

9.2 PRIVATE INSURANCE BY TRADERS OR BUYERS

In place of the Guarantee Fund, the legislation could require traders to individually purchase insurance directly with an insurance company to cover those losses covered by the Guarantee Fund. The main advantage of this option, relative to the existing arrangements, is that premiums would reflect the insurance record of the industry and of individual traders and thereby provide an incentive for good conduct in the form of reduced premiums.

The other perceived advantage would be a reduction in licence fees payable by traders as there is no need to support a compensation fund. However, this benefit may be more apparent than real. This is because the cost of providing some form of compensation or mechanism for minimising loss to buyers is still borne by traders (if it is not passed on in higher prices) albeit paid to a different body. The benefits of this option therefore depend on which option results in the lower overall cost.

As a sufficient reserve currently exists in the Guarantee Fund, licence fee revenue is almost completely used for meeting costs associated with administration aspects of the regulatory scheme rather than in support of the Fund. However even if half of the licensing fee, some \$430, were earmarked for the Fund it is possible that this would represent cheaper 'insurance' than that which could be provided by a commercial insurance company. It is likely that premiums in the commercial market would be high given the risk of default. There is a significant moral hazard in traders purchasing such insurance. Current grounds for claiming against the Fund can be summarised as 'failure [of a motor car trader] to comply with the Act'. This is to a very large extent within the control of the insured. In contrast, commercial companies generally provide insurance against accident or unexpected circumstances.

Other factors are likely to result in commercial premiums being higher than the 'premium' represented by a portion of the licensing fee being used in support of the Fund. These include costs associated with administration, periodic re-assessment of trader risk, handling disputes, keeping records and the mark up sellers of policies will apply to their contracts.

Under a private insurance option, the industry would also be subject to a second source of monitoring probably involving additional paperwork and other compliance costs. Not only would government authorities be involved in such activities but so too would the insurance industry which would need to monitor the industry as a whole and individual clients in order to assess the risk of insuring and to set appropriate premiums. This suggests that a private insurance option could result in more inconvenience to traders than a once-off annual payment to the Guarantee Fund.

From buyers' perspective the Fund is likely to be preferable to private insurance organised by traders because it is not clear whether clients' best interests would be served by an insurance policy to which they are not a party. This could increase the possibilities for disputation if buyers end up having a dispute with the dealer as well as the insurer, and may result in delays in payment or no payment at all.

Further as insurance cover will differ between traders, buyers will face an additional information burden in assessing which trader has the best overall product in terms of vehicle quality and potential for loss. Traders who provide better insurance cover will suffer a cost disadvantage relative to other traders supplying less comprehensive cover suggesting that a minimum level of cover would need to be specified in legislation in the interests of equitable treatment of traders and consumers.

Another significant disadvantage of this option is that new traders, who have yet to establish a trading record for the purposes of calculating an insurance premium, would likely pay higher rates than incumbent traders. This will affect their costs of entering the industry to the benefit of existing traders. Similarly, the private insurance option may only suit high volume and high value traders. For other, particularly small, traders this option may not be cost effective because of the costs of administration and dispute settlement relative to the low value of transactions involved.

An alternative private insurance option involves buyers themselves insuring against loss. This would involve buyers dealing directly with an insurance provider.

This option is flawed for a number of reasons. As individuals purchase vehicles infrequently the informational disadvantages they experience in transacting for a vehicle would be similarly experienced in purchasing an insurance policy to protect against possible loss. For an insurance company to adequately cover its risk it would need to make an assessment of the vehicle and trader being covered with associated inconvenience to all parties concerned.

Most importantly, this option is flawed because it shifts the burden of insuring to the person least able to avoid loss. This does not provide traders with an effective incentive to avoid loss. Traders would only indirectly suffer the consequences of compensating buyers for losses through mechanisms such as a poor reputation. As traders have a greater capacity to prevent loss, a requirement for them to insure against it provides the most appropriate incentives to reduce the occurrence of loss in the first instance.

9.3 A 'USER PAYS' GUARANTEE FUND

This option involves traders levying a fee or 'premium' on buyers at the time of sale to contribute to maintaining a Guarantee Fund.

Under this option the costs of maintaining the Fund are made explicit to buyers. In contrast, the current costs to traders of supporting the Fund are likely to be passed on to buyers in a minor premium on prices paid for vehicles.

The shortcomings of this option are that industry would need to be closely monitored to ensure that the levy amounts were being forwarded to the Fund. Traders' costs would increase as levy amounts would need to be forwarded on a regular, say monthly basis. This involves administration costs as well as the costs associated with establishing a trust account in which to hold monies until transfer to the Fund. In contrast, traders currently submit Guarantee Fund payments once a year reducing both industry and government administration costs and inconvenience.

9.4 INDUSTRY- RUN GUARANTEE FUND

An alternative to the current government-based arrangements would be creation of an industry-run guarantee fund. Such a scheme might be based around the VACC, as the relevant industry body, levying fees and assessing claim payouts.

An advantage of this option is that an industry-run fund may operate at lower cost than a fund run by government authorities. This in turn would have the benefit of lowering contributions payable by traders in support of the Fund. However this cannot necessarily be assumed. Hence the cost of providing compensation arrangements may remain essentially the same although contributions may be paid to a different party.

The option has two other potential problems. Firstly, not all traders may be covered under such arrangements. While the VACC has significant coverage of specialist new car traders, it has only about 20% coverage of specialist used car traders. This has implications for the clients of such businesses. While market mechanisms may shift buyers towards traders with access to a compensation fund, this may take some time to occur. This is partly because the bulk of individuals purchase vehicles infrequently and partly because traders with access to compensation arrangements are unlikely to particularly emphasise this in marketing efforts to differentiate themselves from other traders. Drawing excessive attention to compensation arrangements may create uncertainty in the mind of buyers as to why such arrangements are deemed necessary and may also generate excessive or unwarranted claims.

Secondly, and most importantly, there is a conflict of interest in industry being heavily involved in determining whether payouts from the fund should be made. This is because there is an incentive to deny claims in order to lower fees. This could reduce the effectiveness of the fund as a compensatory mechanism and may also have the negative effect of reducing consumer confidence in the industry.

9.5 VARIABLE CONTRIBUTIONS TO EXISTING FUND

Under current arrangements the Guarantee Fund widely distributes the potential costs of losses that are incurred by a relatively small number of buyers across all traders (and indirectly buyers) of motor cars.

The main disadvantage of this approach is that it penalises traders whose behaviour does not result in claims against the Fund and, indirectly, buyers who may not require the protection provided by the Fund. Furthermore, as the losses arising from a trader's malpractice or incompetence are in part borne by other parties, more frequent losses may occur as incentives to prevent them are reduced.

To reduce the extent of this occurring, and in the interests of more equitable treatment of traders, it would be desirable for contributions to the Fund to reflect traders' risk or history with respect to claims. This might be achieved by setting differential licensing fees or by providing traders with a rebate in subsequent years which reflects their performance in terms of not drawing on Fund resources.

Current arrangements incorporate these principles to a minor degree by levying a licence fee (which incorporates a contribution to the Fund) per licensed premises. In doing so, contributions to the Fund roughly reflect business size which provides a crude indicator of potential for claims against the Fund. While an unsophisticated means for reflecting trader risk, it is likely that the costs of further fine-tuning premiums to reflect risk may not be justified by the gains in terms of improved incentives and fairer treatment of traders.

This is because further refinement would involve considerable monitoring resources requiring regular assessments, say on an annual basis, of a traders' claim history and mechanisms in place to reduce risk and the calculation of differential fees year to year or of rebates for each trader. Underlying these calculations would be a requirement to ensure that the Fund remains viable despite rebates and fee reductions.

Performing these tasks would undoubtedly increase the costs and inconvenience of administering the scheme for both government authorities and traders. On the other hand it is not certain whether complicating the levying of contributions to the Fund would remove the inequities and distortions that exist. Depending on the period of time spent in the industry, or the point in time of entry and exit, traders with similar histories of causing claims against the Fund may end up making different overall contributions to its resources over the period during which they trade. For instance, traders operating during years when a large number of claims are made against the Fund would pay high contributions (even if they had not been personally responsible for claims) in order to ensure the Fund's viability. In contrast lower contributions would be made by traders with similar risk profiles who happen to operate in 'better' years when fewer claims are made.

9.6 CONCLUSION

Retention of existing compensation funding arrangements is preferable to the options examined above as these are not as effective, or lower cost, means for achieving the legislation's objective of minimising loss and efficient recovery of loss when it does occur.

The compensation fund spreads the cost of compensating consumers for loss arising primarily from insolvent traders across the whole industry. This enables a substantial fund to be built up at low cost to individual traders (and buyers through slightly higher prices). This should be able to meet all possible claims with reduced inconvenience for buyers who have incurred a loss.

An Interdepartmental Working Party in SA (1982, p. 28) reported on a review of this issue conducted in Tasmania which concluded that:

We are completely satisfied that a guarantee fund is more efficacious and equitable than either of the other two alternatives [fidelity bonds and requirements as to the financial resources of traders] ... A fund ensures that no consumers will suffer financially from any failure by dealers to comply with the Act. Reimbursement is not only assured but it is possible for payment to be made without delay and without protracted disputation between the vendor and the purchaser. ... Further, ... a compensation fund does not present any impediment to the entry into the motor industry of new dealers of limited means, nor would it make for any difficulties for existing small dealers.

Notwithstanding the current review's similar conclusions in dealing with the issues under *The Guidelines*, it should be noted that Victorian Government central agencies intend to undertake a review in future of all Victorian statutory consumer protection funds from a broader structural efficiency and cost-to-government perspective. Proposals for change to the Guarantee Fund may emerge from that process.

10. POTENTIAL TO STREAMLINE THE EXISTING REGULATION

Given retention of existing licensing arrangements (Chapter 8), the remaining alternative to be considered is the potential to streamline licensing arrangements. The licensing criteria used to determine whether an applicant should be granted a licence or whether existing licensees may continue trading should be examined. These are discussed in turn below.

10.1 DISQUALIFYING OFFENCES AND FITNESS AND PROPRIETY IN LICENSING CRITERIA

The Act contains a number of criteria relating to offences and fitness and character of the applicant to which the Authority refers in deciding whether to grant an application or whether to pursue disciplinary action against an existing licensee. These include the applicant:

- having been convicted of a serious offence (involving fraud, dishonesty, drug trafficking or violence punishable by imprisonment for 3 months or more) within the last ten years;
- not being a person likely to carry on the business honestly, fairly and efficiently or currently carrying on the business in a dishonest, unfair or inefficient manner;
- not being, in any other way, a fit and proper person to be a licensee, including consideration of an applicant's associates; and
- not being likely to maintain effective control of the business.

Similar criteria apply in the case of corporations although in assessing whether an applicant is a fit and proper person for such applications, the criteria also refer to the applicant not being 'of good reputation or character' and that control is 'not likely to be exercised honestly and fairly'.

Applicants whether individuals, partnerships or bodies corporate may be granted permission by the Authority to trade despite conviction for a serious offence or despite being the associate of such a person. Providing the Authority with the power to vary conditions and restrictions on licences in cases such as these (which would otherwise result in refusal of a licence or suspension of an existing licence) is less restrictive than not granting a licence at all in such cases in order to protect the public interest.

It is clear that the disqualifying offences and fitness and character criteria are directed to meeting the legislation's objectives of effective disciplining of traders and minimising loss to buyers.

There are three components to the current disqualifying offences test:

- the content of the offence;
- the seriousness of the offence; and
- the recency of the offence.

Content of the disqualifying offences test

Given the reasons for screening entrants to the motor trading industry, there can be no objection to notice being taken of a record of criminal fraud or dishonesty. On the other hand, involvement in drug trafficking or violence are less clear indicators of a predisposition to behave in a dishonest or fraudulent manner.

A possible rationale for excluding past drug traffickers is that they may currently be, or intend to again become, involved in trafficking. For such persons a motor trading business may represent a suitable means for 'laundering' criminally obtained funds. Alternatively a person's willingness to engage in drug trafficking *may* indicate a willingness to take advantage of people in other ways. This possibility would be increased if the trafficking was associated with drug dependence or addiction. In these circumstances an individual in a motor trading business might take advantages of opportunities to misappropriate clients' monies or deposits in order to support a drug habit.

A record of violence does not necessarily mean that the perpetrator is disposed to obtain financial advantage by illegitimate means. The rationale for exclusion here is probably not so much prevention of dishonesty as a concern that a licence to conduct business should not be issued to someone known to resort to physical means to resolve conflict.

An absolute presumption against persons with a discrediting record would be a concern on civil liberties grounds. However the fact that licences may be granted, despite convictions, on permission of the Authority probably tips the balance in favour of the regulation, even for drug trafficking and violence offences. The industry is not so lacking in competition that a reversal of the presumption might be likely to drive prices down or standards up.

Seriousness of the disqualifying offences test

Any sentencing period chosen as an indicator of the seriousness of an offence for licensing purposes will be arbitrary. It can at least be confidently asserted that no offence punishable by imprisonment for a minimum of 3 months is likely to be trivial. Again, the fact that the presumption against licensing is rebuttable means that the exact standard used in the statute is not a crucial issue.

Recency of the disqualifying offences test

Whether a relevant offence should be disqualifying if proven in the last ten years, the last eight or the last twelve is also a somewhat arbitrary decision. A ten year period seems reasonable and is not likely to operate as a restriction on competition.

Fitness and propriety

It is true that a licensing authority cannot estimate with certainty that a given act or omission, whether taken in isolation or in conjunction with other behaviour, might be deemed to demonstrate unfitness or insufficient propriety to be approved for a particular licence at some future time. However, this does not necessarily imply that the concept of fitness and propriety should be condemned as one without content and liable to arbitrary application.

In the licensing context, it is the propensity for a potential trader to take liberties rather than the actual commission or omission of specific actions which is at issue. The objective of disqualification is to prevent potential public harm not to achieve redress. The fit and proper person and associated tests provide the necessary flexibility to exclude people who may be known to be dishonest, or particularly likely to succumb to the temptation to inappropriately deal with customers, but who have not demonstrated this in the licensed industry or by sustaining specific convictions in other contexts.

While these more subjective criteria have their place and are directed at meeting the legislation's objectives, it appears that references to them throughout the legislation could be simplified in expression or otherwise streamlined.

The issues of simplifying administrative processes and assessing the suitability of licensing criteria are not considered to any significant degree in this review as they are being assessed in the context of a broader proposal to establish a Victorian Civil and Administrative Tribunal (VCAT). As rationalising the expression of the criteria is not a matter going to competition in the industry, it is considered appropriate to defer to the VCAT review. However, the criterion relating to whether an applicant is likely to carry on the business efficiently should be removed. It is not clear how denial of a licence on these grounds would contribute to achieving the legislation's objectives.

10.2 INVOLVEMENT IN COMPENSATION FUND CLAIMS

The Act states that an application for a licence must be refused by the Authority if the applicant has had a claim admitted against the Fund. Similarly, a licence is automatically suspended 30 days after a claim is admitted against the Fund in relation to an existing licensee. The Authority may grant permission for a person to hold, or continue to hold, a licence if it is satisfied that the person has refunded all amounts paid out of the Fund in respect of the claim, has agreed to repay the amounts, or there is no reasonable expectation that the person will not comply with the regulatory requirements in future and the granting of the application will not be contrary to the public interest.

The purpose of these criteria is to minimise losses in the industry and claims against the Fund. These criteria protect buyers who would otherwise incur loss, and traders who are adversely affected by the negative publicity associated with the misconduct of a minority of traders as well as the potential for increased licence fees due to higher claim costs.

Section 76 lists situations in which a buyer may make an application for a claim against the Fund. The purpose of the compensation funding arrangement established under the Act is to recover losses incurred by buyers as a result of the actions of motor car traders. However, section 76 allows a claim by a financier for loss incurred from the failure of a licensed motor car trader to procure the cancellation of a security interest in a motor car and for a claim to be made against the Fund where the debtor under the relevant security interest arrangements was a motor car trader. This is an inappropriate use of the Fund's resources as it compensates specialist traders who through their expertise are better placed, than buyers in general, to avoid loss. This criteria for access to compensation funding should be removed in the interests of protecting the Fund's resources and thereby limiting potential fee increases.

A further recommendation for protecting the Fund's resources relates to clarifying the grounds under which an application for a claim may be made. Section 76 specifies some of these but also makes a general statement that grounds for a claim are 'loss has been incurred from a failure of the motor car trader to comply with this Act or the *Motor Car Traders Act 1973*'.

A clearer specification of what 'failure to comply with the Act' means could protect the resources of the Fund and thereby limit licence fee increases. By clarifying this section, potential processing of costly and time-consuming applications for claims which have no grounds could be reduced. A clear specification of the grounds for eligibility for claims also reduces trader uncertainty.

Section 76 should be changed to reflect a number of key breaches of the Act. These relate to breaches which could potentially result in significant loss to buyers and which are therefore reasonable grounds for claims against the Fund. They include failure of the trader to comply with the following provisions:

- s. 36 — prohibition on consignment selling;
- s. 38 — prohibition on odometer tampering;
- s. 43(3) — disposal of a trade-in vehicle during the cooling-off period;
- s54(1) — traders' obligations with respect to warranties; and
- s56(2) — special conditions purporting to limit or modify warranty obligations.

10.3 OTHER LICENSING CRITERIA

Knowledge of Act

The Act states that an application for a licence must be refused if it appears to the Authority that the applicant does not have sufficient knowledge or expertise of the Act and regulations to enable the applicant to carry on the business of motor car trading.

Clearly this criterion relates to ensuring that businesses are conducted in a fair and honest manner by ensuring that traders have sufficient knowledge of their obligations to disclose information to purchasers, and that they are aware of what conduct is viewed as unfair or dishonest and will attract disciplinary action.

It is not unreasonable to expect potential traders to be aware of their responsibilities in the marketplace. Buyers and competing traders benefit if new licensees conduct their businesses in an acceptable manner. This benefit is acquired at low cost as the criterion requires demonstrable knowledge but does not require the knowledge to be acquired through a formal course, qualification or any other particular means. Thus the requirement confers significant benefit but is not onerous as the information is easily obtainable.

Further this criterion is considered essential as there are commercial incentives for traders to prefer not to know about their legislative requirements.

Financial capacity

In order to obtain a licence or avoid disciplinary action applicants must satisfy a condition that they have, and are likely to continue to have, sufficient financial resources to carry on the business.

Theoretically this could affect competition in the marketplace by denying potential market participants the right to trade. The rationale for this criterion relates to the need for traders to have access to adequate finances in order to comply with the Act's requirements such as honouring warranties and to reduce the negative effects of business collapses on customers, other businesses and the reputation of the industry as a whole. Relating to this is the possibility that customers incurring a loss as a result of the financial collapse of a trader will make claims on the Guarantee Fund, thus again indirectly impacting on traders through potentially higher licensing fees.

The *Motor Car Traders (Amendment) Act 1996* introduced greater flexibility in the application of this criterion to cater for applicants who have insufficient liquid assets but who are in a sound financial position overall. The Act now allows the Authority to require, as a condition of holding a licence, that the trader provide a guarantee or indemnity in a form and secured in a manner specified by the Authority.

This criterion relating to sufficient financial resources should be retained in combination with the flexibility for the Authority to grant licences in cases it thinks appropriate.

Suitable premises

A third criterion for refusal of a licence or grounds for disciplinary action relates to the applicant having a premises suitable for a motor trading business.

The main objective of the criterion appears to involve ensuring that traders have a dealership yard or similar premises from which to sell. This can reduce the possibility that they will use inappropriate locations, such as residential premises, to avoid the Act's requirements by posing or appearing to buyers as private sellers. However the criterion does not specify what 'suitable premises' means and may run the risk of establishing stereotypes of how such businesses should be run with the danger that service innovations could be stifled.

This criterion should be changed and more usefully specified as a requirement for potential and existing traders to have all relevant planning approvals for the premises at which they carry on, or propose to carry on business.

10.4 EXEMPTIONS

The legislation contains exemption provisions relating to the sale, by public auction, of vehicles formerly owned by government departments, public statutory authorities or municipalities. Persons specialising in, or concentrating heavily on, such dealings may have some competitive advantage over general motor car traders in terms of compliance costs.

At an early stage of this review process, it was considered that the exemptions for former government vehicles should be removed in the interests of equivalent treatment of all traders of used vehicles, regardless of the source of the vehicles traded.

However, central government agencies (Department of Premier and Cabinet and the Department of Treasury and Finance) suggested that the key problem of information asymmetry may not be as acute when consumers purchase former government vehicles as it is when purchasing other used cars. Former government vehicles are, on average, likely to be significantly newer than other used vehicles on the market and tend to be of a standard make with more commonly identified defects. Insofar as previous government ownership provides consumers with greater certainty in relation to the condition of a vehicle, there is no need to extend regulation to these vehicles.

In the absence of evidence that the current exemption provisions for former government vehicles are leading to undesirable outcomes, the review concludes that they should remain.

10.5 EMPLOYEE RESTRICTIONS

Section 35A of the Act prohibits licensees from employing, in a customer service capacity, persons whom the trader *knows*:

- have had a claim admitted against the Fund (*unless permission has been granted by the Authority*);
- have, within the last 10 years, been convicted of a serious offence (*unless permission has been granted by the Authority*);
- are disqualified from holding a licence or from being employed in any capacity in connection with a motor trading business; or
- have had their last application for a licence refused for some other reason.

Failure of the trader or prohibited person to observe this provision may subject either party to disciplinary action.

This provision is primarily directed at preventing persons who have been denied a licence from nonetheless establishing themselves in the industry by maintaining control of, and effectively operating, a motor car trading business which has another person as licensee. It is essential to prevent the establishment of these circumventory proxy arrangements in order to preserve the integrity and enforceability of the licensing system.

In addition to preventing circumventory proxy arrangements, this provision reinforces licensees' commercial and legal incentives to hire competent staff by providing guidance as to which persons are deemed unsuitable employees. This avoids the negative consequences imposed on buyers and traders by unsuitable persons in the industry. These benefits are achieved without imposing significant costs on traders as the provision does not unduly restrict the supply of potential employees to the industry.

The provision has virtually no impact on the overall supply of potential employees and creates little cost because it merely requires a trader to deny employment to certain persons if the trader *is aware* that aspects of the prospective employee's history would disqualify him or her from employment in the industry. Moreover persons affected by this provision are *not automatically* denied employment as they may obtain the Authority's permission to be employed in the industry despite otherwise being disqualified under s. 35A.

The Office of Regulation Review (ORR) has recognised the need for some form of regulation of employees in the industry in order to protect buyers and reputable traders. The ORR (correspondence, 25 June 1997) has suggested the introduction of a negative licensing system to complement the licensing of traders. It considered that a system similar to that existing under the *Trade Measurement Act 1995* for service licensees and their employees may be suitable. Under this system a licensee is required to notify the licensing authority of the prospective employment of an employee. The Authority advises whether the prospective employee is permitted to work in the industry. Prospective employees are precluded if serious breaches are continuously made against the Act. The ORR noted that the system operates with negligible costs for licensees, employees and the licensing authority. It considered that " a similar system in the motor car trade industry sector could prevent unethical salespersons from moving to another licensed motor car trader and undertaking similar breaches of the Act".

While this system is obviously less onerous than the licensing of motor trading employees (which is the form of regulation for employees preferred by some states) it is more onerous than the mechanisms currently in place under s. 35A. The current arrangements ultimately achieve the same result as the system outlined by the ORR yet do so without requiring licensees to notify the licensing authority of every hiring decision.

Given the factors discussed above, it can be confidently stated that s.35A has no significant impact on competitive conditions in the industry. For the sake of completeness, however, an alternative is considered below.

A possible alternative to directly regulating employees or the hiring decisions made by licensees would be to concentrate entirely on holding managers or licensees responsible for inappropriate employment decisions should employees misbehave. However this option would not be desirable for two main reasons.

Firstly, this approach would allow harm to occur rather than prevent it. As employee misconduct in the motor car trading industry is likely to come to public notice only after significant harm has been done, it is insufficient to rely on commercial pressures alone to ensure that employers make careful hiring decisions that protect their reputations and returns. Furthermore such commercial signals would become muted and less effective in a market where traders' services are required infrequently by the bulk of customers.

Moreover when harm does occur, it affects not only the trader and buyer directly involved but indirectly all traders through potential claims against the Fund for recovery of loss or, in more serious cases, through reduced confidence in the industry. As financial penalties for inappropriate hiring decisions are not fully borne by the licensee, commercial incentives to make careful hiring decisions are further reduced.

As a result irresponsible hiring decisions will be made, harm will result, and significant resources will need to be applied in taking 'corrective' action after the event.

Secondly, this approach would reduce the constraints on a licensee allowing a disqualified person to assume control of the licensee's business in the guise of an employee. It is contrary to the public interest to allow a person to flout a legal disqualification, even if no direct harm results in a particular case.

As stated earlier, s. 35A is unlikely to have a significant impact on competition in the industry while it serves the key function of ensuring compliance with the licensing arrangements and preventing circumventory proxy arrangements. This is achieved without unduly creating a regulatory burden for licensees. The degree of specificity s. 35A employs improves enforceability of the Act relative to the option of generally holding licensees or managers responsible for employees' conduct.

PART FOUR COST BENEFIT ANALYSIS OF PROPOSALS

11. THE PROPOSALS IN TURN

There is an absence of data on which to quantify the benefits and costs of the proposals outlined below. Norman (1997, pp. 36, 42-43) suggests a scoring system to allow a comparison of benefits and costs in the same units. While less information intensive than traditional cost benefit analysis, Norman's approach still requires considerable quantitative information on costs and valuation of benefits.

Therefore a qualitative assessment of the benefits and costs of each proposal has been provided below. This provides an overview of issues raised elsewhere in the report.

11.1 RETAIN LICENSING OF MOTOR CAR TRADERS

Costs

- The licensing system costs about \$2.4 million per annum to administer. This is fully recovered from motor car traders through licence application and renewal fees. The application fee of \$681 plus licence fee of \$866 per annum per premises represents about 0.03% of the value of annual turnover for an average motor trading business (\$4.5 million).
- The requirement for traders to be licensed imposes compliance costs on traders.

Benefits

- It is not unreasonably difficult to get a licence yet the threat of disciplinary action or licence withdrawal and loss of the right to trade represent a credible deterrent to traders from engaging in inappropriate conduct and failing to observe obligations to consumers, such as unscrupulous traders failing to honour warranty obligations.
- Records obtained through the licensing process also provide readily accessible information for the purposes of disciplining traders who are behaving inappropriately, and in some cases for tracking of stolen vehicles.
- By conducting prior vetting of those able to trade, possibilities for loss to buyers are reduced.

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- Consumers, particularly those who are less knowledgeable about motor cars or do not feel confident trading in the ‘buyer beware’ private used car market, have available another source of vehicles where the conditions of trade offer some assurances for buyers.

Conclusion

While the licensing system creates administration and compliance costs which are met by traders, it effectively has no impact on barriers to entry to the industry. Thus the benefits associated with maintaining a licensing system are likely to significantly outweigh the costs it creates.

11.2 RETAIN THE MANDATORY STATUTORY WARRANTY

Costs

- Traders must meet the costs of repairing defects under warranty. This will generally be reflected in higher prices for used vehicles which may affect traders’ ability to compete on price with the private market for used cars.
- Removes traders’ discretion to voluntarily supply warranties only on selected vehicles.
- Some buyers who do not value the warranty are required to pay higher prices incorporating the costs of warranty if they purchase in the trader market.

Benefits

- Buyers’ bargaining position is improved as a proxy for information on the vehicle’ s reliability at the time of sale is provided. This reduces the extent of information asymmetry in the market.
- A market comprising trading conditions involving some degree of assurance on product quality is made available to buyers who are risk-averse, less knowledgeable or less confident about purchasing a vehicle without unduly compromising options available to those buyers who are indifferent to risk.
- The cost, time and resources that would be expended by buyers in using other options such as increased search and independent third party testing to obtain information about vehicle reliability (which is essential for determining willingness to pay for the vehicle) are averted as the bulk of information is provided more efficiently through warranty.
- As the warranty better defines general notions of ‘merchantable quality’ and ‘fitness for purpose’, more effective enforcement of a minimum level of reliability of used vehicles sold is possible.

Conclusion

The mandatory statutory warranty undoubtedly increases traders' costs. However it is a feature that at least 50% of buyers are willing to pay for. While its removal may result in warranties being voluntarily provided, it is not clear to what extent this would occur and whether their coverage and enforcement would be adequate. Hence the legislation's objective of improving buyers' bargaining position with respect to availability of information on vehicle quality or reliability may be seriously compromised. This would disadvantage buyers in negotiations over purchase which would likely result in consumer losses, thus the benefits of retaining the mandatory warranty requirement outweigh its costs.

11.3 RETAIN OTHER KEY CONDUCT REQUIREMENTS

Costs

- Conduct requirements in general affect the day-to-day operation of traders' businesses and can increase costs. Excluding the warranty requirement (discussed above), the requirement for traders to allow a cooling-off period on the sale of used cars is likely to represent the most significant cost burden to traders because it delays the finalisation of transactions. This can penalise traders as they may not receive a financial return on the investment of staff time and resources when sales are cancelled and as they may incur costs in holding stock and trade-ins.

Benefits

- Provision of a cooling-off period deters high pressure sales tactics on the part of traders and can prevent losses associated with forcing buyers to discharge agreements entered into in the heat of the moment which on reflection they are unable to afford.
- Consumer confidence in the industry is enhanced as conduct provisions attempt to ensure that transactions are conducted in a fair and honest manner.
- By improving the information and the bargaining position of buyers, the conduct requirements improve the functioning of the market by better enabling buyers to make purchasing decisions that serve their best interests.
- Conduct provisions directed at encouraging fair trading practices and preventing losses can avoid expensive disputation and attempts at loss recovery.

Conclusion

It is not clear how significant the costs of meeting conduct requirements are to traders. This is particularly so because some requirements such as requiring standardised provision or documentation of information represents a variation of an activity most traders would perform rather than a new requirement. The potential costs of other provisions, such as cooling-off and rescission, are to a degree within the control of traders. As the bulk of conduct provisions essentially require traders to behave in an ethical manner, the costs imposed on traders by reducing opportunities for unethical behaviour are likely to be offset by the benefits to buyers of preventing such behaviour. Most importantly, conduct requirements improve the way the market functions as information asymmetry between transacting parties is reduced. Therefore the benefits of the conduct requirements outweigh the costs.

11.4 RETAIN THE GUARANTEE FUND

Costs

- The need to support a Guarantee Fund raises the licence fee payable by traders.
- As individual traders do not bear full responsibility for compensating buyers who have suffered loss as a result of their actions, the incentive for individual traders to do all that is possible to prevent loss is reduced.
- The existence of a compensation fund may blunt, to a minor degree, buyers incentive to do all that they can to protect themselves from loss.

Benefits

- Buyers have access to a last resort compensation mechanism that is an accessible and efficient means for compensating them for losses incurred as a result of the behaviour of traders.
- The social consequences and inequities of requiring people to shoulder losses imposed by trader dishonesty or incompetence are averted by restoring, as far as possible, parties to a transaction to their positions prior to sale.
- The compensation arrangements reduce the overall burden of losses which occur in the industry by spreading the burden of recouping them to all traders and, indirectly, buyers of motor cars. This imposes a minor and affordable cost on all participants in the industry rather than imposing a major cost on those individuals who have incurred a loss as a result of trader's behaviour which they may have had no, or limited opportunity, to avoid.

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- A small premium on the price of vehicles bought in the trader sector effectively provides buyers with a ‘safety net’ for recouping certain losses should these occur despite the regulatory requirements designed to minimise them.

Conclusion

The most significant cost arising from the compensation funding arrangements is the need for traders to fund such a scheme through higher licensing fees. Currently however the costs of supporting the Fund account for a small proportion of licence fee revenue. In return for a relatively small impost on traders (or indirectly buyers), the guarantee fund provides a ‘safety net’ for buyers to recover losses resulting from traders’ conduct. Given the choice, it is likely that most buyers would be willing to incur this cost for the insurance it provides against unforeseen losses that may involve significant amounts of money. Hence the benefits of providing an efficient means for recovering loss outweigh the costs imposed by the Guarantee Fund.

As noted previously, notwithstanding this conclusion, Victorian Government central agencies intend to undertake an assessment in future of all Victorian statutory consumer protection funds from a broader structural efficiency and cost-to-government perspective. Proposals for change to the Guarantee Fund may emerge from that process.

11.5 DEFINE THE ELIGIBILITY CRITERION OF SUITABLE PREMISES

Costs

- No significant costs.

Benefits

- Reduces uncertainty for traders by more clearly specifying what is required.

Conclusion

The benefits of this proposal outweigh its costs.

11.6 REMOVE THE DISQUALIFYING CRITERION RELATING TO RUNNING A BUSINESS 'EFFICIENTLY'

Costs

- No significant costs.

Benefits

- Reduces uncertainty for traders.

Conclusion

Since the link between achieving the legislation's' objectives and this criterion is not clear the benefits of removing this criterion would likely exceed the costs.

11.7 PROTECT THE RESOURCES OF THE GUARANTEE FUND BY CLARIFYING GROUNDS FOR CLAIMS AGAINST THE FUND

Costs

- No significant costs.

Benefits

- Reduces uncertainty for both traders and consumers.
- Saves costs to buyers in establishing whether there is grounds for a claim and in preparing applications for claims which are not likely to be compensated.
- Saves Fund resources by reducing handling costs associated with potential applications for claims that are unlikely to proceed, thereby reducing the potential for licence fee increases.

Conclusion

The benefits of this proposal outweigh its costs.

12. CONCLUSION

The review finds that the legislation has no significant effect on competition in the motor trading industry and that the benefits it is intended to generate outweigh the costs it may impose. However, in some instances the legislation's objectives could be achieved equally well with less regulation hence a number of recommendations have been made.

As the review has not yet consulted with industry and other interested groups, there is a possibility that issues have been overlooked or have been given undue weighting. The review understands that there will be consultation with key stakeholders before any decision is made to proceed with any proposals for amendment of the legislation emerging from the review.

Subject to appropriate consultation, the review considers that the recommendations set out in the Overview of the report should be adopted.

APPENDIX

A TERMS OF REFERENCE

The review of regulation of motor car traders has been commissioned by the Minister for Fair Trading in accordance with the Victorian Government Timetable for the Review and Reform of Legislation that Restricts Competition, determined in accordance with National Competition Policy.

Legislation to be Reviewed

The review will examine the case for reform of legislative restrictions on competition contained in the *Motor Car Traders Act 1986* and the Motor Car Traders Regulations 1987.

In particular, the review will provide evidence and findings in its report in relation to the following:

- clarify the objectives of the legislation;
- identify the nature of the restrictions on competition;
- analyse the likely effect of the restriction on competition and on the economy in general;
- assess and balance the costs and benefits of the restriction; and
- consider alternative means of achieving the same result including non-legislative means.

Reform Options

The review should make recommendations on the extent to which it would be appropriate and feasible to narrow the scope of, simplify and relax the Act's licensing requirements, up to and including complete abolition. In addressing this question consideration should be given to the inter-relationship between the licensing provisions and those establishing the Motor Car Traders' Guarantee Fund and to the costs and benefits of repealing or amending the latter.

Other restrictions on employment within the industry should also be reviewed.

The review should examine whether existing restrictions on the conduct of motor car trading businesses, such as the ban on consignment selling and the requirement to provide a non-waivable warranty for certain used cars, could be relaxed or removed. Any other opportunities for reducing compliance costs should also be identified.

The potential for greater industry self-regulation should be considered.

Review Arrangements

This review is to be established and conducted in accordance with the in-house model contained in the Guidelines.

B CROSS REFERENCES TO REPORT

Task	Chapter	Page
Clarify the objectives of the legislation	5	17
Identify the nature of restrictions on competition	4	15
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Feasibility of narrowing, simplifying or abolishing licensing requirements	10	50
Costs and benefits of repealing or amending the Motor Car Traders Guarantee Fund	9, 10	43, 50
Review restrictions on employment within the industry	10	50
Relaxation or removal of conduct requirements eg ban on consignment selling & requirement for a non-waivable warranty on some used cars	7	25
Other opportunities for reducing compliance costs	10	50
Potential for greater industry self-regulation	8	38

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