

Discussion paper

# National Competition Policy Review of the Second-Hand Vehicle Dealers Act 1995 - Final Report

Issued March 2001

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Government  
of South Australia



Office of  
Consumer and  
Business Affairs

NATIONAL COMPETITION POLICY REVIEW  
OF THE  
SECOND-HAND VEHICLE DEALERS ACT 1995

FINAL REPORT

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## EXECUTIVE SUMMARY

On 11 April 1995 the Council of Australian Governments (“CoAG”) entered into three inter-governmental agreements to facilitate the implementation of national competition policy (“NCP”) objectives.

One of these agreements was the Competition Principles Agreement (“the Agreement”). As part of the obligations under the Agreement, State and Territory governments gave an undertaking to review all existing legislation that restricts competition. The Office of Consumer and Business Affairs is reviewing the *Second-hand Vehicle Dealers Act 1995* as part of this process.

The Act seeks to regulate activity in the second-hand vehicle market, namely:-

- the entry into the market of those who wish to carry on business as second-hand vehicle dealers; and
- the conduct of those who carry on business as second-hand vehicle dealers.

Only those licensed as second-hand vehicle dealers can carry on the business of selling second-hand vehicles in the South Australian market.

The first regulation of second-hand vehicle dealing in South Australia was under the *Second-Hand Motor Vehicles Act 1971*. That Act was introduced in response to the “*Rogerson Report*”, compiled by the Law School of the University of Adelaide in 1969, and presented to the Standing Committee of Attorneys General of the Commonwealth and States of Australia.

In 1983, the 1971 Act was repealed, and a new *Second-Hand Motor Vehicles Act* was enacted. The new Act followed a review conducted by an Interdepartmental Working Party who submitted a report to the Minister of Consumer Affairs in May 1982.

In 1995, the current *Second-Hand Vehicle Dealers Act* replaced the 1983 Act. The new (1995) Act maintained the basic structure of the 1983 Act. It addressed some anti-competitive elements in the licensing system by removing any reference to the knowledge, experience and financial resources of an applicant. Provision was made for a scheme of individual indemnity insurance and second-hand motorcycle dealing was brought within the ambit of the Act. Many other changes were made, including the allocation of all tasks in relation to those deemed to be second hand dealers, be they corporate bodies or individuals, to the Commissioner for Consumer Affairs.

Second-hand vehicle dealers are involved in some of the more significant transactions that a consumer will enter into during his or her life. Although they are not generally in the same price range as new vehicles, the purchase price of the majority of second-hand vehicles nevertheless often represents a significant portion of the average consumer’s income.

The Review Panel has concluded that there is continuing justification for the continued regulation of the market. The nature of the transaction, combined with the ever-increasing complexity and technological sophistication of second-hand vehicles, render consumers liable to risk of significant financial loss in this market.

The Review Panel has considered various less regulatory alternatives, including reliance on market forces, reliance on the insurance market, industry self- and co-regulation and negative licensing. In each case the Review Panel has concluded that these alternatives are not viable for ensuring that the current level of consumer protection is maintained.

The Act contains a number of restrictions, in the form of barriers to entry and conduct restrictions. The scope of work reserved under the Act is a barrier to entry, as it reserves a body of work to a particular class of person (that is, those who meet the requirements of the Act). Nonetheless, the Review Panel has concluded that the current scope of work for which a licence is required is appropriate and can be justified.

Ensuring the fitness and propriety of dealers is a prime objective of the Act. Currently, a person must not have been convicted of an offence of dishonesty if they wish to hold a second-hand vehicles dealers licence. Similarly, a body corporate is precluded from obtaining a licence in the event that any director of that body corporate has ever been convicted of an offence of dishonesty. The Review Panel is firmly of the view that the probity requirement must remain, but acknowledges that “an offence of dishonesty” has a broad meaning in law, and may act to exclude a person from operating in the market, even where the offence bears little relevance to the work of a dealer. The Review Panel has therefore recommended that convictions for summary offences of dishonesty should exclude someone from obtaining or holding a licence for a period of ten years, while other offences of a more serious nature would continue to impose a permanent prohibition.

Another restriction contained in the Act is the requirement on bodies corporate that they have in place a licensed dealer who is a natural person to properly manage and supervise the corporate dealer’s business. While this does represent a potential barrier to entry to the market for small business, nonetheless the public derives considerable benefit through a guarantee that the business operations of the corporate dealer are managed and supervised by an appropriate person who is personally licensed and therefore has something to lose if the business is poorly conducted. The Review Panel has therefore concluded that the current legislative arrangement in relation to the management and supervision of corporate dealers is appropriate.

The requirement that licensed dealers must only carry on business from premises approved by the Commissioner for Consumer Affairs is also a restriction on the market. However, it is noted that the Commissioner for Consumer Affairs in practice simply accepts approval from local councils under the *Development Act 1993* as sufficient for the grant of approval under the Act. Therefore, the Act itself does not impose any additional restriction over and above those imposed under the *Development Act 1993*. The reductions in information asymmetry and transaction costs afforded through the restriction are seen to provide benefits which outweigh any associated costs. The conclusion of the Review Panel is that this restriction is justified and should be retained.

The existence of a compulsory compensation fund, and the potential for compulsory indemnity insurance, also present a potential barrier to entry to the market. However, the Review Panel has concluded that given the risks faced by consumers in this market, the retention of a scheme of compensation, statutory or otherwise is justified.

The Act contains a number of restrictions on the conduct of dealers once they have become licensed. The requirement to display certain notices, as well as the requirement to include

certain information in standard form in contracts, have the potential to restrict competitiveness of dealers within the market. In each case, the provision of necessary information to consumers and the accompanying reduction in the incidence of transaction costs provide significant benefit to the community as a whole. On this basis, the retention of both is considered justified.

The existence of the statutory warranty to repair defects in certain circumstances also has the potential to negatively impact on competition. Dealers are required to factor into their pricing structures the potential costs of performing warranty work. Higher prices to consumers will be one of the results of this process. In addition, if the incidence of warranty costs were significant enough, they could serve to discourage new entrants to the market. This would reduce the overall level of competitiveness and stifle innovation, again to the detriment of the community as a whole. However, all parties who made submissions to the Review Panel identified the benefits arising from the warranty provisions, the reduction in transaction costs for consumers, to outweigh those costs. The Review Panel has therefore recommended that the warranty provisions be retained.

The Review Panel has also considered the scope of application of the warranty. The implication of a warranty into contracts for second-hand vehicles sold for between \$3,001 and \$6,000, as well as into contracts for second-hand vehicles less than 15 years old, or have travelled less than 200,000 kilometres, is considered justified. In each case the Review Panel considered the social and economic impact that the purchase of a second-hand vehicle has on the average consumer in coming to its conclusion. Notwithstanding that other States may have different criteria governing the implication of the warranty, the nature of the South Australian market is such that the benefit provided under the current regime is considerable, and outweighs the associated costs.

The Act makes interference with odometers a criminal offence, not only for licensed dealers, but for all people. While acknowledging that there is potential for upwards price pressure as a result of the prohibition, the Review Panel noted that there are a number of justifications for it. Firstly, many consumers rely, for better or worse, on the odometer reading when making a decision to purchase a second-hand vehicle. If this information is not accurate, then consumers may misallocate their scarce resources in the market. Secondly, the prohibition serves to remove from the market those who attempt to distort it, and thereby provide inefficiencies. The community as a whole derives benefit from the removal of such persons.

The Act provides for disciplinary measures to be taken against dealers under a range of circumstances. Disciplinary measures may result in a reduction in the number of persons who can provide services within the market, and may therefore be seen as a mechanism by which competition within the marketplace can be restricted. However, normal competitive behaviour within the marketplace is unaffected by the operation of the Act, and the disciplinary procedures only operate to remove from the market those who engage in conduct which is against the interests of consumers generally. For these reasons, the Review Panel sees any restriction that may arise from the operation of the disciplinary provisions to be justified as being in the public interest.

Certain entities are exempted from the requirement to be licensed under the Act. In particular, credit providers, auctioneers and the Crown do not have to obtain a licence subject to certain provisos. While the exemptions have the potential in each case to act as a



distortion on competition within the market, nonetheless the Review Panel has concluded that the current exemptions are appropriate and should be retained.

Therefore, the Review Panel has concluded that there is clear public benefit in the retention of regulatory control of the market and that the current legislation is the least restrictive and most effective means of achieving the objective of consumer protection.

**The only change recommended by the Review Panel is that section 9 of the Act be amended to reflect the recommendation that convictions for summary offences of dishonesty should exclude someone from obtaining or holding a licence for a period of ten years, while other offences of a more serious nature would continue to impose a permanent prohibition.**

## PART 1 : INTRODUCTION

### 1.1 WHY IS THE ACT BEING REVIEWED?

Economic and social imperatives, not only in Australia but also globally, have in recent times required the imposition of more rigorous market conditions on every sector of the economy. This process has affected the agricultural, mining, manufacturing and utilities sectors of the economy, and is ever increasingly impacting on the occupational and professional fields.

Formal governmental recognition of this process came at the Council of Australian Governments meeting on 11 April 1995 with the adoption by the Commonwealth and all State and Territory Governments of the National Competition Policy package.

The package comprised three separate agreements aimed at facilitating the implementation of National Competition Policy objectives:-

- The **Competition Principles Agreement** consisting of six distinct areas of competition reform:-
  - Legislative review;
  - Process oversight for government business;
  - Structural reform of public monopolies;
  - Competitive neutrality;
  - Access to essential infrastructure; and
  - Application of competition principles to local government.
- The **Conduct Code Agreement** committing all governments to implementation of uniform competition laws as set out in the schedule version of Part IV of the *Trade Practices Act 1974*. Under this code all persons, including governmental bodies and professional and occupational bodies, are now subject to competition laws.
- The **Agreement to Implement Competition Policy and Related Reforms** committing all signatories to a reform timetable. The Commonwealth is also committed to making payments to State and Territory Governments subject to their meeting the necessary reform timetables.

It is the legislative review element of the Competition Principles Agreement which forms the basis for this review. In this context it must be borne in mind that legislative reviews, such as this review of the *Second-hand Vehicle Dealers Act 1995* and the regulations under it, do not occur in isolation but rather form a part of a fully comprehensive economy-wide policy agreed to by all Australian governments.

The legislative review process extends not only to existing legislation, but also to new legislation. Further, the concept of "legislation" encompasses all Acts, Regulations, Rules, Proclamations, Notices, Amendments and By-Laws. The reform timetable contained in the Agreement to Implement Competition Policy and Related Reforms requires the legislative review process to be completed by the end of June 2002.

While competition is a notoriously difficult term to define globally, it may perhaps be most simply considered as a process of rivalrous behaviour by suppliers in a market that has many actual and potential buyers. National Competition Policy aims to make better use of competitive forces as a means to enhance overall material living standards, to improve Australia's social and environmental outcomes, and to extend the productivity enhancing effects of competition to virtually all sectors of the economy.

It has been said that National Competition Policy is about:-

*"ensuring that the way markets work serves the whole community, rather than resulting in back-room deals which benefit a few. It is about improving efficiency of the public sector to provide better services at lower prices. And it is about ensuring that legal protections from competition genuinely promote the welfare of all Australians, rather than the narrow interests of the businesses protected. The policy doesn't prevent governments guaranteeing desirable social objectives."*<sup>1</sup>

Underlying National Competition Policy is the notion that greater competition will create incentives for producers:-

- to use their resources better, resulting in higher productivity;
- to increase their efforts to constrain costs and therefore lower prices; and
- to be more responsive to users' demands in terms of improved quality.

It is important to acknowledge at the outset that many laws restrict competition. It is also important to acknowledge that often these restrictions are essential to achieve a significant community benefit. However, National Competition Policy requires that all laws restricting competition be identified, so that the community benefits they provide and the necessity for the restriction can be reviewed in an objective fashion.

In this sense, National Competition Policy embraces competition as a means, not an end in itself. Any increase in competition in a sector of the economy can therefore only be justified under Competition Policy Principles insofar as it provides an increase in net public benefit.

That said, any National Competition Policy review must start with the presumption that any identified restriction on competition should be repealed unless it can be demonstrated that a net public benefit arises from its existence. In line with Competition Policy Principles, those who wish to maintain a legislative restriction on competition bear the onus of proving that there is such a net public benefit.

This presumption arises from the text of the Competition Principles Agreement, which states at clause 5(1):

*The Guiding Principle is that legislation (including Acts, enactments, ordinances or regulations) should not restrict competition unless it can be demonstrated that:*

- a) the benefits of the restriction to the community as a whole outweigh the costs; and*

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<sup>1</sup> Mr G. Samuel, President, National Competition Council, *Australian Financial Review*, 22 June 1998, p. 20

*b) the objectives of the legislation can only be achieved by restricting competition.*

Therefore, the only restrictions on competition permitted under the Competition Principles Agreement are those that are demonstrably in the public interest. However, clause 5(1)(b) further requires that those restrictions, which are so justified, must also be the most appropriate way of meeting the legislation's objectives.

To put matters another way, while a public interest defence is a necessary step for retention of a legislative restriction, it is not in itself a sufficient one; if the policy objectives can be achieved by other means, then the legislative restriction must be removed, even if they are in the public interest, and replaced by the less restrictive alternative.

The process of determining whether a restriction is in the public interest is known as the "public benefit test". Clause 5(1)(c) of the Competition Principles Agreement requires that competition and associated economic impacts be assessed under this test.

The Review Panel notes that in this regard clause 1(3) provides guidelines on the content of public benefits tests such that, without purporting to limit what may be considered, the following matters must be taken into account where relevant:

- (a) *government legislation and policies relating to ecologically sustainable development;*
- (b) *social welfare and equity considerations, including community service obligations;*
- (c) *government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;*
- (d) *economic and regional development and investment growth;*
- (e) *the interests of consumers generally or a class of consumers;*
- (f) *the competitiveness of Australian businesses; and*
- (g) *the efficient allocation of resources.*

These criteria contain a clear expectation that social, environmental and regional concerns will be considered alongside the more narrow economic criteria in arriving at an assessment of overall benefits and costs. However, it should also be appreciated that, where relevant, matters beyond those set out in the Competition Principles Agreement, including rural issues, have been considered by the Review Panel.

It is important to acknowledge at the outset that some laws may restrict competition. In many such cases restrictions may be essential in order to achieve a significant community benefit. However, National Competition Policy requires that all laws restricting competition should be identified, so that those community benefits and the necessity for the restriction can be reviewed in an objective fashion.

## 1.2 WHAT IS BEING REVIEWED?

The Agreement requires that all existing legislation (including Acts, enactments, ordinances or regulations) be reviewed.

Accordingly, this Review applies to:-

- *Second-hand Vehicle Dealers Act 1995* (“the Act”); and
- *Second-hand Vehicle Dealers Regulations 1996* (“the regulations”)

References have been made to other legislation where appropriate. However, the scope of this review is limited to the *Second-hand Vehicle Dealers Act 1995* and the regulations. Issues relating to competitive restrictions in other legislation are beyond the scope of this review and are not considered in this Final Report.

## 1.3 THE REVIEW PANEL

The review was conducted by a Review Panel consisting of the following persons:-

- Ms Judy Hughes, *Deputy Commissioner - Policy and Legal, Office of Consumer and Business Affairs;*
- Mr Adam Wilson, *Senior Policy Officer (Competition Policy), Office of Consumer and Business Affairs;*
- Ms Gillian Schach, *Legal Officer, Policy and Legislation Section, Attorney-General’s Department;* and
- Ms Sherree Goldsworthy, *Senior Project Officer, Legislation and Policy Development, Transport SA.*

This Review Panel was appointed by the Minister for Consumer Affairs in accordance with the Department of Premier and Cabinet’s guidelines for the conduct of legislative reviews under the Council of Australian Governments Competition Principles Agreement.<sup>2</sup>

## 1.4 CLASSIFICATIONS OF RESTRICTIONS ON COMPETITION

Restrictions on competition identified in the Act will not be of uniform effect, with varying degrees of impact on competition inherent in each particular restriction. Therefore, the Review Panel has adopted the process of categorising potential restrictions on competition as **trivial**, **intermediate** or **serious** in order to assist in deciding on the depth of analysis to be given in each case.

The categorisations attributed by the Review Panel to the various restrictions are derived following a consideration of various factors including the height of barriers to entry and the

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<sup>2</sup> “Guidelines Paper for Agencies conducting a Legislation Review under the CoAG Competition Principles Agreement”, Department of Premier and Cabinet, February 1998, Part E, page 19 et seq.

impediments to rivalry in all dimensions of the price-product-service packages offered to consumers by market participants given the nature of the market.

## **1.5 THE REVIEW PROCESS**

The purpose of the Final Report is to present to the Minister for Consumer Affairs the conclusions and recommendations of the Review Panel in relation to each of the legislative restrictions on competition identified within the *Second-hand Vehicle Dealers Act 1995* and the *Second-hand Vehicle Dealers Regulations 1996* in accordance with the requirements of the Competition Principles Agreement. A summary of the conclusions and recommendations of the Review Panel can be found at Appendix 1 while a summary of the classification of identified restrictions can be found at Appendix 2.

In February 1999 the Commissioner for Consumer Affairs wrote to key industry and consumer groups advising them of the upcoming review of legislation within the Consumer Affairs portfolio. These groups were invited to attend one of a number of briefing sessions in March 1999, during which representatives of the Office of Consumer and Business Affairs and the Department of Premier and Cabinet outlined the basis and structure of the review process.

The Term of Reference for this review were subsequently set. These may be found at Appendix 3.

An Issues Paper was released for public consultation in March 1999. Three submissions were received by the Review Panel. A schedule showing the distribution of Issues Papers and submissions received can be found at Appendix 4.

Based on submissions received, a Draft Report was then prepared by the Review Panel and released in September 2000 for a six-week period of further public consultation. The Review Panel received 4 submissions in response to the Draft Report. A schedule detailing the distribution of the Draft Report and submissions received can be found at Appendix 5.

This Final Report has now been prepared based on the materials contained in the Draft Report, information provided in submissions and further research conducted by the Review Panel.

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## **PART 2 : THE MARKET**

### **2.1 WHAT IS THE RELEVANT MARKET?**

In general terms, a market is a collection of buyers and sellers that interact, resulting in the possibility of exchange<sup>3</sup>. Buyers include consumers who purchase goods and services, and sellers include firms and individuals who sell their goods and services.

The structure of a market is characterised by a number of factors including the number and size of competitors, the barriers to entry into the market, and the ability for different products to be substituted. Of all the elements making up a market structure, ease of entry into the market is probably the most important. It is the difficulty which potential competitors face in entering a market which establishes the possibility of market concentration over time, and it is the threat of the entry of a new player into a market which operates as the best regulator of competitive conduct on incumbents.

The Act seeks to regulate activity in the second-hand vehicle market, namely:-

- the entry into the market of those who wish to carry on business as second-hand vehicle dealers; and
- the conduct of those who carry on business as second-hand vehicle dealers.

Only those licensed as second-hand vehicle dealers can carry on the business of selling second-hand vehicles in the South Australian market. There are presently 1,400 second-hand vehicle dealers licensed in this State, of these, 81 carry on business solely as second-hand motorcycle dealers.<sup>4</sup> Currently, bodies corporate hold 452 licenses, whereas there are 948 licenses held by natural persons. These dealers operate from 1,428 registered premises.

In the 1999-2000 financial year the Office of Consumer and Business Affairs received 235 applications for second-hand vehicle dealers' licences (8 of these being for motorcycle dealers licences), of which three were refused. This application figure is significantly lower than in the preceding year when 411 applications were received (15 of which were for motorcycle dealers' licenses), of which 7 were refused. The Review Panel also notes that the 1997-1998 financial year demonstrated low figures as well, with only 166 applications being received (21 of these being for motorcycle dealers' licenses), with eight being refused.

The market for motor vehicles comprises a significant sector of the South Australian economy. As at 31 October 1998 there were 834,863 passenger vehicles registered in this State, which equated to 562 passenger vehicles registered per 1,000 population.

This figure demonstrates a rising trend in motor vehicle usage in South Australia, with 542 passenger vehicles registered per 1,000 population in 1997 and 540 in 1996. This per 1,000 population figure is significantly higher than in other States and Territories, with the next highest state, Victoria, registering 552 passenger vehicles per 1,000 population, and the most populous state, New South Wales, registering only 467 passenger vehicles per 1,000 population.

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<sup>3</sup> Pindyck R.S. and Rubinfeld D.L., Microeconomics (Second Edition), MacMillan, USA, 1992, p.11

<sup>4</sup> Commissioner for Consumer Affairs' Annual Report 1998/99 p22

These figures demonstrate the significant impact of this sector of the economy. There will obviously be a large number of transactions involving vehicles, and second-hand vehicles, given the total number of vehicles. Of course, not all vehicles and sales will fall within the scope of the Act. However, it is of note that the average age of passenger vehicles in South Australia at 31 October 1998 was 11.9 years, equalled only by Tasmania. This figure, which is again significantly higher than in other States and Territories, would tend to indicate that there is a vast market for older vehicles in South Australia particularly.

The inherent nature of the goods dealt with in the market is also worthy of consideration. Vehicles as a class are technologically complex products, and levels of complexity have been rising steadily over the past fifteen to twenty years. Items which may have been relatively rare in past times, including engine management systems, traction control and active restraint systems, are more and more commonplace in newer vehicles. As a result, the overall nature of the second-hand vehicle market has changed from one of a relatively unsophisticated product to one in which the product is quite technologically complex.

This degree of technological complexity feeds into one of the other characteristics of this market, namely, the difficulty that a consumer will have in establishing the history of a given vehicle. In older vehicles it may be the case that a relatively unsophisticated consumer could look for readily apparent telltale signs of wear and tear, such as oil leakage. However, the average consumer is in no position to assess matters such as the state of a fuel injector pump, or the adequacy of the engine management system.

A vehicle is likely to be one of the most expensive items ever purchased by a consumer, second only to the family home. In addition to any financial investment, consumers will often have high levels of social investment in their vehicle. Most consumers are dependent to a greater or lesser extent on their vehicles because of the social inconvenience arising from a lack of transportation. This is particularly the case in South Australia given the distances which many people travel for work and other daily activities. In many cases there are significant social and economic costs associated simply with "not being on time".

Finally, the market for second-hand vehicles is one in which there is a relatively high turnover of product. Second-hand vehicles are sold on a frequent basis and this in many instances acts to prevent consumers from obtaining an accurate picture of a vehicle's history.

### 2.1.1 Mutual Recognition

It should be recognised that under mutual recognition legislation, individuals in trades and professions regulated in one jurisdiction have the ability to obtain registration in another jurisdiction by means of administrative process. One of the effects of the mutual recognition legislation is a licensing decision taken in South Australia may also be the licensing decision for the whole of Australia and also for New Zealand. It is therefore appropriate to consider that the market for these services extends beyond the boundaries of South Australia.

Correspondingly, licensed persons from elsewhere within Australia can also carry on business as a dealer within South Australia provided they have made application under the mutual recognition process. The Office of Consumer and Business Affairs has to date granted two second-hand vehicle dealers' licenses under mutual recognition legislation.



## **2.2 CONCLUSION - THE RELEVANT MARKET**

### **CONCLUSION 1**

The conclusion of the Review Panel is that the market affected by the operation of the Act is the South Australian market for the systematic sale and purchase of second-hand vehicles.

### **PART 3: THE NEED FOR REGULATION**

Any review of legislation in line with competition policy principles must commence from a basis that no regulation is required. The case must then be made for regulation, and that regulation should be in the least restrictive form to meet the identified objectives.

It is therefore necessary to identify whether there is a need for any regulation within this market.

#### **3.1 COMPETITION: WHAT IS IT? WHY THE NEED?<sup>5</sup>**

##### **3.1.1 What is it?**

Competition expresses itself as rivalry within a market, and can take a number of forms:-

- rivalry on price;
- rivalry on service;
- rivalry on technology;
- rivalry on quality; or
- rivalry on consistency of product.

Effective competition requires both that prices should be flexible (reflecting the forces of demand and supply), and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers.

##### **3.1.2 Why do we need competition?**

Many economists argue that competitive market forces deliver greater choice and benefits to consumers. If a service provider is able to exercise significant power within its market, a misallocation of resources may result. The provider has no incentive to offer new products to consumers, and consumers may pay more for the service than it is worth. Vigorous competition between service providers encourages them to attract consumers to the business with targeted service provision and/or reduced prices.

Competition therefore functions as an incentive to business to improve performance through service innovation and adaptation to changing market environments. It provides a benefit to the community as a whole by allowing for greater consumer choice, increased efficiencies and economic growth, which may in turn lead to increased employment opportunity.

It is important to note that:-

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<sup>5</sup>Drawn from *re Queensland Co-op Milling Association Ltd & Defiance Holdings Ltd* [1976] ATPR ¶40-012 at 17,246; Commonwealth of Australia, Department of Industry, Science and Tourism, *Codes of Conduct Policy Framework* (Canberra 1998) p9.

*“Competition policy does not require that all firms compete on an equal footing; indeed, differences in size, assets, skills, experience and culture underpin each firm’s unique set of competitive advantages and disadvantages. Differences of these kinds are the hallmark of a competitive market economy.”<sup>6</sup>*

This Review is not primarily concerned with competitive conduct between suppliers within the market, unless such conduct results in inefficiencies and costs to the community at large. Rather, the Review is concerned with provisions in the legislation which may restrict entry into the market by new competitors, or provisions (of general application) which distort competition within the market as a whole.

### **3.1.3 Why do we regulate competition?**

Competition in markets is usually regarded as the most efficient method of allocating resources. However, unrestricted competition may not provide the best or most appropriate economic or social outcome. It has been observed that:-

*“government intervention in a competitive market is not always a bad thing. Government - and the society it represents - might have other objectives besides economic efficiency. In addition, there are situations in which government intervention can improve economic efficiency. This includes externalities and cases of market failure.”<sup>7</sup>*

It is therefore argued that where the potential for market failure exists, a basis for government intervention can be established.

#### **3.1.3.1 Market Failure<sup>8</sup>**

Competition assumes a market that is perfect, ie:-

- where maximum satisfaction and profit are sought;
- where there are no hidden transaction costs;
- where all parties are completely informed; and
- where there are no costs to other parties.

From the consumer’s viewpoint, inefficient market outcomes may result where there are high transaction costs, information asymmetry or externalities. Such situations indicate market failure and may justify regulatory intervention. Market failure will be discussed in greater detail at Part 4.7 of this Final Report.

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<sup>6</sup> National Competition Policy, Report by the Independent Committee of Inquiry, August 1993, p. 293

<sup>7</sup> Pindyck R.S. and Rubinfeld D.L., Microeconomics (Second Edition), MacMillan, USA, 1992, p.320

<sup>8</sup> Partly drawn from Commonwealth of Australia, Trade Practices Commission, *Regulation of professional markets in Australia: issues for review* (Canberra 1990) pp22-25; Victoria, Competition Policy Task Force, *National Competition Policy: Guidelines for the review of legislative restrictions on competition* (Melbourne 1996) pp70-72.

### 3.1.3.2 *Provider Failure*

Conventional forms of market failure do not, however, account for the failure of the service provider to honour their obligations - eg, through the intervention of dishonesty, insolvency or the systematic performance of substandard work.

In theory, consumers and service providers contract for a pre-defined quality of service in exchange for a price that the provider can demand without losing business. The provision of service quality less than that bargained for may be compensated for by regulatory intervention such as the setting of point-of-entry standards, the imposition of ongoing requirements or the provision of a 'safety net' for consumers.

Analyses of occupational regulation schemes in Australia have produced a list of potential risks to consumers that are generally not related to market failure.<sup>9</sup> The main types of benefit provided to the public through regulation consist of protection against a risk of:-

- financial loss;
- substandard work being performed;
- health and safety; and
- criminal activity.

The existence of these situations may also provide justification for regulatory intervention, and will be explained in further detail at Part 4.8 of this Final Report.

## 3.2 THE EFFECT OF OCCUPATIONAL REGULATION ON COMPETITION<sup>10</sup>

The intended effect of occupational regulation is to address concerns with market and/or provider failure. **Any regulation imposed should therefore be appropriate to addressing these concerns.** However, most occupational regulation legislation was designed without any explicit consideration of its impact on competition.

Restrictions on competition imposed by occupational regulation form two broad groupings:-

- barriers to market entry; and
- restrictions on competitive conduct.

These are briefly discussed below.

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<sup>9</sup> See Victoria, Law Reform Commission & Regulation Review Unit, *Principles for Occupational Regulation* (Melbourne 1988).

<sup>10</sup>Partly drawn from Moore & Tarr, "General Principles and Issues of Occupational Regulation" in (1989) 1 *Bond LR* 119 at 122-123.

### 3.2.1 Barriers to Entry

Regulatory barriers to market entry have the most direct influence over competitive conditions within an industry.

Numerous point of entry controls can exist:-

- barriers creating a monopoly;
- restrictions that operate by reference to the number of producers or product;
- barriers operating against interstate goods or service providers;
- barriers operating against foreign goods or service providers;
- restrictions that operate by reference to standards or qualifications.

It is this final barrier which is of most relevance to this Review.

### 3.2.2 Restrictions on Competitive Conduct

Many sectors of the economy operate under regulatory regimes which restrict certain forms of competitive behaviour. Restrictions on conduct may range from price controls to mandatory codes of practice.

If these controls were maintained by private agreement between competitors many would be caught by the competitive conduct provisions of the *Trade Practices Act*. However, as these controls are imposed by government, they are immune from the *Trade Practices Act* provisions.

As discussed previously, competition expresses itself as rivalry within a market. This rivalry may be in terms of price, service, technology or quality. Effective competition requires both that prices should be flexible (reflecting the forces of demand and supply), and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers. Restrictions on competitive conduct can prevent this competitive rivalry from being maximised.

Clearly, justification exists for government intervention in circumstances of market or provider failure in the marketplace. Intervention in an occupational services market, which may take the form of conduct or entry restrictions, must necessarily be subject to close scrutiny to ensure that any anti-competitive effects of this regulation can be justified as being in the best interests of the public.

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## **PART 4: ANALYSIS - THRESHOLD TEST**

### **4.1 IS THERE A NEED FOR ONGOING REGULATION?**

As a threshold question, consideration must be given to whether there is an ongoing need for regulation of this market as a whole. To answer this question it is necessary to consider both the objectives of the legislation to identify the market or provider failure which the Act seeks to address and the contemporary market to identify possible areas of provider or market failure.

### **4.2 HISTORY OF REGULATION IN SOUTH AUSTRALIA**

The first regulation of second-hand vehicle dealing in South Australia was under the *Second-Hand Motor Vehicles Act 1971*.

That Act was introduced in response to the "*Rogerson Report*", compiled by the Law School of the University of Adelaide in 1969, and presented to the Standing Committee of Attorneys General of the Commonwealth and States of Australia. The report found:-

*"ample evidence that purchasers of second-hand motor vehicles are the source of much trouble and hardship in the field of consumer credit. We believe that strong and far-reaching methods are needed if prevalent abuses are to be remedied."*<sup>11</sup>

In 1983, the 1971 Act was repealed, and a new *Second-Hand Motor Vehicles Act* was enacted. The new Act followed a review conducted by an Interdepartmental Working Party which submitted a report to the Minister of Consumer Affairs in May 1982. The Working Party found dealers were being licensed twice, once under the *Second-Hand Motor Vehicles Act 1971* and again under the *Second-Hand Dealers Act*. They further concluded that licensing was too lax, so that an unlicensed person could use another licensed person as a front for the business, and that the premises of a dealer's business ought to be suitable and approved for the purpose. Additionally, a scheme of compensation was recommended for buyers with unsatisfied repair claims or other monetary claims against a bankrupted dealer.

In 1995, the current *Second-Hand Vehicle Dealers Act* replaced the 1983 Act. In the Second Reading Speech, the Attorney-General noted:-

*"The Second-hand Motor Vehicles Act 1983 has been in operation for almost a decade without being fully reviewed.*

*In January 1994, the Government appointed a Legislative Review Team to review the provisions of each of the Acts which fall under the Consumer Affairs portfolio. Given the high level of complaints about second-hand motor vehicle purchases made each year to the Commissioner for Consumer Affairs and the willingness of industry to contribute constructively to the search for better means of dealing with them, the review team gave priority to its examination of the Second-Hand Motor Vehicles Act 1983."*<sup>12</sup>

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<sup>11</sup> *The Law Relating to Consumer Credit & Moneylending* (the "*Rogerson Report*"), a report to the Standing Committee of State and Commonwealth Attorneys-General by a committee of the University of Adelaide Law School, 25 February 1969, SA Government Printer, at page 46

<sup>12</sup> The Hon K.T. Griffin, Second Reading Speech, *Second-hand Vehicle Dealers Bill*, Legislative Council, 24 August 1994 at p. 202

The new (1995) Act maintained the basic structure of the 1983 Act. It addressed some anti-competitive elements in the licensing system by removing any reference to the knowledge, experience and financial resources of an applicant. Provision was made for a scheme of individual indemnity insurance. Following the collapse of a major dealer the Review Team found individual insurance would be more appropriate than a compensation fund as it would encourage responsibility and accountability among dealers. Second-hand motorcycle dealing was brought within the ambit of the Act. Many other changes were made, some of which are discussed in this Report.

Prior to the 1995 Act, the Commercial Tribunal was responsible for the determination of licenses with the Commissioner for Consumer Affairs responsible for administering the 1983 Act. The 1995 Act allocated all tasks in relation to those deemed to be second hand dealers, be they corporate bodies or individuals to the Commissioner for Consumer Affairs. A right of appeal against a decision of the Commissioner lies to the District Court.

### **4.3 OBJECTIVES OF THE CURRENT ACT**

The long title of the Act merely states that it is:-

*“An Act to regulate dealing in second-hand motor vehicles; to repeal the Second-hand Motor Vehicles Act 1983; to amend the Magistrates Court Act 1991; and for other purposes.”*

It is clear to the Review Panel that it is not the sale of second-hand vehicles per se which is the objective of the Act. Rather, it is dealers in second-hand vehicles and the conduct of those dealers that underlies regulation.

The Royal Automobile Association of South Australia Inc. (“RAA”) submitted in response to the Issues Paper that:-

*“The second hand dealers market has generated considerable consumer issues. It is agreed that the main purpose of the Act is to address this problem and to provide adequate consumer protection to buyers of second-hand vehicles through improving purchaser safeguards and the integrity of the market.”*

The Review Panel considers that the objectives of the current Act are several.

The Act aims to protect consumers by regulating entry to the market so as to ensure that only those who do not pose a risk to consumers may become licensed vehicle dealers entitled to carry on the business of dealing in second-hand vehicles.

Further, the Act provides for the regulation of dealers’ conduct by requiring standard forms of contract and the display of information on notices in relation to the sale of vehicles. These provisions are aimed at minimising the potential for consumer loss arising through transactions with dealers and reducing the transaction costs associated with the purchase of a second-hand vehicle. Obligations are imposed on dealers to repair vehicles in certain circumstances in order that the costs of transactions are reduced for consumers. These obligations take the form of a statutory warranty. The existence of disciplinary provisions allows for dealers whose conduct does not reach the prescribed standards, and are therefore more likely to cause loss to consumers, to be dealt with appropriately.

In addition to these requirements, the Act effectively underwrites consumer risks through both the duty to repair provisions and the establishment of a statutory compensation scheme.

#### **4.3.1 Conclusion:- The objectives of the Act**

##### **CONCLUSION 2**

**The conclusion of the Review Panel is that the Act has the following objectives:-**

- 1. to minimise the potential for consumer loss caused by unscrupulous conduct or insolvency, by licensing second-hand vehicle dealers and providing access to a compensation fund or insurance scheme;**
- 2. to minimise the potential for consumer loss by prescribing information and contract standards in relation to the sale of second-hand vehicles; and**
- 3. to minimise the potential for consumer loss arising through purchases from a dealer through the imposition on dealers of roadworthiness requirements and a duty to repair certain defects.**

#### **4.4 THE ONGOING RELEVANCE OF THE OBJECTIVES**

The question must be asked whether these objectives continue to be relevant. An examination of the available complaint statistics in relation to second-hand motor vehicles demonstrates that a significant number of complaints continue to be received by the Office of Consumer and Business Affairs. The Review Panel notes that the level of complaints received by the Office of Consumer and Business Affairs is not necessarily indicative of poor compliance in the second hand vehicle industry. These statistics may reflect a gap between consumer expectations and the actual quality of the vehicle delivered. Nonetheless, complaint statistics serve as a useful indicator of underlying issues and problems.

Year	Purchase Complaints	Repair Complaints	Total
1990-1991	1213	376	1589
1991-1992	668	479	1147
1992-1993	722	352	1074
1993-1991	674	397	1071
1994-1995	412	332	744
1995-1996	388	415	803
1996-1997	167	259	426
1997-1998	204	230	434
1998-1999	184	233	417
1999-2000	185	194	379

*\* Note that the repair statistics are not confined to the repair of second-hand vehicles.*



The statistics demonstrate a significant decrease since the 1990-1991 reporting period in the number of complaints regarding second-hand motor vehicle. However, there has not been a commensurate decrease in repair complaints numbers. While the repair complaints statistics are not confined to the repair of second-hand vehicles, it is nonetheless possible to conclude that there are still significant risks faced by consumers in relation to repairs of second-hand vehicles.

One means of measuring the risk of financial loss faced by consumers when purchasing a second-hand vehicle from a dealer is to analyse the claims brought against the Second-hand Vehicles Compensation Fund in recent times.

Year	Claims Paid(\$)
2000	56,000
1999	85,000
1998	538,000
1997	49,000
1996	20,000
1995	23,000

Source : Commissioner for Consumer Affairs Annual Reports<sup>13</sup>

These figures demonstrate that there remain significant levels of consumer loss in the market. Whilst the value of claims paid in the 1998 year may be considered an aberration, based on a large one off collapse, nonetheless the figures indicate a general upwards trend in the level of loss suffered by consumers when dealing with this market. It must also be borne in mind that there will be consequential non-economic losses arising in these claims, such as inconvenience, which are not compensated and must be borne by consumers.

The Review Panel therefore considers on the basis of the available data that the consumer protection objectives of the Act remain relevant in the current marketplace. No submission received by the Review Panel disagreed with this conclusion.

#### 4.4.1 Conclusion:- Ongoing relevance of the objectives

##### CONCLUSION 3

**The conclusion of the Review Panel is that the identified objectives of the Act remain relevant.**

<sup>13</sup> Commissioner for Consumer Affairs Annual Reports 1995-96, 1997-98, 1998-99, 1999-2000

## **4.5 CURRENT OPERATION OF THE ACT**

### **4.5.1 Licensing**

The Act provides for the licensing of those who carry on the business of selling second-hand vehicles, including motorcycles. A person must not carry such a business, or hold himself or herself out as a dealer, unless they hold a licence under the Act.

#### ***4.5.1.1 Entitlement to be Licensed - Natural Person***

In general, a natural person is entitled to be granted a licence if they are above the age of 18 years and are a fit and proper person. However, certain personal circumstances will prevent an applicant from obtaining a licence. In particular, a person must not:-

- have at any time been convicted of any offence of dishonesty;
- be suspended or disqualified from practising or carrying on an occupation, trade or business under any law;
- be an undischarged bankrupt, or subject to a composition, deed or scheme of arrangement for the benefit of creditors; and
- have been within five years of the application a director of a body corporate wound up for the benefit of creditors.

#### ***4.5.1.2 Entitlement to be Licensed - Body Corporate***

A body corporate is entitled to be licensed as a second-hand vehicle dealer if it is not suspended or disqualified from practising or carrying on an occupation, trade or business under any law and is not being wound up nor under official management or in receivership.

There are further circumstances which will preclude a body corporate from obtaining a licence. These relate to the status of the directors of the body corporate. No director can have been:-

- convicted of any offence of dishonesty at any time;
- be suspended or disqualified from practising or carrying on an occupation, trade or business under any law; or
- have been within five years of the application a director of a body corporate wound up for the benefit of creditors.

Further, each director of the body corporate must be a fit and proper person to be the director of a body that is the holder of a licence.

The Commissioner for Consumer Affairs administers the granting of licenses. A decision of the Commissioner for Consumer Affairs not grant a second-hand vehicle dealer's licence to an applicant may be appealed to the Administrative and Disciplinary Division of the South Australian District Court.

#### **4.5.2**      **Disciplinary Provisions**

In certain circumstances, disciplinary action may be taken in the District Court against second-hand vehicle dealers. The disciplinary power provides remedies over and above those available under other Acts or the common law and also provides a mechanism whereby those who are seen as posing a risk to consumers may be removed or excluded from the industry.

Disciplinary action is commenced by way of lodging a complaint with the District Court. It is important to note that it is not only the Commissioner for Consumer Affairs who may lodge a complaint; the Act allows that any other person may lay a complaint.<sup>14</sup> On the lodgement of a complaint, the District Court must conduct a hearing to determine whether the matters alleged in the complaint constitute grounds for disciplinary action.<sup>15</sup> In conducting a hearing, the District Court may, at the discretion of a Judge of the Court, sit with assessors, who are representatives from industry and consumer organisations.<sup>16</sup>

The grounds on which proper cause for disciplinary action may be made out are wide ranging,<sup>17</sup> as are the penalties available to the District Court in the event that proper cause is made out.<sup>18</sup>

#### **4.5.3**      **Registration of Premises**

The place from which a licensed dealer carries on their business must be registered with the Commissioner for Consumer Affairs. The Act confers a discretion upon the Commissioner for Consumer Affairs to register premises in the name of a licensee if satisfied that the premises are suitable for the purpose of the carrying on business as a dealer.

If a dealer ceases to carry on business at the registered premises, then they must notify the Commissioner for Consumer Affairs within fourteen days. Once notified, or if otherwise satisfied that the business is no longer conducted from the premises, the Commissioner may cancel the registration.

#### **4.5.4**      **Notice Requirement**

When a vehicle is offered for sale, or offered for sale by auction, by a dealer, the Act requires that certain notices be displayed. It is an offence for a dealer not to display the notices as required.

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<sup>14</sup> Section 28

<sup>15</sup> Section 29(1)

<sup>16</sup> Section 30

<sup>17</sup> Section 27

<sup>18</sup> Section 31

The notices must contain certain particulars and statements relating to the vehicle:-

- the licensed name of the dealer and their business address;
- a statement that the dealer will discharge their duty to repair (unless the dealer is acting on the behalf of another dealer)
- if there is no duty of repair, a statement that the dealer is under no duty to repair;
- if the dealer is acting on behalf of another dealer, the licensed name of the other dealer and their business address;
- if the dealer is acting on behalf of another dealer, a statement that the other dealer will discharge their duty to repair;
- if the dealer is acting on behalf of another dealer and there is no duty of repair, a statement that the other dealer is under no duty to repair;
- the name and address of the last non-dealer owner of the vehicle, or, if the last owner does not want their name published on the notice, a statement that the name of the last owner is available from the dealer;
- if the last owner of the vehicle carried on a leasing business and let the vehicle on hire to another person under a vehicle leasing agreement, then the name of that other person must be displayed; or, if that other person does not want their name published on the notice, a statement that the name of the other person is available from the dealer;
- the cash price of the vehicle, inclusive of fees and charges payable to the dealer;
- the vehicle's year of manufacture;
- the vehicle's manufacturer and model designation;
- the vehicle's year of first registration;
- the vehicle's registration number;
- if unregistered, the vehicle's engine number;
- if the vehicle is equipped with an odometer, the reading at the time the vehicle was acquired from the last owner who was not a dealer and, if it is more likely than not that the odometer reading is accurate, a statement to that effect, if that is not the case, the statement prescribed by the regulations; and
- other particulars and statements as are prescribed.

There are similar requirements in relation to a sale of a second-hand vehicle by auction. In those cases the responsibility rests on the auctioneer, and that person may be substituted for "dealer" in the list outlined above.

#### 4.5.5 Prescribed Form Of Contract

Section 17 of the Act sets out certain matters that must be included in every contract for the sale of a second-hand vehicle by a dealer. The requirements are that the contract must:-

- be in writing;
- be comprised in one document;
- be signed by the parties to the sale; and
- contain the following information:-
  - the name in which the dealer is licensed and the business address of the dealer; and
  - a brief description or identification of the vehicle; and
  - the vehicle's registration number; and
  - if the vehicle is not registered, the vehicle's engine number; and
  - the price for which the vehicle is being sold and the amount of any other fees and charges payable by the purchaser together with a description of each such fee or charge; and
  - if all or part of the purchase price is represented by a vehicle or other thing, the monetary value ascribed to that vehicle or thing; and
  - if a place has been agreed on as the place at which the vehicle may be delivered for the purpose of repair, the address of the agreed place; and
  - if a place has not been agreed on, a statement that the vehicle may be delivered to any registered premises of the dealer for that purpose; and
  - such other particulars as are prescribed; and
- contain a statement to the effect that a purported exclusion, limitation, modification or waiver of the rights conferred by the Act is void unless expressly provided for by the Act.

#### 4.5.6 Duty to Repair

Following the sale of a second-hand vehicle, a warranty is implied into the contract that the dealer will repair any defect in that vehicle which is present at the time of sale, or arises after the time of sale. When carrying out work under the warranty, the dealer must ensure that the repairs are carried out in a manner conforming to accepted trade standards.

However, this does not apply to all sales or to all vehicles. No warranty is implied in the case of:-

- the sale of a motorcycle;
- the sale of a vehicle to a dealer;
- the sale of a vehicle by auction on behalf of a person who is not a dealer;
- the sale of a vehicle negotiated immediately after auction on behalf of a person who is not a dealer;
- a sale of a vehicle where the vehicle has been in the eventual owners possession for a period of three months or more before the sale;
- defects in vehicles sold for less than \$3,000;
- the sale of a vehicle first registered for more than 15 years, or which has been driven more than 200,000 kilometres, prior to the sale, unless the defect was present at the time the purchaser took possession and the defect results in the vehicle to not complying with the *Road Traffic Act 1961*, or not being able to be driven safely or at all.

Further, there are certain defects which do not attract the protection of the repair warranty.

If the vehicle was sold for between \$3,001 and \$6,000, then the warranty period expires after the vehicle has either been driven 3,000 kilometres, or two months have elapsed since the sale, whichever occurs first. Similarly, if the vehicle was sold above that price range, then the warranty expires after the vehicle has either been driven 5,000 kilometres, or three months have elapsed since the sale, whichever occurs first.

A defect does not include damage deliberately caused to the vehicle after sale, or arising from the misuse of the vehicle after sale, or defects in paint or upholstery which were reasonably apparent at the time of sale.

The Act also sets out a statutory scheme for the enforcement of the warranty and provides rights and obligations on both the purchaser and the vendor in the situation where the warranty is to be enforced.

#### **4.5.7 The Second-hand Vehicles Compensation Fund**

The Act provides, in Schedule 3, for a scheme of statutory insurance whereby certain persons who suffer loss as a result of actions of dealers may be entitled to receive compensation. As with other statutory insurance schemes, this scheme is not intended to provide full compensation to those who suffer losses. The scheme will be more fully considered at Part 6.7 of this Final Report.

#### **4.5.8 Miscellaneous Provisions**

Rights conferred by the Act in relation to the sale of second-hand vehicles by dealers cannot be excluded, limited, modified or waived except where the prospective purchaser is over eighteen years of age, and waives the right in accordance with the scheme set out in the regulation.

The Act also provides that no person may interfere with the odometer on a second-hand vehicle and sets out a scheme for dealing with odometers.

### **4.6 COSTS OF REGULATION OF THE SECOND-HAND VEHICLES MARKET**

Regulatory intervention into an industry will inevitably give rise to some costs, which may occur in the government, industry or consumer sectors. The sources of cost identified are:-

- the actual and opportunity costs of complying with a regulatory regime;
- the actual and opportunity costs of administering a regulatory regime; and
- the costs arising from a reduction in competition and contestability in the relevant market.

Costs arise through ongoing compliance with the regulatory scheme by service providers. In the absence of regulation, a service provider would be free to structure their business behaviour in the manner most efficient for their business requirements. A regulatory system imposes a framework within which a service provider must operate, and will not necessarily allow the service provider to achieve maximum efficiency. This loss of efficiency is considered a source of cost to the wider community.

Further, there may be actual compliance costs imposed on service providers by the regulatory system. For example, under the present Act, there is a requirement that certain notices be displayed on vehicles when offered for sale by a dealer. The gathering of the information to be contained in the notice, the printing of the notice and the display of the notice will all have a quantifiable cost. Whilst these costs may not be great in the individual case, when one considers the volume of vehicles sold by dealers in the course of a year, the cost becomes more significant. It must also be remembered that these costs will ultimately be borne by the wider community through dealers' pricing structures.

Regulation of markets also imposes costs on government, and thus the wider community, through administration and compliance requirements. This involves not only the immediate

costs of funding, but also the opportunity costs of that funding. Again, the nature of the particular regulatory scheme will direct the extent of costs incurred.

In the case of the Act under consideration, significant governmental costs arise. The Commissioner for Consumer Affairs is the licensing authority for the purposes of the Act. This requires that staff be employed to :-

- process, assess and grant licence applications;
- process and assess annual returns;
- advise current and prospective licensees on matters relating to the Act;
- undertake compliance work;
- undertake disciplinary actions and/or prosecutions;
- educate the public about the operation of the Act.

Obviously, these administrative and compliance costs will be significant given the number of dealers presently licensed. It may be argued that the costs of administration are met by the licence fees collected, and since it is the licensees who pay the fees, any costs incurred in administering the system are ultimately private rather than public costs. However, this does not take account of the fact that these costs will be transferred to the public through licensees' cost structures. Therefore, it can be appreciated that once again the wider community bears the costs of administration and compliance work.

The theory of contestability would suggest that the mere threat of entry by new competitors into the market can act as a spur to incumbents to improve efficiency. Regulation of the market which restricts entry to new competitors is a key contributor to a reduction in the level of contestability in that market. With little threat of new competition, those presently in the market have a greater incentive to maintain the status quo than to explore new or different service delivery options. In these circumstances costs, both tangible and intangible, will be imposed on the wider community.

In addition to decreased contestability, regulation may have other detrimental effects on competition within the present market. Given that the market has been regulated in some form for a considerable time, it is not possible for the Review Panel to accurately assess the effect of regulation on competition, and therefore on prices. However, it is possible to conclude that regulation which determines not only those who may enter the market, but also the manner in which service may be delivered, is of *prima facie* anti-competitive effect. It is argued that since competition is the force which drives down prices, a reduction in levels of competition will cause a resultant increase in the costs of acquiring the relevant services.

Reduced levels of competition and contestability may also give rise to a situation of technological lethargy, where suppliers have lower or no incentive to develop or implement new and potentially more efficient methods of service delivery. There will be costs imposed on the community as a whole through foregone efficiency gains in such circumstances. If a supplier is limited to supplying only a particular type of service, then there is no incentive for that supplier to explore other avenues of service delivery. Whilst



there may be other methods of service delivery which would result in a more efficient use of resources, both by the consumer and supplier, these will not be pursued in the regulated environment. Again, this may be considered to impose both actual and opportunity costs on the wider community.

The Review Panel therefore concludes that regulation in an industry may result in increased costs to the community as a whole through:-

- the requirements of administration and enforcement of the regulation;
- decreasing the level of contestability in the market;
- decreasing the level of overall competitiveness in the market; and
- allowing the potential for technological lethargy to arise.

Having identified that regulation of the market potentially imposes costs on the wider community, it is necessary to analyse the potential for market and provider failure in this market to see what benefits may arise through regulation.

#### **4.7 MARKET FAILURE**

As discussed, market failure may occur due to the existence of:-

- transaction costs;
- information asymmetry; or
- externalities.

If regulation is able to overcome any or all of these causes of market failure, then this may be seen as providing benefits which may be weighed against the costs of regulation.

##### **4.7.1 Transaction Costs**

Transaction costs are costs incurred in doing business with a service provider, including the costs of:-

- locating a service provider;
- reaching agreement on the price and other aspects of the exchange; and
- ensuring that the terms of the agreement are fulfilled, including resort to legal advice and court action.

Market failure may occur where consumers experience significant search costs in a market with which they are unfamiliar, and therefore either abandon the search or make a less than optimal decision. Most consumers will only participate in this market on a limited number

of occasions during their lives. Therefore, unlike the market for household staples, most consumers will have little familiarity with the market and face significant transaction costs.

Markets generally make available less information than would be desirable in a perfectly competitive market. In any event, consumers will only search out and utilise information so long as the costs of their search are lower than the savings that they expect to make. In the absence of regulation, the information available to consumers will be limited and it is hard for a consumer to make a fair estimate of the levels of savings they will make by undertaking research into various service providers and goods. It may be the case that it is not possible for a consumer to come to any conclusion as to an appropriate service provider or good irrespective of the amount of research, and thus expense, undertaken.

Once a consumer has located a service provider, they must then determine whether that provider offers an appropriate price/quality mix for their purposes. Each consumer will have some notion of the quality of the service they desire and a view of how much they are prepared to pay for that level of service or for that good. While it is expected that a consumer will seek the highest quality good or service for the lowest price, it is true that consumers are usually prepared to trade off price and quality - to a point.

Licensing regulation seeks to provide basic information about suppliers in the market. The fact that a person has been granted a licence is an indication to the consumer (although not a guarantee) of the competence of the service that will be provided. This can decrease the cost to consumers of individually measuring the competence of service providers. Economies of scale would dictate that the Government is in a better position than an individual consumer to undertake such an assessment on consumers' behalf.

Regulation of conduct within a market will also reduce the transaction costs of a consumer. In the present market the standard form of contract and the duty to repair assist consumers in completing a transaction at minimal cost. At the same time, their legal rights and obligations are established so as to minimise the likelihood of disputes between the parties. In the event that disputes do arise, and cannot be resolved between the parties, there is added benefit insofar as the issues to be determined by the Courts will be more clearly defined.

Regulation of the second-hand vehicle dealers market therefore provides a public benefit in so far as it reduces the potential incidence of transaction costs.

#### 4.7.2 Information Asymmetry

Information asymmetry occurs when there is a disparity between information at the disposal of the consumer on the one hand, and the service provider on the other. Consumers may be at a disadvantage in:-

- assessing the need for service or the type and quality of goods or services required;
- distinguishing the competent service provider from the incompetent; and
- assessing the quality of the services rendered and whether they are excessive or inadequate for their needs.

This is particularly relevant in relation to services because generally these factors can only be assessed after the goods or services have been provided, by which time it may be too late.

Regulatory intervention can provide consumers with additional confidence in the service provider, instead of exposing them to the risk of inappropriate service selection and the possibility of exploitation by the provider.

It is fair to say that most consumers will transact with second-hand vehicle dealers at some point in their lives, but only on an infrequent basis. Nonetheless, these transactions will usually be relatively expensive for the consumer.

In general, consumers suffer from significant levels of information asymmetry in relation to this market. They are usually not in a position to assess for themselves the quality or appropriateness of the goods or services prior to consumption, when it is often too late. Thus they are at a significant disadvantage in terms of the information possessed in comparison with the second-hand vehicle dealer.

The evolving nature of the goods in this market also contributes to information difficulties for consumers. Vehicles have, over the past decade, become increasingly complex technologically. The average consumer simply does not have the technical expertise to adequately assess the vehicle they are considering purchasing. Compounding the problem are the difficulties which the average consumer will have in adequately assessing the history of a second-hand vehicle.

Requiring all dealers to be licensed, and to comply with all accompanying requirements, is one way of addressing this information asymmetry. Consumers can be assured that a person providing the goods and services to them is suitable to do so, without having to undertake extensive searches to discover the relevant information. This reduces the need for consumers to obtain further independent assurance that the dealer is competent; the Government has performed that task for consumers. Further, the regulatory requirements inform a consumer of crucial information relating to a vehicle they are considering purchasing.

#### **4.7.3 Externalities**

Externalities are costs or benefits to parties not directly involved in the transaction - they are sometimes referred to as 'spillovers'. Externalities can be of positive or negative effect. In some occupations, the risk of externalities is so significant for the community that a high degree of assurance of competence upon entry is required. Subsequent remedial action is often too late and ill directed.

The Review Panel considers that there is serious potential for negative externalities in this market. The safety decisions of a purchaser can have serious effects on those not party to the sale transaction. By way of example, a motorist driving an unroadworthy car presents a significant risk to other motorists and pedestrians.

Further, it is not only the immediate effects posed to these parties which are of concern. One of the characteristics of this market is the high level of vehicle turnover which, in combination with the difficulty in assessing a vehicle's history, can give rise to a situation

where unsuspecting third parties who purchase a second-hand vehicle containing defects will unwittingly put themselves at risk.

Regulation therefore provides significant public benefit by placing effectively prescribing minimum standards on vehicles which may be sold by dealers. The relevant standards being that vehicles must be roadworthy and certain defects must be repaired.

#### **4.8 PROVIDER FAILURE**

As discussed earlier, a set of potential risks to consumers have been identified which are not generally referable to market failure, but rather to the failure of a provider to honour obligations. Occupational regulation schemes can provide protection to the public against the risk:-

- of financial loss;
- of substandard work being performed;
- to health and safety; and
- of criminal activity.

##### **4.8.1 Financial Risk**

The financial risks thought worthy of protecting against may be conveniently described as personal risk and business risk.

###### ***4.8.1.1 Personal Risk***

Personal risks are risks attaching to the individuals behind the supplier. Regulating to reduce the risk of dishonesty is normally reflected in the requirement that an applicant be a fit and proper person to hold a licence. This requirement is commonly tested by reference to the applicant's criminal record regarding offences of fraud or dishonesty. This provides a filter to exclude from the occupation those who have a known predisposition to fraud or dishonesty. A conviction for fraud or dishonesty will also usually be grounds for disciplinary action under the licensing scheme, allowing for the formal and public exclusion of the offender from the occupation.

Protection against this risk is also facilitated by imposing controls (such as trust accounting requirements) on licensees which are directed to securing financial probity in those occupations in which large amounts of money are handled by a licensee on behalf of a third party.

In the market for second-hand vehicles it is often the case that contracts entered into involve significant sums of money. The Review Panel considers that the risk of a dealer behaving dishonestly in relation to this money needs to be minimised to the greatest extent possible and that regulation is required to provide the necessary protection.

#### **4.8.1.2 Business risk**

Business risk is related to the financial stability of the business. It is common for occupational regulation schemes to create some sort of financial threshold for an intending licensee to minimise the possibility of them becoming insolvent while liable to the consumer. This threshold is commonly expressed in the requirement that an applicant have sufficient financial resources to enable the successful carrying on of the occupation authorised by the licence. It is often supported by constraints on persons who are bankrupts, or directors of companies recently wound up, from being licensed.

This risk has particular relevance in the market for second-hand vehicles. The nature of the market is such that consumers will in many instances have relatively large amounts of money invested in the purchase or sale of the vehicle. If the business fails through insolvency a consumer will ordinarily rank only as an unsecured creditor, and to that extent could potentially face significant loss.

#### **4.8.2 Substandard Work**

In many areas, standards of technical competency are mandated to reduce the risk of substandard work being systematically performed. This risk is reduced by the requirement that an applicant for a licence or registration must have completed a prescribed course of training or hold prescribed qualifications. Consumers are thus given confidence that services provided conform to a basic level of skill.

However, the Review Panels considers that the risk of substandard work is not a relevant consideration in the market for second-hand vehicles.

#### **4.8.3 Public Health and Safety**

If the performance of a particular type of work, or the carrying on of a particular occupation has the potential to negatively impact of public health and safety, then there are arguably grounds for government regulatory intervention. Intervention in such circumstances must be designed to eliminate or minimise the potential for harm to the general public. There are many legislative examples of regulation aimed at achieving these outcomes. For example, the regulation of medical practitioners and dentists aims to minimise public health and safety risks by ensuring that only those who are demonstrably competent are permitted to carry out the relevant activities.

As set out at Part 4.7.3, there is a very real risk of externalities in this market. Of concern to this Review is the potential for serious negative externalities. The likelihood of a defective car causing injury not only to its owner, but also passengers, other road users and subsequent purchasers demonstrates the potential for risk to public health and safety which is also present in this market.

#### **4.8.4 Criminal Activity**

The risk of criminal activity is often perceived to be greater in occupations which deal with consumers in their own homes or workplaces, or in circumstances of trust and reliance. The Review Panel does not consider that the risk of criminal activity is either a real or perceived risk in this market. Further, no submissions have been received by the Review Panel to date expressing a contrary viewpoint.

#### **4.9 CONCLUSIONS - CONTINUING REGULATION**

On the basis of the foregoing analysis, the Review Panel has come to the conclusion that justification is made out for the continuing control of the second-hand vehicle market as the potential benefits to the wider community through the addressing of market and provider failure outweigh the identified costs of regulation.

#### **CONCLUSION 4**

**The conclusion of the Review Panel is that the continued regulation of the second-hand vehicle market is justified as the potential benefits to the wider community outweigh the costs.**

## PART 5: ALTERNATIVES

### 5.1 ALTERNATIVES TO THE CURRENT REGULATORY SCHEME

Having established a need for regulation in this market, Clause 5 of the Agreement requires that the Review Panel consider less regulatory alternatives to the current system of regulation.

### 5.2 RELIANCE UPON MARKET FORCES

The government could remove the current legislation and simply rely on market forces to control conduct within the industry. This presupposes that the market will operate to remove incompetent or uncompetitive operators, and relies on consumers exercising their legal rights where operators fail to deliver to contracted standards.

The cost of exercising legal rights (considered to be transaction costs) is significant, particularly for the average consumer. Consumers could potentially suffer significant financial loss, remembering that for the “mum and dad” type consumer, the purchase of a second-hand vehicle is a relatively expensive transaction. Placing consumers at this kind of risk is undesirable both from a social and from an economic perspective. This alone may provide sufficient justification for continuing regulation.

There is also a risk that incompetent and possibly dishonest practitioners could enter the industry in the absence of any controls. Further, market forces only operate reactively, i.e. once damage has been caused.

However, the Review Panel believes that there is room for market forces to play a greater role in addressing matters such as information asymmetry.

This is based on the assumption that licensing exists in part to provide consumers with an indication that a person possesses a basic level of competence. It has been asserted that:-

*“Occupational regulation in the form of licensing is premised on an assessment that it is better at the outset to exclude from the market incompetent or dishonest practitioners rather than deal with the consequences of their actions later.”<sup>19</sup>*

Licensing operates as a control over entry into a market, and in one sense is therefore only concerned with setting minimum standards of competence and conduct, below which the government will not allow a person to participate in the market.

Further, licensing does not provide for recognition of specialist skill or expertise. Market forces may be able to deliver such guarantees, and also give recognition to those who have achieved a degree of skill and expertise beyond the basic level of competence measured by licensing.

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<sup>19</sup> Guidelines for the Review of Legislative Restrictions on Competition, Victorian Department of Premier and Cabinet, p.71

### 5.2.1 Conclusion:- Sole reliance on market forces

#### CONCLUSION 5

The conclusion of the Review Panel is that sole reliance on market forces is an inappropriate mechanism for the overall regulation of the second-hand vehicle market.

### 5.3 RELIANCE UPON EXISTING LAWS OF GENERAL APPLICATION

Consumers of goods and services have a range of laws that they may call on during a dispute.

Providers of services may be liable to their customers for any damage caused by their negligence in circumstances where a duty of care to the customer exists and is breached, resulting in loss or damage that can be attributed to that breach.

There are also a number of laws dealing with the advertising of goods and services. At common law, misrepresentations regarding the price or quality of services may give a consumer legal rights to void the contract or, in certain circumstances, claim damages.

The Review Panel notes at the outset that although consumer protection laws tend to operate reactively (i.e. they are only available to the consumer once loss has been suffered), they still offer some protection to consumers. In addition, they have some deterrent effect, because dealers know that they may face legal action.

#### 5.3.1 Fair Trading Act 1987 (SA)

The *Fair Trading Act 1987* (SA) prohibits misleading and deceptive advertising and other conduct. In particular, the following sections are of relevance:-

- section 56 Misleading or deceptive conduct
- section 57 Unconscionable conduct
- section 58 False or misleading representations
- section 63 Misleading conduct in relation to goods
- section 64 Misleading conduct in relation to services
- section 69 Harassment and coercion.

The business of selling second-hand vehicles is subject to these laws because the definition of services in section 46 of the *Fair Trading Act 1987* is very wide; it includes any rights (including rights in relation to, and interests in, real or personal property), benefits, privileges or facilities that are, or are to be, provided, granted or conferred in trade or commerce, including rights, benefits, privileges or facilities that are or are to be provided,



granted or conferred under a contract for or in relation to the performance of work, including work of a professional nature.

Second-hand vehicles themselves are also subject to these laws as the definition of goods in section 46 provides that goods include “ships, aircraft and other vehicles”.

### 5.3.2 Trade Practices Act 1974 (Cth)

The *Trade Practices Act 1974 (Cth)* implies standard terms into contracts for the purchase of goods and services that cannot be excluded. Those terms stipulate that services purchased will be rendered with due care and skill and fulfil their purpose. Failure to do so will be a breach of contract.

Section 74 of the *Trade Practices Act 1974 (Cth)* reads:-

#### **Warranties in relation to the supply of services**

74. (1) In every contract for the supply by a corporation in the course of a business of services to a consumer there is an implied warranty that the **services will be rendered with due care and skill** and that any materials supplied in connexion with those services will be reasonably fit for the purpose for which they are supplied.

(2) Where a corporation supplies services (other than services of a professional nature provided by a qualified architect or engineer) to a consumer in the course of a business and the consumer, expressly or by implication, makes known to the corporation any particular purpose for which the services are required or the result that he desires the services to achieve, there is an implied warranty that the services supplied under the contract for the supply of the services and any materials supplied in connexion with those services will be reasonably fit for that purpose or are of such a nature and quality that they might reasonably be expected to achieve that result, except where the circumstances show that the consumer does not rely, or that it is unreasonable for him to rely, on the corporation’s skill or judgment.<sup>20</sup>

The section only implies these terms into contracts for the supply of services struck between a corporation and a consumer. Due to constitutional limitations, the *Trade Practices Act 1974* does not in general extend to govern transactions between unincorporated traders and consumers.

A corporation may be liable if services are not rendered with due care and skill, or if the services do not fulfil the requested purpose. It is also the case that the conduct of the directors, servants or agents of the corporation acting within the scope of their actual or apparent authority may be taken into account to ascertain whether a breach of the implied term has been committed.<sup>21</sup>

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<sup>20</sup> Emphasis added.

<sup>21</sup> *Trade Practices Act 1974 (Cth)*, section 84(2).

Although section 68 of the *Trade Practices Act* prohibits the exclusion of these warranties from the contract, section 68A modifies this prohibition so that a corporation may limit its liability to the supplying of the services again or the payment of the cost of having the services supplied again, provided it is fair and reasonable to do so.

### **5.3.3 Consumer Transactions Act 1972 (SA)**

South Australian law has a similar set of terms that are implied into contracts for the performance of services under the *Consumer Transactions Act 1972*, and these are not limited to corporations.<sup>22</sup> However, that Act only applies to a limited range of services, which are defined within the Act and regulations. The sale of a second-hand motor vehicle is not a service, nor is a motor vehicle a good, for the purposes of that Act.

Consumers presently do not have access to the warranties set out in sections 6 and 7 of the *Consumer Transactions Act 1972* and they therefore are required to prove the existence of those warranties when seeking to enforce their rights through the courts. Amendments to the *Consumer Transactions Act 1972 (SA)* would need to occur if second-hand vehicles were to be included in its application.

### **5.3.4 Occupational Health, Safety and Welfare Act 1986 (SA)**

In addition, there are laws protecting persons from unsafe or unhealthy work practices by way of the *Occupational Health, Safety and Welfare Act 1986 (SA)*. In a recent case,<sup>23</sup> a company was convicted of failing to ensure that plant which they installed was safe, in breach of section 24(2) of the Act. Of relevance, section 22 imposes on an employer or self-employed person a duty to take reasonable care to avoid adversely affecting the health or safety of any other person through an act or omission at work (employees are under a similar duty per section 21). Again, these laws are reactive, but do have a deterrent effect against providers.

### **5.3.5 Sale of Goods Act 1895 (SA)**

The *Sale of Goods Act 1895(SA)* is a general Act governing contracts relating to the sale of goods. "Goods" are defined to include all personal chattels, other than things in action and money.<sup>24</sup> Any goods presently owned or possessed by the seller, described under the Act as "existing goods", may properly be the subject of a contract of sale. Therefore, a second-hand vehicle, which clearly falls within the definition of a "good", may properly be subject of a contract of sale and the contract for the sale of a second-hand vehicle will be governed the *Sale of Goods Act 1895(SA)*. The Review Panel has considered below the provisions relevant to this particular market.

The Act deals with all aspects of a contract for the sale of goods: the formation of the contract, the effects of the contract, the performance of the contract, rights of an unpaid seller against the goods and actions for breach of the contract.

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<sup>22</sup> *Consumer Transactions Act 1972 (SA)*, section 7(1), (2).

<sup>23</sup> *Carter v Ad-Box (Australia) Pty Limited and Anor*, Industrial Relations Court of South Australia (Judgement 97-24401), 18 December 1998.

<sup>24</sup> *Sale of Goods Act 1895* section 60(1)

Of particular relevance to the sale of second-hand vehicles are certain conditions implied into transactions involving the sale of goods. These are that:-

- the seller has title and the right to sell;
- the buyer will obtain quiet possession of the goods;
- the goods are free from any charge or encumbrance in favour of a third party which is unknown to the buyer before or at the time the contract is made;
- if the goods are to be sold by description, they correspond to the description;
- if the goods are to be sold by sample, they correspond to the sample shown;
- the goods are fit for the purpose made known to the seller if the buyer reasonably relies on the seller's skill and judgment; and
- if the goods are brought by description from a seller who deals in such goods, that the goods will be of merchantable quality.<sup>25</sup>

However, when a seller breaches a condition of the contract for the sale of goods, that breach does not always have to be treated as a breach of a condition per se. The consumer has an option to either waive the condition or treat the condition as a breach of warranty if they choose.<sup>26</sup> This right of election affects the relief that the consumer may obtain. In general terms, a breach of a condition gives the consumer the right to repudiate the contract. Alternatively, a breach of a warranty gives the consumer a right to seek damages against the seller.

The Act also provides for the transfer of title upon sale by contract. If a person sells goods that they do not own, and they do not have the authority or consent of the owner to sell, then the buyer does not acquire title unless the owner has done something which would preclude them from denying of the seller's right to sell.<sup>27</sup>

Further, even where there are competing interests in the good purchased by a buyer, a buyer will still obtain good title if:-

- the seller has a voidable title to the goods but the title has not been avoided at the time of sale then the buyer acquires good title if bought in good faith and without knowledge of the seller's defect of title;<sup>28</sup>
- the seller sells goods to a buyer but keeps possession of the goods or documentation of title to the goods and then sells and delivers them, or the title documentation, to a second buyer the second buyer obtains good title if bought in good faith and without knowledge of the first sale;<sup>29</sup>

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<sup>25</sup> *Sale of Goods Act 1895* ss12, 13 & 14

<sup>26</sup> *supra* n24 - s11(1)

<sup>27</sup> *supra* n24 - s21(1)

<sup>28</sup> *supra* n24 - s23

<sup>29</sup> *supra* n24 - s25(1)

- the first buyer purchases goods from a seller and receives those goods, or title documentation relating to the goods, and then sells the goods and delivers them, or the title documents, to a second buyer who will then obtain good title if bought in good faith and without knowledge of any rights which the original seller may have held in relation to the goods. It must be noted that this will not operate to defeat a registered interest under the *Goods Securities Act 1986*.<sup>30</sup>

The Review Panel notes however that this Act presents a severe disadvantage insofar as all the consumer protection provisions discussed above may be excluded by the contract between the parties. This is significant where there is an information imbalance, as is the case in this market.

### 5.3.6 Conclusion

Although South Australia undoubtedly has in place a strong scheme of consumer protection under the laws discussed above, there nonetheless is a difficulty in relying on either common law remedies or generalist consumer protection laws to the exclusion of other protection. While they can be effective in some instances, in others they may offer little protection to consumers. If, for example, the dealer is insolvent, or if the loss incurred as a result of the conduct of the dealer is large, then while the consumer may be able to establish a claim, recovering any form of compensation will be difficult if not impossible. Thus any victory will be a moral one only, and will still leave the consumer out of pocket.

Further, the costs of pursuing such remedies may deter some consumers from taking any action. Finally, if litigation increased as a result of a lowering of standards in the industry, there would be significant public costs which would follow through the increased costs to the courts, longer lists and the many other costs involved in litigation.

#### **5.3.6.1 Conclusion:- Reliance on laws of general application**

#### **CONCLUSION 6**

**The conclusion of the Review Panel is that reliance on existing general laws to alleviate the risks existent in the second-hand vehicle market is inappropriate. Rather, the Review Panel considers that these general laws provide an effective framework for regulation of this market only in combination with a licensing or registration system.**

### **5.4 RELIANCE UPON INSURANCE MARKET**

Another option considered by the Review Panel for regulation of this market is sole reliance upon the private insurance underwriting market.

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<sup>30</sup> supra n24 - n ss 25(2) & 25(4)

Under such a scheme, those carrying on business as dealers would be required to hold a policy of indemnity insurance in favour of their customers. Further, there would be an ongoing requirement to maintain a policy of insurance throughout the life of the business.

An issues paper released as part of the review of architects' and builders' legislation in Victoria noted that:-

*"Professional indemnity insurance is a risk management device which benefits both building practitioners and their clients. The clients of any professional person have expectations about the services they will receive and clients who consider they have suffered injury, loss or damage due to the negligence, recklessness or incompetence of a professional person, may take legal action in an attempt to obtain compensation.*

*The compulsory insurance requirements are to ensure that there are funds to meet successful claims by consumers in the event of deficiencies in the professional service they receive and to enable building practitioners, including architects, to defend themselves when such claims are made. Generally, the costs of the premiums are passed through to consumers as fees."*<sup>31</sup>

There are two concerns about a greater reliance on the insurance industry from a competition perspective. Firstly, as has recently been noted in New South Wales, reduced competition in the insurance market can lead to greatly increased premiums.

A newspaper article noted that due to recent rationalisations in the New South Wales building insurance market, there were now only two providers of indemnity insurance products. As a consequence, there had been a considerable increase in premiums over the past 12 months. The possible effects on competition were noted:-

*"The Master Builders Association of NSW is concerned that substantially increased premiums and onerous financial conditions are both forcing builders out and preventing new builders from entering the industry."*<sup>32</sup>

The Review Panel notes in this context that the market for building insurance is far greater in absolute terms than this market. Therefore, if there is difficulty in attracting underwriters to that larger market, those difficulties will be even greater in a market of only 1,400 licensees.

Secondly, and perhaps as a consequence of the concern outlined in the preceding paragraph, difficulties in obtaining indemnity insurance can lead to reduced competition within the market. Reduced competition will inevitably lead to increased costs for consumers.

Although the second-hand vehicle market is significantly different to the market for building work or construction services, the arguments are nonetheless equally applicable across the two markets. The Review Panel therefore has concerns over the effectiveness of a system of insurance standing alone as a means of market regulation. However, as will be discussed later in this Final Report, a scheme of insurance, statutory or otherwise, is considered to play an important role within the market for second-hand vehicles.

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<sup>31</sup> Victoria, Issues Paper - NCP Review of Architects and Building Legislation, Department of Infrastructure/Freehills Regulatory Group (November 1988), p.25

<sup>32</sup> Australian Financial Review, 6 July 1999

#### 5.4.1 Conclusion:- Reliance on the insurance market

##### CONCLUSION 7

**The conclusion of the Review Panel is that sole reliance upon the insurance market is not an appropriate alternative to the current system of regulation.**

#### 5.5 INDUSTRY SELF-REGULATION

There are a number of examples of professions or occupations who self-regulate, and who do so successfully. The accounting profession has never been subject to a licensing system, but has developed a system of internal regulation. The manner in which an accountant's work is performed is controlled by legislation, but the professional bodies decide who will be admitted to their membership.

A significant quantity of analysis of self- and co-regulatory systems has been undertaken recently.<sup>33</sup> In 1996, the Office of Consumer and Business Affairs released an Issues Paper entitled "*Industry Regulation - The Way Forward*", which specified criteria that an industry would need to be able to demonstrate in order that co- or self-regulation would be considered:-

- the legal basis upon which the industry group operates;
- evidence that the industry as a whole is supportive of the proposed role (as opposed to industry association support);
- evidence that the industry group has sufficient coverage of the industry concerned;
- evidence of public and consumer consultation in the development of the proposal;
- proposals for reporting to the Commissioner for Consumer Affairs, methods for identifying and reporting on individual industry members and systemic industry problems, and consultative mechanisms;

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<sup>33</sup> South Australia, Office of Consumer and Business Affairs, *Industry Regulation: The way forward* (Adelaide 1996); Commonwealth of Australia, Department of Industry, Science and Tourism, *Codes of Conduct Policy Framework* (Canberra 1998) p9; Commonwealth of Australia, Trade Practices Commission, *Self-regulation in Australian industry and the professions* (Canberra 1988); Commonwealth Department of Industry, Science and Tourism, *Benchmarks for Industry-based Customer Dispute Resolution Schemes* (Canberra 1997); Commonwealth of Australia, Australian Competition and Consumer Commission, *Benchmarks for dispute avoidance and resolution - a guide* (AGPS, Canberra 1997); Commonwealth of Australia, *Fair Trading Codes of Conduct - why have them, how to prepare them* (AGPS, Canberra 1996); Commonwealth of Australia, Ombudsman's Office, *A Good Practice Guide for Effective Complaint Handling* (Canberra 1997); New Zealand, Ministry of Consumer Affairs, *Market Self-regulation and Codes of Practice* (Wellington 1997)

- evidence that the formal industry agreement and the delegated powers will be applied in a consistent and fair fashion and will not be applied to the detriment of a particular industry sector or non-member in an anti-competitive manner;
- proposals for independent evaluation of the undertaking of the delegated authorities;
- proper funding proposals; and
- evidence of capacity to handle delegations.<sup>34</sup>

The paper further noted:-

*“A mature industry is prepared to take responsibility, does not shield members who deserve censure, assists in the resolution of disputes, and has the motivation to keep industry standards at a high level. A mature industry views external participation not as a threat to “cosy” relationships but as a welcome part of adjudicatory procedures.”<sup>35</sup>*

The current Act provides that the Commissioner for Consumer Affairs (with the permission of the Minister for Consumer Affairs) can enter into agreements with professional organisations.<sup>36</sup> No such agreements have been entered into at this time.

There are a number of industry bodies within South Australia, but at this time none exhibit the necessary characteristics that would justify the Commissioner for Consumer Affairs entering into these types of agreement allowing for co- or self-regulation in this State. However, industry groups currently participate in the regulation of the industry through the Plumbers, Gas Fitters and Electricians Advisory Panel, established under the Act.

The Review Panel also notes the finding of the recent Commonwealth Taskforce on Industry Self-Regulation that *“self-regulation is likely to be most effective where there are clearly defined problems but no high risk of serious or widespread harm to consumers”*.<sup>37</sup> The Review Panel considers that it is applicable to the market in question. As previously discussed, this market has the potential for high levels of harm associated with the performance of work. It is not, therefore, a suitable market for the imposition of an industry self-regulatory scheme.

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<sup>34</sup>*Industry Regulation: The Way Forward*, Office of Consumer and Business Affairs (South Australia), 1996, p. 9

<sup>35</sup>*Industry Regulation: The Way Forward*, Office of Consumer and Business Affairs (South Australia), 1996, p. 9

<sup>36</sup> Section 32

<sup>37</sup> Draft Report of the Taskforce on Industry Self-Regulation, June 200, page 40, Department of Treasury, Commonwealth Government.

### 5.5.1 Conclusion:- Co- and self-regulation

#### CONCLUSION 8

The conclusion of the Review Panel is that the option of greater co- or self-regulation by the industry bodies is not feasible at this time, although the option does exist within the current legislation for this to occur should the industry exhibit the level of maturity sought by Government to justify entering into appropriate agreements

### 5.6 NEGATIVE LICENSING

“Negative licensing” is a system of market regulation in which legislation simply prescribes who may or may not operate within a specified market. There is usually no requirement to be registered with a government agency. As discussed earlier in this Final Report, the Office of Consumer and Business Affairs administers negative licence schemes in relation to process servers (under the *Security and Investigation Agents Act 1995*), land valuers (under the *Land Valuers Act 1994*) and sales representatives (under the *Land Agents Act 1994*).

Negative licensing legislation may preclude persons who do not have specified competencies or who do have certain convictions. It will also usually provide for disciplinary action against persons operating within the market, and would typically allow for the public exclusion of a market participant as a disciplinary measure.

In its submission to the Issues Paper the MTA proposed that:-

*“A system of registration similar to that of the Second-hand Dealers and Pawnbrokers Act 1996 may be a possible alternative to the existing licensing system.”*

The Review Panel has considered this proposal as an alternative regulatory scheme.

#### 5.6.1 The Second-hand Dealers and Pawnbrokers Act 1996

The *Second-hand Dealers and Pawnbrokers Act 1996* contains negative licensing schemes for the regulation of both those who carry on business as second-hand dealers and those who wish to operate a second-hand market.

That Act provides that a person shall not carry on business as a second-hand dealer if they are disqualified under the Act from doing so. The disqualifying events for both natural persons and bodies corporate are substantially similar to those contained in the *Second-hand Vehicle Dealers Act 1995* as set out at Part 4.5.1.1 of this Final Report. Prior to the commencement of their business, a person must notify the Commissioner of Police in writing of certain matters, including:-

- the full name and residential address of the person who intends to carry on business (in the case of partnerships - the full name and residential address of each partner; in the case of bodies corporate the name and residential address of



each directors and the address of the registered corporate office of the body corporate);

- the name under which the business will be carried on;
- the address at which the business will be carried on;
- a description of the nature of the business to be carried on; and
- a statement as to whether the person would be disqualified from carrying on the business as a result of non-compliance with the disqualifying criteria.

The Act also provides that those carrying on business as a second-hand dealer must keep certain records in relation to the goods in which they deal and must deal with goods in specified manners.

If a person wishes to operate a second-hand market then they must provide written notice to the Commissioner of Police prior to the commencement of the market. The notice must contain certain information including:-

- the full name and residential address of the person who intends to operate the market (in the case of partnerships - the full name and residential address of each partner; in the case of bodies corporate the name and residential address of each directors and the address of the registered corporate office of the body corporate);
- the name under which the market will be operated;
- the address at which the market will be operated; and
- a description of the nature of the market to be operated.

#### *5.6.1.1 Assessing the scheme in the context of the market for second-hand vehicles*

Whilst there may appear to be similar outcomes under this scheme, the Review Panel considers that there are significant associated costs.

The experience of the Office of Consumer and Business Affairs is that negative licensing schemes impose a cost on government in terms of administering and enforcing the legislation, with no offsetting revenue from licensing. By way of comparison, a positive licensing scheme involving the payment of initial and periodic fees is a revenue neutral system. The fees collected simply offset the costs of administering the system. Negative licensing therefore imposes a cost on the wider community that must be funded from general revenues.

It is also of note that there is no "fit and proper" person test to preclude from the industry those considered an inappropriate risk to consumers. A positive licensing scheme is based ultimately on an assessment by the Government that a person is "fit and proper" to carry on the business of, in this case, dealing in second-hand vehicles. The absence of such a provision, particularly in a market identified as having high potential for incidence of

provider failure as one of its characteristics, could result in inappropriate persons dealing in second-hand vehicles in such a manner so as to give rise to consumer losses.

This leads in turn to a further problem with the scheme. A negative licensing scheme does not, by definition, provide for disciplinary action to be taken against a licensee whose standards of conduct do not meet the prescribed level. In effect there are no controls on a person's behaviour once they have satisfied the entry criteria. In fact, it is difficult to ascertain exactly who is participating in the industry. Under a system containing disciplinary provisions, a person's behaviour may be controlled by the imposition by a Court of fines, business operating restrictions or even removal from the industry. This is considered to be beneficial for the wider community.

### 5.6.2 Conclusion:- Negative licensing

In light of the foregoing, the Review Panel does not consider at this stage that a negative licensing scheme, such as that set out in the *Second-hand Dealers and Pawnbrokers Act 1996* is appropriate in this market. The potential for provider failure combined with the unfunded administrative costs of a negative licensing scheme constitute costs which do not demonstrably exceed the benefits returned to the community. These benefits are ultimately synonymous with the benefits provided under a positive licensing scheme that has added advantages in terms of conduct regulation and administrative cost neutrality.

#### CONCLUSION 9

**The conclusion of the Review Panel is that negative licensing is not an appropriate alternative to the current system of regulation.**

### 5.7 FURTHER ANALYSIS OF THE ACT

The Hilmer Report noted there will often be significant opposition to regulatory review:-

*"beneficiaries of the restrictions usually have powerful incentives to resist reform, with those advocating change bearing the burden of establishing that existing restrictions are not justified"*<sup>38</sup>

and further,

*"regulation that confers benefits on particular groups soon builds a constituency with an interest in resisting change and avoiding rigorous and independent re-evaluation of whether the restriction remains justified in the public interest."*<sup>39</sup>

As discussed, justification for government intervention into a market may be provided by the occurrence of market or provider failure. Having established that regulation of the relevant markets is necessary, and that there are no appropriate less regulatory alternatives,

<sup>38</sup> National Competition Policy - Report by the Independent Committee of Inquiry, August 1993 at page 189 ("the Hilmer Report")

<sup>39</sup> Hilmer Report at page 191.

it is necessary for the Review Panel to examine the competitive restrictions in the current form of legislation and assess whether they can be justified in the public's best interests.

Inappropriate regulation can reduce the competitiveness of a market in numerous ways. Both managerial and financial costs may be imposed which may in turn lead to the diversion of resources and time from more productive activities. Barriers to innovation, in terms of product and service delivery, may also result from inappropriate regulatory methods.

As discussed earlier in this Final Report, restrictions on competition imposed by occupational regulation fall within two broad groupings:-

- barriers to market entry; and
- restrictions on competitive conduct.

As will be seen in the following analysis, the Act in its current form contains both barriers to entry and restricts the conduct of service providers in this market. While the Review Panel has formed the conclusion that alternatives to the current overall scheme of regulation are not appropriate in this industry at this stage, nonetheless it is necessary to examine each restriction on competition in the legislation to determine whether there are less restrictive alternatives for achieving the desired objectives.

## PART 6: BARRIERS TO ENTRY

### 6.1 INTRODUCTION

Regulatory barriers to market entry have the most direct influence over competitive conditions within an industry, and may take the form of :-

- barriers creating a monopoly;
- restrictions that operate by reference to the number of producers or product;
- barriers operating against interstate goods or service providers;
- barriers operating against foreign goods or service providers; or
- restrictions that operate by reference to standards or qualifications.

It is this final barrier which is of most relevance to this Review.

The Hilmer Report noted that some “*regulatory regimes may be more restrictive than necessary to protect the public interest objectives for which they were imposed*”, and even if the imposed standards are objectively reasonable, “*there may be concerns over whether they are administered or enforced in a way that unduly favours incumbents.*”<sup>40</sup>

The theory of “contestability” suggests that the mere threat of potential competition can have efficiency effects similar to actual head-to-head competition. Removing or reducing entry barriers can therefore have a positive impact on performance, even if few or no competitors actually enter the market.

The imposition of point-of-entry controls for these purposes may preserve the status quo in the industry but, given a stable demand for the services, restriction on their supply may lead to price increases. Further, such regulation may affect the relative prices of labour and material inputs, thereby causing service providers to use inefficient mixes.

Another consequence of the imposition of point-of-entry controls may be ‘technological lethargy’ where suppliers have no incentive to innovate. Given that many innovations may result in cost reductions to consumers, regulation that inhibits innovation is imposing a hidden cost.

Point-of-entry regulation may also result in functional separation of an industry, restricting market competition and raising the cost of services. Again, this is particularly relevant to this Review. Functional separation may limit the functions that can be performed by other occupations and less-skilled workers. Without functional separation due to regulatory intervention, market forces would determine the most efficient forms of organisation and specialisation. If there are no substantial economies to be made in specialisation, persuasive public interest reasons would need to be advanced for enforcing industry segmentation.

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<sup>40</sup> Hilmer, at p.197

## 6.2 SCOPE OF WORK

The term “dealer” is given broad definition in the Act to mean a person who carries on the business of selling second-hand vehicles. “Vehicle” means a vehicle that is wholly or partly propelled by an engine and is able to be used for transport on land. To be a second-hand vehicle, the vehicle must have been used for a purpose not connected with its manufacture or sale. It should be noted that a “demonstration” vehicle is considered to be a second-hand vehicle for the purposes of the Act. Sale of a vehicle includes sale on behalf of another person. The definition catches all those who deal in second-hand vehicles whether by consignment, auction or otherwise.<sup>41</sup>

A critical limitation is that the definition of a dealer only includes those who carry on the business of selling second-hand vehicles. While the Review Panel acknowledges that the concept of “carrying on business” is notoriously difficult to define, there are certain characteristics which may be taken as indicia of whether an entity is carrying on business. These include elements of system, repetition and continuity, commercial enterprise and a view to a profit.<sup>42</sup>

The Act raises a rebuttable presumption that a person is carrying on the business of selling second-hand vehicles if they sell, offer to sell or expose for sale four or more vehicles during a twelve month period.<sup>43</sup> If a person falls within this provision, and cannot provide proof that they are not carrying on the business of selling second-hand vehicles, then the Act requires that they hold a licence.

### 6.2.1 What are the objectives of the restriction?

The objective of this restriction is to “ring-fence” certain transactions from the general sector of the economy. As discussed earlier in this Final Report, there are strong grounds for supporting regulation of such transactions.

### 6.2.2 Impact of the scope of work on competition

The current scope of work may be restrictive of competition if it is too broad and therefore encompasses the provision of services that could appropriately be performed by anyone without risk to the consumer. The Review Panel has identified this as a **serious restriction on competition**.

### 6.2.3 Costs of the scope of work

Whenever a class of activity is regulated, costs will be incurred. The reservation of the business of dealing in second-hand vehicles has potential to reduce competition in the market. Economic theory would dictate that the number of persons carrying on this activity is less than would be the case if the work were not reserved. Consequently, there is likely to

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<sup>41</sup> See Section 3 generally for these definitions.

<sup>42</sup> *Swayne v. Palm* (1970) SASR 158

<sup>43</sup> Section 50(1)

be a reduction in supply of services, with corresponding higher prices for consumers, in a regulated market.

None of the submissions received by the Review Panel in response to the Issues Paper or the Draft Report identified any costs associated with the current scope of work reserved under the Act. Nor were any areas identified in which regulation was considered inappropriate or unjustified. Several submissions to the Issues Paper did however deal with the issue of exemptions from the scope of work. The Review Panel prefers to treat the issue of exemptions as a matter separate from the scope of work per se, and will discuss these issues further at Part 8 of this Final Report.

#### **6.2.4 Benefits of the scope of work**

As previously identified, the complex technological nature of second-hand vehicles, the financial outlay involved in the purchase of second-hand vehicles and the difficulty of accurately assessing a second-hand vehicle's history all combine to make the purchase of second-hand vehicles risky for consumers.

The risk becomes magnified when the average consumer purchases the vehicle from someone who has greater experience and knowledge of second-hand vehicles. Moreover, when that other person has greater experience and knowledge of not only second-hand vehicles, but also the sale of those vehicles and the market generally, then the transactions assume the highest levels of risk for consumers. It is this area of the market which is regulated under the Act.

In regulating only those transactions that present the highest risk to consumers, the current scope of work provides dual benefit. Firstly it addresses market and provider failure risks for consumers and allows the market to operate efficiently in the consumer-dealer transaction sector. Secondly, and as a corollary of the first benefit, it allows the market as a whole to operate more efficiently by not imposing unnecessary regulation on the remaining sectors in which risk levels are not so high.

#### **6.2.5 Assessing the costs and benefits of the scope of work**

In its submission to the Issues Paper, the RAA considered that "*the scope of work for which a licence is required is appropriate*".

The Review Panel concurs with this statement.

The benefit provided by the current scope of work in reducing the incidence of market and provider failure is of significance given the nature of market as discussed in this Final Report. Regulation is not imposed on all transactions involving second-hand vehicles, but rather on those transactions that pose high risk for consumers. Although there is a cost borne by the community as a whole, due to fewer persons dealing in second-hand vehicles than would be the case without regulation, this cost is more than offset by the benefits provided.

### 6.2.6 Alternatives

The Review Panel has not identified any areas currently reserved under the Act which do not warrant regulation. Further, no submissions have been received which suggest that there are areas currently regulated which do not require regulation. As a consequence, the Review Panel's conclusion is that there are no alternatives to the current scope of work.

Having considered the effect of the current scope of work, the Review Panel does not believe that there is any justification for an increase in the area of work regulated. On the basis of the foregoing analysis, any such regulation would be unnecessary and impose costs on the community as a whole.

### 6.2.7 Conclusion:- Scope of work

#### CONCLUSION 10

**The conclusion of the Review Panel is that the current scope of work reserved under the Act is a justified restriction on competition within this market.**

## 6.3 THE REQUIREMENT TO BE LICENSED

The Act prohibits a person from carrying on business as a dealer, or holding themselves out to be a dealer, unless they hold a licence granted under the Act. Therefore, if a person falls prima facie within the definition of a dealer they must obtain a licence. A licence granted under the Act remains in force indefinitely so long as the annual fee is paid.<sup>44</sup>

### 6.3.1 What are the objectives of the restriction?

Having identified, at Part 6.2 above, that the current scope of work reserved under the Act is a justified restriction on competition in this market, it necessarily follows that a scheme is required to put into effect risk minimisation objectives of the reservation of work. Such a scheme is to be found in the requirement to be licensed.

The requirement to be licensed can therefore be seen as the enforcement of the scope of work. The restriction seeks to ensure that only those who obtain a licence may perform the work reserved under the Act.

### 6.3.2 Impact of licensing on competition

The impact of the restriction on competition cannot be considered in isolation from the scope of work reserved under the Act. As with the scope of work, the requirement to be licensed reduces the number of entrants to the market by raising a barrier to entry.

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<sup>44</sup> Section 11 - The current licence renewal fees for a natural person are \$236 (\$113 for a motorcycle dealer), and in the case of a body corporate \$354 (\$164 for a motorcycle dealer).

The presence of a barrier to entry results in levels of suppliers in the market being below that which would exist without regulation. A reduction in suppliers without a corresponding reduction in demand will result in higher unit prices for consumers. The market will therefore be less efficient than would otherwise be the case.

The Review Panel's assessment of this requirement is that it is a **serious restriction on competition**.

### 6.3.3 The costs of the requirement to be licensed

The requirement to obtain a licence before commencing the business of a second-hand vehicle dealer results in fewer dealers in the market than would otherwise be the case. Further the existence of the requirement may dissuade potential dealers from entering the market. In either case, the Review Panel considers it apparent that limited competition will result in inflated prices for the consumer.

In its submission to the Issues Paper, the MTA did not favour the retention of a licensing system:-

*"Given the low levels of complaints received by OCBA regarding second-hand vehicle sales and the overall 'nil benefit' of being a licensed dealer, along with the consumer penchant for vehicle purchases other than from a licensed dealer, it is difficult to justify maintaining a licensing system."*

The Review Panel notes however, that the levels of complaint received by the Office of Consumer and Business Affairs are not low. Statistics would indicate quite the opposite, with motor vehicles generating the second highest level of complaints after the building and construction area.

The Review Panel also notes that the MTA did not further press this issue by way of a submission to the Draft Report.

Licensing imposes a cost on the Government in administering a licensing system. The Commissioner for Consumer Affairs is the licensing authority for the purposes of the Act. This requires that staff be employed to: -

- process, assess and grant licence applications;
- process and assess annual returns;
- advise current and prospective licensees on matters relating to the Act;
- undertake compliance work;
- undertake disciplinary actions and/or prosecutions; and
- educate the public about the operation of the Act.



Obviously, these administrative costs will be significant. The licence fees collected meet the costs of administering the system, and, since it is dealers who pay licence fees, it may be argued that the costs incurred are private costs and not public costs. However, this does not take account of the fact that these costs will be transferred to the public through dealers' cost structures. Therefore it is the wider community which ultimately bears the costs of government administration.

#### **6.3.4 The benefits of the requirement to be licensed**

The RAA submitted in response to the Issues Paper that:-

*"The Association submits that the licensing requirements are justified in terms of the net consumer benefit in ensuring that second hand dealers are reputable and that their behaviour is regulated such a way as to protect consumers from unfair trading practices."*

An advantage of a system of licensing over other regulatory schemes is that it allows for a central monitor of suppliers to be established. The licensing agency, consumers and dealers themselves are able to access information about who is carrying on business where. As discussed at Part 5, other schemes do not allow for central pooling of information.

Further, licensing seeks to ensure only appropriate people can carry on business as dealers. The existence of a licence therefore serves as an indicator to consumers that the particular dealer will not present a risk to them. This boosts consumer confidence in the second-hand vehicles market, which can have the effect of enhancing economic activity in this market. This in turn provides economic benefit to the community as a whole.

More importantly however, licensing reduces the transaction costs of consumers. Consumers do not have to undertake extensive and potentially expensive searches to determine relevant information about the person with whom they wish to transact. In granting a licence the Government has performed these tasks for them. The economies of scale resulting from this process provide benefit through the reduction in overall costs incurred by the community in this market.

#### **6.3.5 Assessing the costs and benefits**

As discussed at Part 5 generally, this market is considered best regulated by a system of positive licensing. The Review Panel acknowledges that there may be significant costs faced by the wider community through a reduction in competition in the market as a result of the restriction. However, given the conclusion of the Review Panel that there is significant enough risk inherent in consumer-dealer transactions to justify regulation, then the costs of a licensing system will have to be relatively great to offset benefits provided.

A consideration of the benefits provided by the requirement to be licensed demonstrates that there are numerous economic benefits provided to the community as a whole. It is clear that a precise quantification of the dollar value of those benefits is difficult to perform given the extended history of regulation in this State. Nonetheless, the levels of cost borne by the community prior to the introduction of the *Second-hand Motor Vehicles Act 1971*, the first industry specific regulation in this area, give some indication of the potential extent of likely costs. The Rogerson Report provided an indication of the level of problems:-

*"...there is ample evidence that the purchases of second-hand vehicles are the source of much trouble and hardship in the field of consumer credit."<sup>45</sup>*

On this basis, the Review Panel has come to the conclusion that the benefits provided by the restriction outweigh the costs imposed. The Review Panel notes that all submissions received in response to the Draft Report support this finding.

### **6.3.6 Alternatives**

Having determined that the benefits of a licensing system outweigh the costs, the Review Panel is obliged to consider the individual criteria which entitle an applicant to be granted a licence under the Act. The following discussion identifies and provides analysis of various entitlement criterion considered by the Review Panel to be prima facie restrictions on competition.

### **6.3.7 Conclusion:- Requirement to be licensed**

#### **CONCLUSION 11**

**The conclusion of the Review Panel is that the requirement to be licensed is a justified restriction on competition.**

## **6.4 REPUTATION**

### **6.4.1 General reputation**

The Act imposes a restriction by requiring a person to be of good general reputation. This is assessed at the point of entry into the industry by the requirement that a person must not:-

- a) have been convicted of an offence of dishonesty; or
- b) be suspended or disqualified from practising or carrying on an occupation, trade or business under a law of this State, the Commonwealth, another State or a Territory of the Commonwealth.<sup>46</sup>

In the case of a body corporate the requirement is that:-

- a) no director of the body has been convicted of an offence of dishonesty; or

<sup>45</sup> Rogerson Report, page 46

<sup>46</sup> Section 9(1)

- b) neither the body corporate or any of its directors be suspended or disqualified from practising or carrying on an occupation, trade or business under a law of this State, the Commonwealth, another State or a Territory of the Commonwealth.<sup>47</sup>

In both the case of a natural person and a body corporate, there is a further requirement that the applicant, or each director of the body corporate applicant, be a fit and proper person to be the holder of a licence.<sup>48</sup>

#### **6.4.2 Financial reputation**

The requirement that a person be of good financial reputation may pose a further barrier to entry. This is assessed at the point of entry into the industry by the requirement that a person must not:-

- a) be an undischarged bankrupt or subject to a composition or deed or scheme of arrangement with or for the benefit of creditors; or
- b) during the period of five years preceding the application for registration, have been a director of a body corporate wound up for the benefit of creditors-
- i) when the body was being so wound up; or
  - ii) within the period of six months preceding the commencement of the winding up.<sup>49</sup>

A similar requirement is in place in relation to bodies corporate, which states that:-

- a) a body corporate must not be under official management, in receivership or being wound up; or
- b) no director of the body corporate has during the period of five years preceding the application for registration, been a director of a body corporate wound up for the benefit of creditors-
- i) when the body was being so wound up; or
  - ii) within the period of six months preceding the commencement of the winding up.<sup>50</sup>

#### **6.4.3 Impact of the requirements on competition**

While these requirements restrict entry into the occupation, they clearly exist to protect consumers from risk of financial loss or criminal activity. As discussed earlier in this Final Report, consumers face potentially significant risks when dealing with second-hand vehicle

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<sup>47</sup> Section 9(2)

<sup>48</sup> Sections 9(1)(f) & 9(2)(c)

<sup>49</sup> Sections 9(1)(d) & 9(1)(e)

<sup>50</sup> Sections 9(2)(a)(ii) & 9(2)(b)(iii)

dealers. Relatively large amounts of money are often involved in the purchase of a second-hand vehicle. Fraud or, in some circumstances, negligence may result in the loss of that money. Those who have a history of dishonesty or financial mismanagement are thought to pose a greater risk to the consumer.

The Review Panel has assessed these requirements as **serious restrictions on competition**.

#### **6.4.4 What are the benefits of these requirements?**

The benefits of the requirements are that those who are likely to pose a risk to consumers are kept out of the industry. This reduces the risk of provider failure, especially in an industry where significant amounts of money change hands on a daily basis in return for a technologically complex good on which consumers place a great deal of reliance.

#### **6.4.5 What are the costs of these requirements?**

A particular cost identified in relation to the prohibition on those who have been convicted of any offence of dishonesty is that it keeps some people out of the industry who may otherwise have been able to participate in it. In *Commissioner for Consumer Affairs v Standley*<sup>51</sup> the Full Court of the Supreme Court held, in relation to a similar provision under the *Security and Investigation Agents Act 1995*, that the Commissioner for Consumer Affairs has no discretion to grant a licence to a person convicted of a prescribed offence. The Review Panel considers that there is no reason for assuming that a Court would not apply the same reasoning in relation to applications for registration under the *Second-hand Vehicle Dealers Act 1995*. Thus conviction for a single offence would exclude a person from the industry for life.

It is arguable that this is an undesirable restriction on competition. Nonetheless, it may be possible to target the restriction with even greater precision so that only those who have committed the offences most relevant to the identified risks are permanently prevented from participation in the industry. If this is so, then there is a cost associated with the present exclusion of those people from the industry.

#### **6.4.6 Assessing the costs and benefits**

The Review Panel considers that the benefits of the restrictions outweigh the costs. All submissions agreed that the current requirements do not impose an unnecessary restriction on competition. The RAA submitted in response to the Issues Paper that:-

*"The cost of such restriction on obtaining a licence relate to a reduction in competition amongst licensed dealers due to the barriers to entry they represent. The benefits relating to such provisions, however, result in significant consumer benefit in terms of having fit and proper dealers operating in the market, and the level of consumer confidence in making vehicle purchases that this establishes."*

However, the Review Panel considers that it may be possible to reduce the costs of the restriction while maintaining its benefits. This possibility is discussed below.

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<sup>51</sup> (1998) 71 SASR 152

#### **6.4.7 *What are the alternatives?***

An alternative method would be to narrow even further the range of offences which result in permanent disqualification from participation in the industry. This was an option supported by all submissions. Currently, any person who has committed any offence of dishonesty is prevented from obtaining a second-hand vehicle dealers licence, no matter what offence of dishonesty was committed or how long ago it was committed. While there are some offences which are clearly of such a character that permanent disqualification from participation in the industry is warranted, there may be other offences where a first offence may be considered to warrant a shorter period of disqualification.

This issue received considerable comment when raised in the Issues Paper.

CASA submitted that:-

*"A prescribed list of offences relevant to operating a business that disqualify a person or body corporate from obtaining a licence for a period similar to other states would be a sufficient restriction that benefits consumers."*

The MTA expressed a similar view:-

*"The eastern states application of a 10 year time limit may be a reasonable rehabilitation period for past minor offences."*

The RAA submission was also supportive of such a proposal:-

*"However, it is agreed that the lack of a time limit on an offence is draconian. This is particularly in light of the provision capturing offences which may have little bearing on the operation of a dealership. It is considered appropriate that a time limit be placed, of say ten years."*

While no specific response was received in relation to the Draft Report, the RAA did comment that it agreed with the conclusions contained in that report.

The Review Panel has also considered the position in other jurisdictions.

In Western Australia *The Motor Vehicle Dealer's Act 1973* requires the Board to formally review only those applicants whose offences occurred within the preceding five years. Offences prior to this are disregarded. Any criminal history is considered under the fit and proper person test.

*The Motor Dealers Act 1974 (NSW)* allows the Director General, in determining whether an applicant is a fit and proper person, to have regard to the fact that the applicant has been imprisoned or convicted of a dishonesty offence in the preceding ten years.<sup>52</sup>

Pursuant to the *Sale of Motor Vehicles Act 1977 (ACT)* a person must be of good fame and character to hold a licence<sup>53</sup> which is determined by (amongst other things) whether the person has been convicted of an offence in the preceding ten years of dishonesty:-

<sup>52</sup> *Motor Dealers Act 1974(NSW)* , Section 12(3)(a)

<sup>53</sup> *Sale of Motor Vehicles Act 1977 (ACT)* Section 8(1)(b)

- against the Act;
- against the *Trade Practices Act*; or
- the *Fair Trading Act*.<sup>54</sup>

The *Motor Car Traders Act 1986 (Vic)* has much stricter criteria. A licence must be refused if the applicant has been convicted of a serious offence (fraud, dishonesty, drug trafficking and violence offences punishable by three months or more imprisonment within the last ten years),<sup>55</sup> unless the Authority is satisfied the public interest will not be compromised.<sup>56</sup>

The Review Panel considers that where a person has been convicted of a summary offence of dishonesty, or an offence of dishonesty for which the maximum penalty is no more than 2 years imprisonment, that conviction should not disqualify the person from obtaining a licence after a certain period of time has elapsed. The Review Panel considers that ten years from the date of conviction would be an appropriate time period.

It is proposed that after ten years, a conviction for any summary offences of dishonesty, for example under the *Criminal Law Consolidation Act*, Commonwealth tax and social security laws or other South Australian law, will not be taken into consideration for licensing purposes.

The Review Panel acknowledges that there may be some concerns where a person has been convicted of many offences of dishonesty but has not offended in that way for ten years.

An option considered by the Review Panel was to provide that only a *first* conviction for a summary offence of dishonesty would be disregarded for licensing purposes. Any subsequent conviction would permanently disqualify a person from participation in the industry. However, the Review Panel considered that this may be draconian and, in terms of the intended effect of the new provision, may be ineffective. If, for example, a person at the age of 18 committed a number of “shoplifting” offences, but then reformed and applied for a licence at the age of 35, then the Act would be keeping such a person out of the industry unduly. Therefore, the Review Panel rejected this option.

In any event however, the Review Panel considers that on analysis there is sufficient protection in the Act already to safeguard against such a situation. The Commissioner for Consumer Affairs has discretion, through the “fit and proper person” requirement, not to register someone where they display a history of offending which indicates that licensing would be inappropriate.

When weighing these costs against the benefits which would accrue from the imposition of the test, it must be borne in mind that the ten-year disqualification period refers to **summary** offences of dishonesty and not the more serious categories of **indictable** offences, which will still permanently exclude a person. By definition, summary offences of dishonesty will be at the low end of the scale in terms of seriousness of offending.

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<sup>54</sup> as above Section 71

<sup>55</sup> *Motor Car Traders Act 1986(Vic)*, Section 13(4)(l)

<sup>56</sup> as above Section 29B

The Review Panel's conclusion is that a person should be disqualified for the relatively long period of ten years following a conviction for a summary offence. This position recognises that any offence of dishonesty is serious, summary or otherwise, but does take into consideration rehabilitation principles bearing in mind that summary offences are of less gravity than indictable offences.

On the basis of the foregoing, the Review Panel considers that the ten-year exclusion period in relation to summary offences, be it a first or subsequent offence, is sufficient, in conjunction with other protection mechanisms in the Act, to provide consumer protection in relation to the personal reputation of a second-hand vehicle dealer.

#### 6.4.9 Conclusion:- Reputation requirements

##### CONCLUSION 12

The conclusion of the Review Panel is that benefits of the restrictions relating to reputation outweigh the costs. However, the Review Panel would recommend that while the restrictions ought to be retained, they should be modified so that a conviction for a summary offence of dishonesty will only disqualify a person from becoming licensed as a second-hand vehicle dealer for ten years.

#### 6.5 INCORPORATED DEALER'S BUSINESS TO BE PROPERLY MANAGED AND SUPERVISED

Section 13 of the Act requires that in the case of a licensed dealer who is a body corporate, that dealer must ensure that their business is properly managed and supervised by a licensed dealer who is a natural person.

##### 6.5.1 The objectives of the management requirement

This provision is considered by the Review Panel to be a consumer protection provision. It aims to ensure that there will be at least one natural person possessing appropriate supervisory and managerial abilities that consumers can deal with when purchasing a second-hand vehicle from licensed bodies corporate.

##### 6.5.2 The impact of the management requirement on competition

The effect of the requirement in competition terms is that there may be additional costs imposed on a dealer. For example, in the case of a small business where the director of the body corporate licensee is also the natural person managing the business, the need for two licence applications and two fee payments could impose additional costs. It is possible, dependant perhaps on the fee levels, that these additional costs could deter bodies corporate from entering the market in the small business sector of the market.

The Review Panel considers that this restriction is an **intermediate restriction on competition**.

### **6.5.3**      **Costs of the management requirement**

As discussed above, the requirement could have the effect of imposing additional costs on bodies corporate by requiring two licence applications with two fee payments. This not only imposes additional costs upon the body corporate, but also results in administrative repetition and costs for the Office of Consumer and Business Affairs.

The general public will ultimately fund these costs. This licensing system is revenue neutral, insofar as licence fees imposed meet the administrative costs associated with running the scheme. Therefore, funds to run the scheme are not drawn from general revenues and to this extent the public does not fund the administration of the scheme. However, it is clear that dealers will incorporate fees into their cost structures when setting prices for second-hand vehicles. Although the proportion of the price of any given vehicle that reflects the fees paid by a dealer is not large, the result is nonetheless increased prices for consumers.

There is also the possibility that dealers will be discouraged from entering the market due to the double payments of fees. Less competition will result in decreased choice for consumers and higher vehicle prices overall.

### **6.5.4**      **Benefits of the management requirement**

The Review Panel considers that the restriction provides a benefit to the public by ensuring that the business operations of a dealer are managed and supervised by an appropriate person who is licensed and therefore subject to the disciplinary provisions of the Act. Implicit in this scheme is an acknowledgment that the manager has something to lose if the business is poorly conducted.

Under this system, consumers' transaction costs are reduced, as they do not have to undertake searches to establish whether the person with day-to-day responsibility for the running of the business is suitable to do so: the Government has already performed this job for them. Economies of scale would dictate that the costs incurred by Government in doing this, though ultimately borne by the community, are far less than the total cost to the community if consumers were required in each case to search out this information for themselves.

### **6.5.5**      **Assessing the costs and benefits**

The Review Panel views as significant the certainty and reduction in transaction costs afforded by this restriction. However, there does remain some residual concern over the levels of cost imposed by the requirement. Advice received from the Office of Consumer and Business Affairs indicates that fees are often waived in the case of the manager and supervisor of a body corporate dealer. Nonetheless, it is incumbent upon the Review Panel to consider alternative means of achieving the same outcomes.



### 6.5.6 Alternatives to the current regulation

One alternative would be to remove the requirement for a positive licence and move to a negative licensing system, as is the case for sales representatives under the *Land Agents Act 1994*.

Under that Act, a person must not employ another as a sales representative unless that other person:-

- holds the qualifications prescribed by regulation; or
- already holds a registration as a land agent; and
- has not been convicted of an offence of dishonesty; and
- is not suspended or disqualified from practising or carrying on an occupation, trade or business under a law of this State, the Commonwealth, another State or a Territory of the Commonwealth.

Further, a person must not be or remain in the service of a person as a sales representative, hold themselves out to be a sales representative or act as a sales representative if they do not satisfy the above criteria.

In the case of a dealer's business, similar criteria could apply, perhaps based on the entitlement criteria set out in section 9 of the Act, with the added proviso that any natural person holding a licence under the Act would be entitled to be a manager and supervisor.

A notification requirement could be imposed on the licensee carrying on the business to inform the Commissioner for Consumer Affairs of who is supervising and managing each premise at which their business is being carried on.

In order to maintain the consumer protection focus of the legislation, it would be necessary to provide for the removal of a manager and supervisor from the industry through disciplinary action in appropriate circumstances. It would also be necessary to make provision for the discipline of a dealer who employed or engaged a person to act as a manager and supervisor who did not satisfy the criteria.

However, the Review Panel has come to the conclusion that the costs imposed on the community as a whole by such a scheme would ultimately outweigh any benefits gained. As identified at Part 5 of this Final Report, negative licensing schemes impose a cost on Government, and therefore the community, which is not offset by any generated revenue. Further, it is difficult to see what essential difference there would be between the entry criteria for a negative licensing scheme and the current entry criteria for the positive licensing scheme. As matters stand, the entry criteria are not onerous, apart from the dishonesty offence provisions, and simply represent the minimum elements necessary to ensure consumer protection. Therefore, while a negative licensing scheme is an option, costs under such a scheme would rise whereas the level of benefit provided would remain static.

#### **6.4.7 Conclusion:- Management and supervision**

##### **CONCLUSION 13**

**The conclusion of the Review Panel is that the current scheme for management and supervision is appropriate in the current market and should be retained.**

#### **6.6 REGISTRATION OF PREMISES**

Before a licence can be obtained, the business premises must be registered. This means that the Commissioner for Consumer Affairs must be satisfied that the premises are suitable for carrying on the business of dealing in second-hand vehicles. Only then can they be registered with the application for a licence.<sup>57</sup>

A fee applies where the registration of the premises is separate to the licensing application or if another premise is being registered after the licensing application.<sup>58</sup>

A licensee is required to notify the Commissioner within fourteen days of ceasing to carry on business at registered premises. Failure to do so results in a maximum penalty of \$2,500 with an expiation fee of \$160.<sup>59</sup>

##### **6.6.1 Objectives of the restriction**

One aim of this provision is to prevent suspended or banned persons dealing from their premises with another acting as a “puppet” licensee.

The restriction also ensures that licenses are not granted to those who wish to use unsuitable premises to mislead the unsuspecting consumer. In particular, it seeks to restrict the practice of dealing from home which may lead consumers to believe that the sale is a private sale and they are therefore not entitled to any statutory warranty.

##### **6.6.2 Impact of the registration of premises restriction on competition**

The requirement that a licensed dealer register the premises from which they intend to carry on business has the potential to restrict competition as it erects a further barrier to entry into the market. Even if a licence is granted, a licensee must obtain the Commissioner for Consumer Affairs’ registration of the premises before they can commence business.

In determining whether registration will be granted, the Commissioner for Consumer Affairs must consider whether those premises are suitable for the purpose of carrying on business as a dealer. The Act and Regulations are silent on what constitutes suitability, however in practice the Office of Consumer and Business Affairs requires a letter of approval from the relevant local council. The rationale for this approach is that the council

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<sup>57</sup> Section 14 & Section 39- register must be kept.

<sup>58</sup> Part 2, Division 2, Section 14

<sup>59</sup> Regulation 8(1)

is better equipped to make a decision on suitability based on the Development Act and Regulations.

The notification requirements do not pose a barrier to entry as such, but the Review Panel notes that they correspond with the requirements imposed on certain businesses under section 11(3)(b) of the *Business Names Act 1996*. To this extent there may be some replication of effort involved if a dealer ceases to carry on business at certain premises.

The Review Panel has assessed this requirement as an **intermediate restriction on competition**.

### **6.6.3 Benefits of the restriction**

Submissions from the motor vehicle industry received in response to the Issues Paper supported the continuation of the registration of premises. Both the RAA and the MTA considered that there are benefits to consumers provided by the requirement insofar as it is less likely that consumer will be misled as to the legitimacy of the dealer.

The Review Panel considers that this identified benefit has further effect. Schedule 3 of the Act outlines a statutory scheme known as the second-hand vehicles compensation fund (the "Fund") which allows a consumer who suffers loss as a result of a transaction with a dealer to apply to the Magistrates Court for compensation.<sup>60</sup> However, there are certain criteria which a consumer must satisfy in order to successfully establish a claim. Of particular relevance in relation to the registration of premises is the requirement that if the dealer was not licensed at the time of the transaction, then the consumer must establish that they had reasonable grounds for believing the dealer to have been licensed at the time of the transaction.<sup>61</sup>

Since the Act requires the registration of premises as a precondition to carrying on business as a dealer, the existence of registered premises should provide indication to a consumer that the dealer is licensed. In this sense, the registration requirement can reduce the transaction costs incurred by a consumer by facilitating a claim against the Fund in the event that their valid loss is otherwise unable to be satisfied.

The requirement is also seen to provide benefit as it assists in reducing the numbers of unlicensed dealers operating in the State. The RAA submission considered the removal of this restriction could encourage "back-yarding" as an unlicensed dealer could set up operations in any premises.

The requirement for registered premises may assist consumers by providing a suitable place known to the consumer where any repair work that might arise under the dealer's warranty obligations can be performed. This is particularly so in light of the requirement under section 39 of the Act that the Commissioner for Consumer Affairs maintain a register of registered premises.

Finally, the requirement allows for the matters pertaining to second-hand vehicle dealing to be administered through one Act. Under this arrangement, benefits arise for second-hand

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<sup>60</sup> For more detailed discussion of the Second-hand Vehicles Compensation Fund see Part 6.7

<sup>61</sup> Schedule 3, cl. 2(2)(b)

vehicle dealers through managerial and administrative efficiencies as they are able to deal with one, rather than several, Government departments. With one Act and one department responsible for the administration of second-hand vehicle dealer licenses, consumers are also able to benefit from a similar 'one-stop shop'.

#### **6.6.4**      **Costs of restriction**

As discussed above, the current regulatory scheme requires that a licensed dealer who wishes to carry on business must undertake a two-stage approval process prior to commencement. Firstly, they must obtain council approval under the *Development Act 1993*, and once that is gained must obtain registration from the Commissioner for Consumer Affairs for those premises. This may be considered a hidden barrier to entry.

Several submissions to the Issues Paper addressed this issue. CASA submitted that:-

*"[r]egistration of premises appears to be an unnecessary restriction as it is regulated elsewhere."*

The RAA submission considered standards of suitability to be a barrier to entry and, if too onerous, to hinder the operation of competitive forces in the market with marginal benefit to the consumer.

There may also be up-front and on-going costs imposed on dealers in keeping premises to standards set by councils so that they can obtain council approval.

The Review Panel notes that no submissions directly addressed this issue in response to the Draft Report. However, the RAA did express agreement with the conclusions of that report.

#### **6.6.5**      **Assessing the Costs and Benefits**

While the Review Panel agrees that the use to which premises are put is a matter which is dealt with appropriately under the *Development Act 1993*, it notes that the *Second-hand Vehicle Dealers Act* is not concerned so much with the regulation of the usage of premises as with addressing information disparities between dealers and consumers and reducing transaction costs.

Therefore, the Review Panel considers that standards of suitability and costs associated with reaching and maintaining those standards are matters governed by local councils and not the Office of Consumer and Business Affairs. The Office of Consumer and Business Affairs does not impose its own standards but rather accepts local council approval in each case. Therefore neither the Act nor the Office of Consumer and Business Affairs imposes any additional restrictions over and above what the local councils require under the *Development Act*.

#### **6.6.6**      **Alternatives**

The only alternative is to repeal the section and rely on information gathered under the *Business Names Act 1996*.

Section 11(3)(b) of the *Business Names Act 1996* requires a business to provide particulars of the address for service of the proprietor and the address of each place at which a business is to be carried on. Section 12(1)(b) requires that in the event of a change in the particulars, notice must be given of the change within 28 days. These requirements are very close to the requirements under the Act.

There are two difficulties inherent with this proposal however. The first of these is of a fundamental nature, the second of a legal nature.

The fundamental difficulty with the proposal is that not all businesses are required to be registered under the *Business Names Act 1996*. Section 7 allows that if a person carries on business under their own name then they do not have to register that business name under the Act. It therefore follows that they will not have to provide the particulars to the Corporate Affairs Commission for recording on the register. The Review Panel is not in a position to assess the numbers of businesses which operate under this exception from registration, but it is sufficient to say that as there is no guaranteed coverage of businesses by the *Business Names Act 1996*, then reliance on that Act to provide information to consumers and the licensing authority is not feasible.

The legal difficulty inherent in this option is however that the *Business Names Act 1996* is not committed to the Minister for Consumer Affairs, and by extension the Office of Consumer and Business Affairs has no role to play in its administration. Rather, it is committed to the Attorney-General, with the Corporate Affairs Commission being the administering body.

Where information is given under compulsion, as is the case under section 13(b), the Corporate Affairs Commission can only use the information for the purpose for which it was given.<sup>62</sup> Arguably the purpose in this case is for recording on the public register. The scheme outlined in the Act does not provide that the information may be shared between Government agencies. The effect of this being that the Corporate Affairs Commission could not disclose the information to the Commissioner for Consumer Affairs under the Act.

For these reasons, the Review Panel considers that there are no viable alternatives to the present restriction.

#### 6.6.7 Conclusion:- Registration of premises

#### **CONCLUSION 14**

**The conclusion of the Review Panel is that the benefits of the current provisions for the registration of premises support their retention.**

#### **6.7 INSURANCE REQUIREMENTS AND THE COMPENSATION FUND**

As discussed at Part 6.6, schedule 3 of the Act contains a statutory insurance scheme known as the second-hand vehicles compensation fund.

<sup>62</sup> See *Castrol v EmTech* (1980) 33ALR 31

The schedule provides that the Magistrates Court may authorise payment out of the Fund to compensate a non-dealer purchaser of a second-hand vehicle in certain circumstances. The person must have purchased a second-hand vehicle from a dealer, sold a second-hand vehicle to a dealer or have left a second-hand vehicle with a dealer for sale by consignment. Further, the person must have a valid unsatisfied claim against the dealer arising from the transaction and have no reasonable prospect of recovering the amount of that claim from another source.

An important proviso on the ability of a person to claim against the fund is that the dealer must have been licensed at the time of the transaction. If they were not, then the person claiming must show that they reasonably believed the dealer to have been licensed at that time.

Sales effected by auction or negotiated immediately after an auction do not attract the protection of the Fund if the sale was after the commencement of the *Second-hand Vehicle Dealers (Compensation Fund) Amendment Act 1997* and the auctioneer effecting the sale was acting as an agent on behalf of a person who was not themselves a licensed dealer.

The scheme is funded by annual contributions from all licensed dealers. Schedule 5 of the regulations provides that the contribution relates to each registered premise at which a licensed dealer carries on business, rather than the dealer personally. The present level of contribution is \$100 for those who carry on business consisting solely of selling second-hand motorcycles and \$350 in any other case.

The Act also contains a requirement that a person must be insured in accordance with the regulations at all times when carrying on business as a dealer. It provides that a dealer's licence is automatically suspended for any period for which the dealer is not insured.<sup>63</sup> The regulations do not presently make any provision for insurance and therefore dealers are not required to hold insurance.

### 6.7.1 Objectives of the Requirements

Any licensing scheme has at its core the objective of ensuring that those who carry on an occupation do so in a manner that presents least possible risk to the public. Mechanisms such as entry criteria and restrictions on conduct, as discussed throughout this Final Report, are employed to achieve this outcome.

However, no matter how well thought out and directed a licensing system is, there will be situations where licensees fail to live up to the standards imposed. Further, a licensing system, such as the one in place under the Act, cannot prevent external matters from negatively influencing a business. It is not uncommon for second-hand vehicle dealers' businesses to encounter some form of external financial pressure, in certain cases leading to the financial collapse of that business.

In these cases, it is often consumers who carry the brunt of the financial burden. They may be left with unenforceable warranty claims following the bankruptcy or insolvency of the dealer. In several instances, dealers have become bankrupt or insolvent immediately following receipt from consumers of monies intended to be passed on to third parties, for

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<sup>63</sup> Section 12

example stamp duty, registration fees and money to be paid to a credit provider to pay out prior credit facilities. Due to the bankruptcy or insolvency, these monies have not been forwarded and consumers were faced with the reality of having to pay these items for a second time.

The existence of a scheme of compensation or insurance enables consumers to make good their losses and has the objective of protecting them from the results of provider failures.

### **6.7.2 Impact of the compensation fund and insurance on competition**

The requirement to contribute to the fund, or hold insurance, may present a barrier to entry. The contribution or premium may be a significant restriction for those newly entering the industry with possibly very little capital. Additionally, the requirement to remain a contributor to the fund or maintain insurance may increase the costs of business, which may also deter entry to the occupation.

The Review Panel has assessed these requirements as **intermediate restrictions on competition**.

### **6.7.3 Benefits of the compensation fund and insurance**

The nature of the statutory compensation fund means that costs are spread amongst the whole industry. This results in a relatively low contribution, or “premium”, which has to be paid annually by dealers. It also means that a substantial pool of money may be built up in a relatively short time to compensate consumers who suffer financial losses at the hands of licensed dealers.

The effect of the fund is that consumers who deal with licensed second-hand vehicle dealers should not suffer a direct financial loss as a result of failure by a dealer to comply with the Act or cause loss in some other way. Reimbursement is assured if a consumer’s claim satisfies the criteria set out in Schedule 3, payment is made within a relative short time frame and without protracted disputation between the dealer and the consumer.

The Review Panel notes that it is not merely individual consumers who benefit from these outcomes, but also the community as a whole. Activity in the market for second-hand vehicles is enhanced, as consumers feel more confident in making purchases. This confidence will have a flow on effect to other sectors of the market, for instance, aftermarket parts for vehicles.

The actual dollar benefits that consumers have received in recent times from the compensation fund are significant. The extent of payments made in recent times is shown in the following table:<sup>64</sup>

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<sup>64</sup> This table is also reproduced at Part 4.4

Year	Claims Paid (\$)
2000	56,000
1999	85,000
1998	538,000
1997	49,000
1996	20,000
1995	23,000

Source : Commissioner for Consumer Affairs Annual Reports<sup>65</sup>

The Review Panel is not in a position to assess the benefits of a private insurance scheme, as there is not a scheme in place.

#### **6.7.4 Costs of the compensation fund and insurance**

As set out in Part 6.7, the annual cost incurred by dealers through contributions to the fund is \$350 per registered premise.<sup>66</sup> The Annual Reports of the Commissioner for Consumer Affairs shows that in the financial year ending 30 June 1998, licensees contributed \$283,000 to the fund, with that figure rising to \$298,000 in the financial year ending 30 June 1999 and \$301,000 in the financial year ending 30 June 2000.

These costs, while being directly funded by licensed dealers, are ultimately passed on to the community through licensees' pricing structures. Therefore, the South Australian community bears annual costs of around \$300,000 as a result of the compensation fund.

As there is presently no insurance scheme outlined in the regulations, dealers are not required to hold insurance. There is therefore no actual cost currently associated with this requirement.

Other costs associated with the compensation fund and insurance requirements involve the potential for lessened competition which entails. As discussed above, there is a possibility that new entrants to the market will be discouraged and that incumbents will exit the market due to cost incurred. Either of these situations will reduce the numbers of competitors in the market, driving up prices and reducing choice.

It may also be possible to argue that the existence of a scheme of compensation could encourage reckless behaviour from both dealers and consumers. Both parties are comforted by the knowledge that a scheme is in place which will "pick up the pieces" in the event of a default. However, no evidence is available to the Review Panel suggesting that such behaviours are a reality in the present second-hand vehicles market.

#### **6.7.5 Assessing the costs and benefits**

As discussed at Part 4.8.1, one of the significant risks of provider failure in this market is the business risk faced by consumers. Briefly, this risk relates to the potential for loss arising

<sup>65</sup> Commissioner for Consumer Affairs Annual Reports: 1995-96,1997-98, 1998-99, 1999-2000

<sup>66</sup> \$100 for motorcycle dealers.



from the lack of financial stability of a dealer's business. With the identified high level of investment that the average consumer has in a second-hand vehicle, the issue of business risk becomes very significant.

Means of addressing business risk have been addressed elsewhere in this Final Report. However, there will always be cases where a licensee's behaviour does not meet the minimum required standards, notwithstanding the regulatory scheme. The existence of an insurance scheme may be considered an acknowledgement by the Government that this market poses so great a risk of provider failure that barriers to entry and conduct restrictions alone cannot provide adequate protection for consumers. Schemes of insurance or compensation are ultimately remedial mechanisms aimed at curing market failures that have occurred notwithstanding the best efforts of regulation.

The extent of decreased competition arising from the scheme will be entirely dependant upon the barriers to entry, or the ongoing imposts it contains. Currently there is a requirement that dealers make a financial contribution to the fund, which is both a barrier to entry and an ongoing cost. In overall terms the cost of the requirement is significant, around \$300,000 per annum. However, in terms of each dealer the cost will not be that great. Indeed, the Review Panel considers that the annual cost to each dealer is trivial in terms of the overall costs of a dealer's business. In light of this, there is a real doubt that contributions at the current level lead to any lessening of competition.

The Review Panel has considered the benefits accruing to the community from compensation payments in light of the costs to the community brought about through the lessening of competition that may result from the existence of the scheme. It is the conclusion of the Review Panel that such a netting exercise demonstrates that net benefits to the community outweigh any costs.

Analysis may also be made of the dollar benefits paid to the community, which fluctuates from year to year, in comparison with the yearly costs imposed. As discussed, these costs of around \$300,000 per annum are ultimately borne by the community as a whole. There is thus a tension between the significant community benefit provided by the existence of some form of insurance or compensation scheme, and the actual costs of that scheme.

The simple answer to this problem is to assert that the averaged dollar figures for each year demonstrate that the costs of the current system outweigh the benefits by a significant margin. However, such an answer fails to take into account the contingent nature of the fund's liability. For example, a comparison for the claims payment figures between the 1997 and 1998 years shows a difference of almost half a million dollars. It is simply not possible to predict in advance the potential liability of the fund from year to year.

The Review Panel considers that although contributions paid may potentially exceed the compensation paid in any given year, there is an equal likelihood in this market that the balance could swing the other way, as occurred in 1998. History has shown that it only takes the collapse of one large dealership to make a significant impact on the fund's liability. On this basis, it is not possible to conclude that the costs outweigh the benefits, as costs accruing in one year provide benefits that may accrue at a later date.

However, the Review Panel accepts that this issue requires some further investigation. Therefore, although the Review Panel has come to the conclusion that the benefits of the

scheme outweigh the costs, alternative means of achieving the desired outcomes will be considered below.

#### **6.7.6      Alternatives**

The obvious alternative is to open up the compensation fund to competition from the private insurance market. Such a move would ensure that consumers still have the ability to recover compensation, while at the same time allowing market forces to determine the levels of annual contribution required from dealers.

However, the Review Panel notes that a mechanism for a scheme of private insurance to be put into place is already provided for in section 12 of the Act. That section requires all dealers to carry insurance in accordance with the regulations. At present, this provision is of no effect, as no regulations are in place.

Nonetheless, it would merely require the details of the scheme to be put into the regulations to give it effect. Of course, it is not for the Review Panel to recommend that a particular private scheme of insurance should be implemented; it is for those who wish to utilise the scheme to raise the matter with the Commissioner for Consumer Affairs at the first instance. The Review Panel would simply reiterate that the possibility of an alternative scheme is already provided for in the Act.

Submissions received in response to the Issues Paper indicated a degree of acceptance for this proposal. CASA was supportive of an insurance scheme, but only to the extent that it would not impose greater costs on dealers and provided it gave expeditious recourse for the disappointed consumer. The MTA supported indemnity insurance as cheaper for consumers than the present system of application to the Magistrates Court.

The RAA however was more guarded and submitted that:-

*“Our concerns with the indemnity include potential significant delays through protracted disputation under an insurance arrangement and whether such an insurance policy with universal coverage would be commercially viable.”*

The RAA also highlighted these concerns in its response to the Draft Report. The Review Panel agrees that the concerns raised by the RAA are of significance and would emphasise that any insurance scheme would have to provide at least the same levels of protection as presently afforded by the compensation fund.

The Review Panel notes that one of the difficulties in private insurance relates to the problems in obtaining cover against fraud. While it is usual for professional indemnity insurance policies to cover fraud by a partner, employee or agent, such policies do not (and cannot) legally cover fraud by the insured in consequence of their own acts. The fund does however cover this liability.

In the Draft Report the Review Panel suggested that the Commissioner for Consumer Affairs would need to be satisfied that an insurance proposal would cover this particular consumer protection aspect of the fund. In its submission to the Draft Report, the RAA supported this suggestion.

The Review Panel also notes the potential for the funds to become an insurer of last resort under a competitive scheme, and the potential effects of such a situation. Therefore, the Review Panel considers that these potential costs should be given serious consideration in any proposal for private insurance.

**6.7.7 Conclusion:- Compensation Fund and Insurance**

**CONCLUSION 15**

**The conclusion of the Review Panel is that a scheme of compensation in some form is appropriate in the current market, and the benefits of having such a scheme outweigh the costs associated.**

**The Review Panel considers that the current scheme as established under Schedule 3 of the Act should be retained and in doing so notes the already existing potential for competition from the private insurance market provided under section 12 of the Act.**

## PART 7: CONDUCT RESTRICTIONS

### 7.1 NOTICES TO BE DISPLAYED

The Act requires that notices be displayed on second-hand vehicles if offered for sale by a dealer or an auctioneer.<sup>67</sup> The specific information required to be included in those notices is set out at Part 4.5.4 of this Final Report. In each case the notices are required to be attached to the vehicle offered for sale.

#### 7.1.1 Objectives of the requirement to display notices

The market for second-hand vehicles is one in which consumers are generally at a significant disadvantage in comparison with dealers in terms of the information they have available about both the product and service they require. The Review Panel considers that the requirement to display notices is aimed squarely at addressing information asymmetry problems present in the market.

#### 7.1.2 Impact on competition of the requirement to display notices

The implication of this requirement on competition relates solely to the cost of providing the information. If there were no requirement, money spent on gathering information and printing a notice could be spent in other areas of the dealer's business.

The Review Panel has assessed this restriction as a **trivial restriction on competition**.

#### 7.1.3 Costs of the requirement to display notices

The only cost that the Review Panel has identified in relation to this requirement is the cost of gathering and assembling information to be published in the notice. Dealers have to expend resources to comply with the requirement that could be used elsewhere in the dealer's business. The extent of expenditure is likely to be limited to the costs of purchasing paper and printing the notices, as well as the costs of labour in collating and recording the relevant information.

The Review Panel would therefore concur with the MTA's submission to the Issues Paper that:-

*"Cost would not be a significant factor in providing and displaying the required information..."*

#### 7.1.4 Benefits of the requirement to display notices

In response to the Issues Paper, the RAA submitted that:-

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<sup>67</sup> See sections 16 and 20 respectively.

*“Asymmetric information represents a significant consumer concern and hence it is considered that the costs of displaying information to the dealer is far outweighed by the consumer benefit.”*

While CASA submitted that:-

*“The key issue being addressed by notices for display is to ensure, or at least to reduce, the potential for market failure through asymmetric information. The key objective is to ensure that the appropriate information is made available to the consumer at the appropriate time.”*

As has been stressed many times throughout this Final Report, consumers suffer an information disadvantage in this market, which makes them more susceptible to loss. The information provided to consumers through the compulsory notice scheme is essential information about the vehicle that assists in a determination of whether the vehicle is appropriate or suitable for the individual consumer. Reducing levels of information asymmetry reduces the risk of the market failing, thereby enhancing efficiency within the market. Enhanced market efficiency provides benefits that travel beyond the immediate consumer to the community as a whole.

#### 7.1.5 Assessing the costs and benefits

The Review Panel considers that the benefits arising from the restriction outweigh the minimal costs associated. Only if the information displayed was excessive or unwarranted, or a large element of the community did not require such information, would the Review Panel be inclined to give more weight to the costs incurred by dealers in collating and disseminating information.

#### 7.1.6 Alternatives

In response to the Issues paper, CASA submitted that:-

*“A secondary issue is the form of means of communication of that information. Should there be a more beneficial or cost effective manner in conveying the appropriate information, then the legislation should not prohibit its use. That is, the legislation should be technologically neutral.”*

The Review Panel would concur with this submission to the extent that a more cost effective means of displaying the required information should be used if there are such means available. To date, no information has been provided to the Review Panel as to what sort of mechanisms might be cheaper than the current paper notice format.

The Review Panel notes that the legislation merely provides that at least the required information must be set out in a notice attached to the vehicle. This requirement does not stop dealers from displaying the more, the same, or less information about a second-hand vehicle by whatever secondary alternative means they desire, so long as they also comply with the primary requirements of the Act.

### 7.1.7 Conclusion:- requirement to display notices

#### CONCLUSION 16

The conclusion of the Review Panel is that there are significant benefits arising from the requirement that notices be displayed that exceed the costs incurred by dealers as a result of the requirement, and the restriction should be retained.

## 7.2 FORM OF CONTRACT

The Act requires that a contract for the sale of a second-hand vehicle by a dealer must possess certain characteristics. These characteristics have been set out in full at Part 4.5.5 of this Final Report.

### 7.2.1 Objectives of the requirement to include certain information in contracts

The objectives of the requirement that the contract for sale of a second-hand vehicle by a dealer possess certain characteristics are to ensure that sales are executed by a contract in writing, and that contracts contain all relevant information that consumers should be expected to possess.

### 7.2.2 Impact on competition of the requirement to include certain information

Prescribing a standard form of contract for use in sales of second-hand vehicles by dealers has two potential impacts on competition; it may prevent transactions from occurring in the most economically efficient manner possible, and it may also cause slightly higher prices for consumers than would otherwise be the case.

The Review Panel has assessed this requirement as a **trivial restriction on competition**.

### 7.2.3 Benefits of the requirement to include certain information in contracts

In its response to the Issues Paper, the MTA submitted that:-

*"A prescribed form of contract is of unquestionable benefit to both parties involved... The industry accepts the current level of information on a Contract as being a reasonable requirement."*

The Review Panel notes that the Act does not prescribe a standard form of contract, but rather governs the information that must be contained within a contract. This is a crucial difference in competition terms. If the Act were to provide that contracts must be in a certain form in entirety then the freedom of parties to contract as they wish would be seriously impaired. However, the Act merely provides that contracts must contain at least certain information and statements, which must be in specified form. Provided that any other details that the parties wish to include are not inconsistent with those requirements, they are free to incorporate any other details they believe necessary in the contract.

The information and statement required to be incorporated into the contract are, on analysis, aimed squarely at reducing transaction costs and information asymmetry for consumers. The requirements of sections 17(1)(a), (b) and (c) ensure that a consumer is given certainty with respect to the contract they have entered; it is available to them in a written and signed single document. If consumers need to enforce their rights under the contract then those rights are readily identifiable to them, and, if appropriate, a Court. The requirements under section 17(d) provide the meat on the bones of this scheme, insofar as the information that outlines these rights to consumers is identified.

It is not only consumers who benefit from the requirement though; dealers are also afforded certainty in their contractual relations. As the basic information pertaining to the second-hand vehicle is set out, there is less chance of time consuming on-going disagreement with consumers as to the precise terms of their contract.

#### 7.2.4 Costs of the requirement to include certain information in contracts

There are costs associated with the requirement that dealers use a contract compliant with the Act. To satisfy this requirement, a dealer will have to expend time and labour in collating and setting out the information in the necessary format. Without the requirement, these costs would not be incurred and the dealer would be free to use those resources elsewhere.

It also inhibits the freedom of a dealer to contract in whatever form they wish. It may be the case that it would be cheaper for dealers not to have any form of written contract at all and simply carry on business using verbal contracts with consumers.

#### 7.2.5 Assessing the costs and benefits

The Review Panel considers that the restriction to conduct in conforming to a standard type of contract is balanced by the advantages of the clear statement it provides as to the rights and duties of all parties. The chance of future litigation resulting from misrepresentations or an incomplete transaction is reduced and consumers are fully aware of relevant details prior to actually entering into the contract.

The Review Panel notes that dealers are still free to determine their own form of contract provided that the fundamental requirements are observed.

#### 7.2.6 Conclusion:- Contract requirements

##### CONCLUSION 17

**The conclusion of the Review Panel is that the requirement to use a standard form of contract is justified as the benefits to the community as a whole outweigh the costs.**

### **7.3 WARRANTY OF REPAIR**

Part 4 of the Act is a self-contained scheme that in certain circumstances implies a statutory warranty into contracts between dealers and consumers for the sale of a second-hand vehicle. Generally speaking, this involves a duty to repair any defect present in the vehicle at the time of sale, or which appears in the vehicle after the sale.<sup>68</sup>

However, as is often the case with statutory warranties, it is not imposed in all situations. There are three broad categories which fall outside the warranty:-

- certain types of transaction;<sup>69</sup>
- defects appear after certain events have occurred;<sup>70</sup>
- certain kinds of defects.<sup>71</sup>

These will be discussed in greater detail below.

The Review Panel notes at the outset that while the Act refers to a duty to repair, the provisions impose a statutory warranty into contracts for sales of second-hand vehicles.

#### **7.3.1 Objectives of the warranty provisions**

As identified in the Issues Paper, the Review Panel considers that the provisions assist in addressing information asymmetry between consumer and dealers. Consumers can have confidence that hidden problems which did not appear prior to sale will be repaired without additional cost. As a corollary, their transaction costs will be reduced.

#### **7.3.2 Impact of the warranty on competition**

The imposition of a warranty of repair affects the manner in which a dealer carries on their business. There is also the potential for the warranty to represent a barrier to entry as it may discourage potential dealers from becoming licensed due to the burden and cost of fulfilling warranty obligations, the extent of which may be unknown.

The Review Panel has assessed the warranty as an **intermediate restriction on competition**.

#### **7.3.3 Costs of the warranty**

The immediate costs of the warranty were not identified by any submission to the Issues Paper or Draft Report. The Review Panel does however suspect that there is a component of the purchase price of every second-hand vehicle sold by a dealer that represents the costs of bringing that vehicle "up to standard" as well as a provisioning for any warranty work that

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<sup>68</sup> Section 23(1)

<sup>69</sup> Section 23(3)

<sup>70</sup> Section 23(4)

<sup>71</sup> Section 23(6)



may be required within the warranty period. These costs will be borne ultimately by the consumers purchasing vehicles.

In the absence of any data however, the Review Panel is unable to make any determinative finding on this issue. In the Draft Report, the Review Panel specifically sought submissions on the matter. However, it should be noted that none of the submissions received addressed the costs of the warranty provisions of the Act.

The imposition of the warranty might also have implications for the inter-State competitiveness of South Australian dealers. If other States have lesser or no warranty requirements then dealers from those jurisdictions will be able to offer vehicles at lower price than South Australian dealers. This will only have some effect however if there is some significant inter-State trade in second-hand vehicles. Again, the Review Panel has been presented with no evidence to suggest that such a situation exists.

There is also a possibility that the imposition of the warranty could act as a barrier to entry to the market for potential suppliers. Given that the extent of cost involved with warranty repairs is unknown prior to the commencement of a business, it may be that some who might otherwise seek to become licensed as a dealer would be discouraged from so doing.

#### 7.3.4 Benefits of the warranty

In their submissions to the Issues Paper, both the RAA and the MTA agreed that the imposition of the warranty provides benefit to consumers. The Review Panel concurs with this position and notes that benefits are also provided to the wider community.

The immediate consumer who purchases a vehicle obtains a reduction in transaction costs, as any defects appearing within a short time of the date of sale will be repaired without further expenditure on their behalf. Whilst it is acknowledged that dealers will make provision for warranty repairs in their pricing structures, those provisions are likely to be based on the repair costs in terms of their overall business, rather than for individual vehicles. If this is the case, then the provisioning component for each vehicle sold will be considerably less than the actual costs to consumers of repairing that vehicle if the warranty is called on. In effect, the cost burden of the statutory warranty is spread across all consumers of second-hand vehicles, who subsidise one another.

This situation may be contrasted with a system whereby individual consumers would have to effectively purchase a warranty from the dealer on a case-by-case basis. Economies of scale would not necessarily be available to dealers and the overall cost of second-hand vehicles would be predicted to rise.

The duty to repair may also be considered as part of a codification of rights and obligations in relation to the second-hand vehicles market. Both the *Trade Practices Act 1974* and the *Consumer Transactions Act 1972* provide that statutory warranties that goods will be fit for the purpose for which they are sold are incorporated into contract. In this instance, the legislation is simply stating that second-hand vehicles must be fit for purpose. It also provides a remedy within the codification by providing that if the vehicle is not fit for the purpose for which it was sold, that is to say, it develops faults as set out in section 23(10),

then the dealer must repair that fault without the consumer incurring further expense.<sup>72</sup> While this is of itself clearly beneficial, the reduction in information asymmetry provided through relevant rights and obligations being clearly spelled out in the one Act must also be taken into consideration.

The Review Panel also noted that dealers obtain a benefit under the scheme for statutory warranties, as the liability for repair work is limited to the life of the warranty. This provides more business certainty for dealers.

### 7.3.5 Assessing the costs and benefits of the duty to repair

While the Review Panel has identified a number of costs associated with the imposition of the statutory warranty in certain instances, it notes that the levels involved are not significant. While it has been considered possible that the warranty could present a barrier to entry, it is nonetheless unlikely that this would have significant practical effect in the market. If a person wishes to become a dealer, warranty provisions are unlikely to be a dissuading factor.

The Review Panel would also query the extent of inter-State trade in second-hand vehicles in terms of the South Australian market. No evidence has been presented to the Review Panel to suggest that the levels of inter-State trade are significant enough to put South Australian dealers at a disadvantage in terms of their primary market.

On the other hand, the Review Panel does consider that the benefits outlined above are of significance. As stressed earlier in this Final Report, one of the underlying justifications for Government intervention in a market is market failure. One of the common causes of markets failing is the existence of high transaction costs. Imposing the warranty is considered to ultimately reduce the transaction costs associated with the purchase of a second-hand vehicle, and therefore the risk of market failure is reduced.

Similarly, the reduction in information asymmetry effected by the warranty provisions further minimises the risk of market failure.

The Review Panel has therefore come to the conclusion that the benefits of the repair warranty outweigh the associated costs.

### 7.3.6 Conclusion - Statutory Warranty

#### CONCLUSION 18

**The conclusion of the Review Panel is that the retention of the scheme of statutory warranties for the repair of defects is a justified restriction on competition.**

<sup>72</sup> Section 23 (10) provides that a defect in relation to a second-hand vehicle means a defect in the vehicle because of which the vehicle does not comply with the *Road Traffic Act 1961*, or cannot be driven safely or at all, or because of which the part of the vehicle affected is not in proper working condition, or which would not reasonably be expected to be present in the vehicle given the apparent condition of the vehicle at the time of sale and representations by the dealer prior to sale as to the vehicles condition.

### **7.3.7      *Scope of the warranty***

While the Review Panel is of the conclusion that the statutory warranty provisions ought to remain, their scope needs to be examined.

#### **7.3.7.1      *Vehicles sold between \$3,001 and \$6,000***

Sections 23(4)(a)(i) and (ii) provide that in the case of a vehicle which has been sold in this price range the duty to repair does not apply if the vehicle has been driven 3,000 kilometres or more after the sale or if two months have elapsed since the date of the sale. To put this into the positive, there is a duty to repair second-hand vehicles sold for between \$3,001 and \$6,000 if the vehicle has not been driven 3,000 kilometres or two months have not elapsed since the date of sale. It is noted that once either of these criteria are satisfied then the duty to repair ceases. In other words, the statutory warranty expires.

##### **7.3.7.1.1      *Costs relating to vehicles sold between \$3,001 and \$6,000***

The MTA submitted in response to the Issues Paper that the imposition of a duty to repair in this class of vehicle was not appropriate:-

*“The \$3,001 minimum equates to less than 1/10th of the new purchase price of the current popular range of Australian manufactured vehicles. The expectation that any defect that appears in a vehicle (in this price range) after the sale must be repaired under the Duty to Repair is clearly unjust.”*

However, the MTA did not make any response to the Draft Report.

In line with the general comments above, the Review Panel is unable to identify the quantum of actual costs imposed by the statutory warranty provisions in relation to this class of vehicles. Clearly, if the Review Panel is correct in the assumption that dealers build in provisioning for warranty liability to the price of a vehicle, then prices for vehicles within this range will be greater than would otherwise be the case. However it is noted that it is consumers who will bear the costs of the imposition of the warranty in this range and not dealers.

##### **7.3.7.1.2      *Benefits relating to vehicles sold between \$3,001 and \$6,000***

The particular benefit provided in relation to this range of vehicle is that those consumers who through economic necessity are only able to make purchases within this range are protected from continuing costs in relation to their purchase. While the MTA has noted that the purchase price in this range is less than one tenth of certain new vehicles, this fails to appreciate that for many consumers a good purchased in the \$3,000 to \$6,000 price range represents a significant portion of annual income.

The Review Panel does not consider that consumers who purchase within this price range are any less deserving of a reduction in transaction cost than other segments of the community.

The Review Panel notes that the provisions governing the extent of the warranty within the price range do take into consideration the likely “older” condition of these vehicles by providing reduced time and distance criteria.

#### **7.3.7.1.3 Assessing the costs and benefits for vehicles sold between \$3,001 and \$6,000**

As noted by the MTA, vehicles sold within this range are at the lower end of the pricing scale. Nonetheless, when considered in relation to other purchases that consumers may make, the financial involvement is quite significant. It must also be remembered that a vehicle is in many senses a “necessity” for many people.

Therefore, although vehicles within this range are not expected to be of the same quality as more expensive vehicles, it is expected that they will be fit for the purpose for which they were sold for a reasonable time following the sale. Having regard to the criteria delimiting the statutory warranty, namely the 3,000 kilometres or two-month provisions, the Review Panel considers that the benefits to the community as a whole outweigh the costs of the requirement.

#### **CONCLUSION 19**

**The conclusion of the Review Panel is that the statutory warranty in relation to vehicles within the \$3,001 to \$6,000 price range is a justified restriction on competition.**

#### **7.3.7.2 15 years or 200,000 kilometre restriction**

Section 23(7)(ab) provides that the statutory warranty does not apply when the vehicle sold was either first registered more than fifteen years before the sale, or has been driven more than 200,000 kilometres prior to the sale. Satisfaction of either of these two criteria will therefore exclude the statutory warranty.

##### **7.3.7.2.1 Costs of the 15 years or 200,000 kilometre restriction**

The converse of this limitation provision is that sales of vehicle where the vehicle was first registered within fifteen years of the sale, or has been driven less than 200,000 kilometres prior to the sale, prima facie attract the statutory warranty.<sup>73</sup>

The MTA stressed in its submission to the Issues Paper that the restriction levels were too great, and should be reduced to 10 years and 160,000 kilometres. The basis for this submission being that in certain other States these were the relevant limits and therefore South Australian dealers are at a competitive disadvantage when competing with these dealers.

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<sup>73</sup> Subject of course to other qualifications contained within section 23.

In its submission, CASA also identified that comparable provisions in other States refer to 10 years and 160,000 kilometres respectively.

Both of these submissions highlighted the costs borne by consumers when purchasing a vehicle under conditions attracting the statutory warranty. As dealers make provision for warranty costs in their pricing structures, consumers ultimately have to pay higher price than would otherwise be the case.<sup>74</sup>

#### **7.3.7.2.2 Benefits of the 15 years or 200,000 kilometre restriction**

When responding to the Issues Paper, the RAA did not consider that the current criteria were unduly restrictive given “recent increases in vehicle durability, build standards and corrosion protection”. It noted that in its experience “it is common for properly maintained vehicles to have engine/transmission life of 200,000 kilometres or more”.

When considering the benefits of this aspect of the restriction, the Review Panel would reiterate the benefits afforded by the statutory warranty scheme, as outlined at part 7.3.5. It also notes the complexion of the South Australian market as set out at Part 2.1.

It must be remembered that South Australia has the equal highest median age of passenger vehicles in Australia, at 11.9 years. A significant volume of sales of vehicles aged more than ten years will therefore occur each year in this market. The position in this State must be contrasted with other Australian States where the median age of vehicles is much lower.<sup>75</sup> Having a limitation period of fifteen years allows that these sales will receive the identified benefits of the statutory warranty.

#### **7.3.7.2.3 Assessing the costs and benefits**

Given the earlier conclusion of the Review Panel that significant benefits arise under the scheme, combined with the available data on the average age of passenger vehicles in South Australia, the Review Panel is driven to the conclusion that the current criteria are appropriate and should be retained.

In reaching this position, the Review Panel has given serious consideration to the position put by the MTA in relation to the inter-State competitiveness of South Australian dealers. However, in the absence of any meaningful data on the extent of commerce in this context, the Review Panel is unable to take this matter further.

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<sup>74</sup> See discussion at Parts 7.3.3 and 7.3.4

<sup>75</sup> For example, 9.4 years in New South Wales and 10.3 years in Victoria. Source ABS Motor Vehicle Census, 31 October 1998, 9309.0.

7.3.7.2.4 *Conclusion: 15 year or 200,000 kilometre restriction*

**CONCLUSION 20**

**The conclusion of the Review Panel is that the 15-year or 200,000-kilometre restriction is a justified restriction on competition.**

**7.4 INTERFERENCE WITH ODOMETERS PROHIBITED**

Section 34 of the Act provides that a person shall not interfere with the odometer on a second-hand vehicle. It must be noted that the prohibition does not apply only to dealers, but rather to every member of the community.

Interference with an odometer is defined to mean:-

- altering the reading on an odometer; or
- removing or replacing an odometer; or
- rendering the odometer inoperative or inaccurate.

As is the case with most prohibitions, there is an exception to the rule. Pursuant to section 34(3) a person may alter the reading on an odometer or replace an odometer under the terms of a written approval from the Commissioner for Consumer Affairs.

If the reading of the odometer decreases between the time the person gained possession of the vehicle and the time they disposed of it, then a presumption arises that the person tampered with it.<sup>76</sup>

If a Court finds a charge of interference proven it may impose a maximum penalty of \$5,000.<sup>77</sup> If a person charged with interference can show that the action was not taken with the intent of enhancing the apparent value of the vehicle or for any other fraudulent purpose, then they are entitled to rely on those facts as a statutory defence.<sup>78</sup>

If a person is found guilty on an interference charge then on application of the purchaser, the Court may order that the dealer compensate the purchaser for any disadvantage suffered as a result of the purchase of the vehicle.<sup>79</sup>

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<sup>76</sup> Section 34(4)

<sup>77</sup> Section 34(1)

<sup>78</sup> Section 34(5)

<sup>79</sup> Section 34(6)

#### **7.4.1 Objectives of the restriction**

As discussed earlier, one of the characteristics of the product sold in this market is the difficulty consumers face when attempting to determine the history of a vehicle. Determination of history is important, as it can serve to provide a consumer with an indication of the fair value of the vehicle. Interference with the odometer of a vehicle simply serves to compound any difficulties already faced by a consumer.

The Review Panel considers that the objective of this restriction is set out in the statutory defence provisions of section 34(5). That is to say, the restriction aims to prevent people from enhancing the apparent value of the vehicle or in some other way perpetrating a fraud on an unsuspecting third party in relation to the age or history of that vehicle.

In this sense the restriction is considered to be addressing both market failure and provider failure issues.

#### **7.4.2 Impact of the restriction on interference with odometers on competition**

It is true to say that many consumers faced with the problem of identifying a vehicle's history rely on an odometer reading to assess its condition. It has previously been commented that this strategy is one perhaps too heavily relied upon. However, the Review Panel accepts that it is one of the few ways in which consumers are able to assess the history of these technologically complex products.

The reliance placed on odometer readings is also seemingly acknowledged by the industry itself. This is demonstrated by the use of statements such as "low kilometres" in advertisements, which are designed to entice consumers.

Considered in competition terms, the true restriction is not that odometers must not be interfered with but rather that those dealers who do so, and are convicted, are liable to disciplinary action and therefore removal from the industry.

The Review Panel has come to this conclusion on the following basis. The restriction does not apply only to dealers, rather, it applies to all members of the community. Therefore, it makes no difference whether a person is a licensed dealer or not, the conduct is prohibited in any event.

The potential difference in the case of dealers is that under section 27(1)(c) of the Act, there is proper cause for disciplinary action if the dealer has acted in a manner contrary to the Act. In the case that a dealer is convicted of interference with an odometer, then they would be immediately liable to have disciplinary proceedings commenced against them. If the Court hearing the matter were then to determine that there was proper cause for disciplinary action, then it would subsequently be open to that Court to make an order suspending or disqualifying that dealer from carrying on business as a dealer.<sup>80</sup>

The Review Panel's conclusion is that this is a **trivial restriction on competition**.

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<sup>80</sup> See section 31 generally for the types of penalty which may be imposed by a Court if a finding that proper cause for disciplinary action is made.

### 7.4.3 Assessing the costs and benefits

The Review Panel can see no costs associated with this restriction apart from the situation outlined above. In that case there is arguably a cost to the community, as the removal of dealers from the market will reduce the numbers of suppliers. Economic theory would predict that with static levels of demand, a reduction in supply will result in higher prices to consumers. The Review Panel would however question the extent of a price rise resulting from the exclusion of a few dealers in a market comprising 1,400 licensed second-hand vehicle dealers.<sup>81</sup>

In its submission to the Draft Report, the Passenger Transport Board ("PTB") noted that the prohibition on interference with odometers without written approval by the Commissioner for Consumer Affairs provides a significant support base for the requirements of the *Passenger Transport (General) Regulations 1994*.

Those regulations refer to odometer readings as the means of governing the maximum distance that vehicles of various categories are permitted to travel. The PBT provided the example of a vehicle in the Small Passenger Vehicle Traditional category. According to the PBT, such vehicles have a maximum operation life of 320,000 kilometres. Another example provided is that of other categories, such as Small Passenger Vehicle Traditional and Special Purpose, under which the vehicles must not travel more than 40,000 kilometres per year without the approval of the Passenger Vehicle Review Committee.

In this context, the Review Panel agrees that accurate odometer readings clearly enhance an important regulatory scheme which has significant public health and safety impact.

Therefore, whilst acknowledging that there is the potential for upwards price pressures, the Review Panel notes that this sort of conduct is prohibited for a number of reasons. These include the provision of accurate information about vehicles to consumers as well as allowing prices to more accurately represent value in the marketplace. In light of this it may be appreciated that those who attempt to distort the market, thereby producing inefficiencies, are best removed from the market. Therefore, an overall community benefit may be seen to exist which outweighs the rather minimal costs associated with the removal of dealers from the industry.

All submissions received by the Review Panel considered that the benefits of the restriction outweighed any costs.

#### **CONCLUSION 21**

**The conclusion of the Review Panel is that the restriction on interference with odometers is a trivial restriction on competition and should be retained as the benefits to the community as a whole outweigh the costs.**

<sup>81</sup> Commissioner for Consumer Affairs' Annual Report 1998/99 p22



## 7.5 DISCIPLINARY ACTION

The Act prescribes certain situations in which disciplinary action can be taken. The objective of these provisions is to provide remedies over and above those existing under other Acts and at common law. They provide a way of excluding persons from the industry who have demonstrated that they pose a risk to consumers.

Disciplinary action may be taken against a contractor where the licence of the dealer was improperly obtained, where:-

- the dealer has acted contrary to an assurance accepted by the Commissioner under the *Fair Trading Act 1987*;
- the dealer or another person has acted contrary to the Act, or has acted unlawfully, improperly or negligently in the course of conducting, or being employed or otherwise engaged in the business of the dealer;
- in the case of a dealer who has been employed or engage to manage and supervise an incorporated dealer's business, the dealer or another person has acted unlawfully, improperly or negligently in the course of managing or supervising, or being employed or otherwise engaged in that business;
- the dealer has failed to attend a conference with a consumer convened pursuant to the requirements of the statutory warranty provisions of the Act, or has not conducted themselves reasonably at that conference, or has failed to carry out obligations under an agreement reached at such a conference;
- the dealer has failed to comply with an order of the Magistrates Court made under Part 4 of the Act;
- the registered premises of the dealer have become unsuitable for the purpose of carrying on business as a dealer; or
- events have occurred such that the dealer would not be entitle to be licensed as a dealer if they were to apply.<sup>82</sup>

Action may be taken against each director of a body corporate where there is proper cause for disciplinary action against the body corporate. This includes a shadow director. This prevents people hiding behind the corporate veil in an attempt to evade the provisions of the Act.<sup>83</sup>

There are a number of penalties available which range from a reprimand or a fine to suspension or expulsion from the industry.<sup>84</sup> The grounds for disciplinary action are quite extensive, as are the types of disciplinary action which may be taken. This allows flexibility in the treatment of dealers, and enables proportionality in the action taken against them, while concurrently ensuring that consumers are properly protected.

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<sup>82</sup> Section 27

<sup>83</sup> Section 27(2)

<sup>84</sup> Section 25(1)

### 7.5.1 Impact of the provisions on competition

The disciplinary provisions may be seen as placing some restrictions on market conduct. However, the market conduct restricted by these provisions is conduct which is wholly undesirable - negligence or deliberate wrongdoing. Restricting such conduct cannot be seen as truly restricting competition. Additionally, such conduct is penalised under the common law.

The MTA submitted in response to the Issues Paper that:-

*"The disciplinary penalties are not generally viewed by the industry as being too onerous."*

The RAA made a similar submission.

The Review Panel considers that the disciplinary provisions are necessary for the protection of consumers and are a **trivial restriction on competition**.

#### CONCLUSION 22

**The conclusion of the Review Panel is that the disciplinary provisions are a trivial restriction on competition and should be retained as their benefits outweigh the associated costs.**

## **PART 8 : EXEMPTIONS FROM LICENSING**

The Act exempts certain classes of person or entity from the requirement to be licensed. Any exemption from this requirement may be considered to represent a *prima facie* distortion on competition within the market, as it removes costs from some suppliers at the expense of others.

The Review Panel will consider below the various exemptions contained in the Act.

### **8.1 CREDIT PROVIDERS**

Section 7(2)(a) of the Act exempts people (natural or bodies corporate) who lawfully carry on the business of a credit provider within the meaning of the *Consumer Credit Act 1972* from the requirement to be licensed under the Act.<sup>85</sup> However, the exemption only applies if the “dealing” comprises an incidental part of their overall business as a credit provider. Further, allowance is made for the governance under the regulations of that “dealing” component of a credit provider’s business.<sup>86</sup>

#### **8.1.1 Objectives of the credit provider exemption**

The clear objective of the exemption is to remove the need for credit providers to obtain a second-hand vehicle dealers licence where they would otherwise be required to be licensed.

It should be noted that the exemption is not from the Act as a whole, but only from the need for credit providers to obtain a second-hand vehicle dealer’s licence under section 7. As a corollary, the exemption extends to those provisions of the Act which relate to “licensed dealers”, but does not provide an exemption from the requirements imposed on those who simply fall within the definition of “dealer” set out in section 3.

#### **8.1.2 Impact of the credit provider exemption on competition**

The exemption from the requirement to be licensed represents a potential distortion on competition within the market. A credit provider selling second-hand vehicles will not incur the costs associated with obtaining a licence, nor will they incur the costs involved in complying with the requirements imposed on licensed dealers, such as maintaining suitable premises and the management and supervision provisions. They will therefore be able to either offer vehicles for a lower price than licensed dealers, or will take a larger profit margin.

However, given the requirement of the Act that any “dealing” must form only an incidental part of the credit providers business, it is likely that the extent of market distortion will be limited.<sup>87</sup>

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<sup>85</sup> The Review Panel notes at the outset that the reference in section 7(2)(a) to the *Consumer Credit Act 1972* may be read as a reference to the *Consumer Credit (South Australia) Act 1995* by virtue of the operation of section 14B(3)(b)(i) of the *Acts Interpretation Act 1915*.

<sup>86</sup> The Review Panel notes that there are not presently any regulations in place in relation to this issue.

<sup>87</sup> By “dealing”, the Review Panel means any transactions that would otherwise result in the credit provider having to be licensed under the Act.

The Review Panel has therefore assessed this exemption as a **trivial restriction on competition**.

### 8.1.3 Costs of the credit provider exemption

The MTA in its submission to the Issues Paper highlighted the distortion created in the market by the exemption as being to the “*detriment of licensed vehicle dealers*”. Presumably this is on the basis that credit providers will not incur the same costs as licensed dealers in carrying on business.

Following this argument through, it could arguably be the case that consumers would have less demand for the services of licensed dealers, and would instead seek cheaper purchases of second-hand vehicles from credit providers. If this trend were to become significant enough, a point would be reached where the numbers of licensed vehicle dealers would shrink, as the market could not sustain the level of incumbents. Under these conditions there would also be less incentive for new entrants to come into the market to supply their services.

Economic theory would predict that a decrease in supply, combined with fewer new entrants, will result in lessened competition within the market. A decrease in supply exceeding the decrease in demand will result in higher prices for consumers, whilst a decrease in the level of contestability in the market could give rise to a situation whereby incumbents have lesser incentive to offer lower prices or improved service delivery. In each case, it is the wider community which will bear significant costs.

The MTA also raised the issue of the lack of statutory warranties in the case of sales by credit providers. The benefits of the statutory warranty provisions were outlined at Part 7.3 above, and were found by the Review Panel to be significant. Lack of warranty in the case of sales by credit providers deprives the community of those benefits and exposes it to costs that would otherwise not be incurred. These costs include the cost of having vehicles repaired, costs associated with having to ascertain the roadworthiness or otherwise of vehicles and the costs associated with establishing a warranty at common law in any legal proceedings against a dealer. In the latter case, it is not only those costs, but also the costs of dealer in defending such actions, and the general cost to the community of legal action, which must also be considered.

The RAA also noted the potential costs to consumers through the purchase of a vehicle without a warranty.

However, the Review Panel would point out that the warranty provisions relate to “dealers”, and not merely “licensed dealers”. Therefore, if in any given situation the credit provider deals in second-hand vehicles in such a way as to constitute “carrying on business” as a dealer for the purposes of the Act, then all provisions which are referable to dealers, including the warranty provisions, will apply.

#### **8.1.4 Benefits of the credit provider exemption**

If the exemption were not in place, credit providers selling cars on a regular basis would be required to obtain a second-hand vehicle dealer's licence and comply with the accompanying provisions of the Act. This would create an added burden on those who carry on business as credit providers. If these cost levels were significant enough, this could act to force exit of suppliers from the credit provision market as well as discouraging new entrants to that market. In this way, regulation of one market would have a deleterious effect on a secondary market, and impose costs on the wider community.

Therefore, a major benefit derived from the exemption is the avoidance of cost in another sector of the wider market.

#### **8.1.5 Assessing the costs and benefits of the credit provider exemption**

In discussing this issue, the Review Panel considers it important to bear in mind that the exemption is not a total exemption; rather, it is an exemption from the requirement to obtain a licence in the event that any dealing in second-hand vehicles by a credit provider comprises only an incidental part of their business as a credit provider. Therefore, any dealing must be in connection with the core business of the credit provider and, moreover, must not form a substantial part of a credit provider's business. Implicit in this is a recognition that a credit provider's business is credit provision, not dealing in second-hand vehicles.

It must also be remembered that the exemption only applies to the requirement to hold a licence under the Act, and by logical extension, to those provisions of the legislation that impose certain duties on licensed dealers.<sup>88</sup>

Other provisions of the legislation, in particular Part 3 and 4, apply to "a dealer", whether licensed or not. Credit providers must still comply with the other requirements of the Act when they carry on business within the Act's definition of a dealer. However, it is in any event unlikely that credit providers would fall within that definition, as they generally display none of the characteristics which Courts have nominated as indicia of "carrying on business" when disposing of second-hand vehicles.<sup>89</sup>

Taking these elements into consideration, it becomes clear that the costs outlined above are not going to be significant in this market. While theoretically there may be a diminution in competition, the practical result is likely to be otherwise.

Therefore, in light of the benefits arising from this exemption, the Review Panel has come to the conclusion that it ought to be retained.

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<sup>88</sup> For example, the requirement that a licensed dealer must not carry on business as a dealer except at registered premises (section 13) - see discussion at Part 6.6 generally.

<sup>89</sup> See the discussion of the indicia of "carrying on business" at Part 6.2.

### 8.1.6 Conclusion:- Credit provider exemption

#### CONCLUSION 23

**The conclusion of the Review Panel is that the credit provider exemption represents a trivial restriction on competition and should be retained.**

## 8.2 AUCTIONEERS

Section 7(2)(b) exempts from the requirement to be licensed auctioneers who sell second-hand vehicles on behalf of others by auction, or by sale negotiated immediately after the conduct of an auction for the sale of vehicles. However, this exemption is subject to the proviso that the auctioneer must not otherwise carry on the business of selling second-hand vehicles; if they do so, then they are required to be licensed.

### 8.2.1 Objectives of the auctioneers exemption

As in the case of credit providers, the core business of auctioneer is not dealing in or selling second-hand vehicles. Rather, the business of an auctioneer is to sell goods on behalf of others. However, the Act provides that selling a second-hand vehicle, or exposing or offering a second-hand vehicle for sale on behalf of another is construed as dealing. As a result, auctioneers performing these tasks would be required to hold a licence in the absence of the exemption.

As in the case of credit providers, it should be noted that the exemption is not from the Act as a whole, but only from the need for auctioneers to obtain a second-hand vehicle dealer's licence where they would otherwise have to under section 7. As a corollary, the exemption extends to those provisions of the Act which relate to "licensed dealers", but does not provide an exemption from the requirements imposed on those who simply fall within the definition of "dealer" as set out in section 3.

### 8.2.2 Impact of the auctioneers exemption on competition

The exemption from the requirement to be licensed represents a potential distortion on competition within the market when one considers that there would appear to be a relatively large number of auction sales within the market. Auctioneers selling second-hand vehicles will not incur the expenses associated with obtaining a licence, nor will they incur the costs involved in complying with the requirements imposed on licensed dealers, such as maintaining suitable premises and costs arising from the management and supervision provisions. They will therefore be able to offer vehicles for a lower price than licensed dealers.

The Review Panel notes that auctioneers are also exempt from the warranty provisions of the Act where they auction vehicles on behalf of another person.

The Review Panel has therefore assessed this exemption as an **intermediate restriction on competition**.

### 8.2.3 Costs of the auctioneers exemption

As auctioneers are not required to obtain a licence, or comply with the accompanying requirements, their business operating costs will be less than those of licensed dealers. As a result, the second-hand vehicles they dispose of may be cheaper than those sold or auctioned by licensed dealers, as there will be a smaller component of the asking price that is reflective of business operating costs.

As the costs involved in disposing of second-hand vehicles will be lower for owners who sell through auctioneers, then it stands to reason that in the case of two similar second-hand vehicles, one offered for sale via auction, the other via a dealer, the asking (or reserve) price of the auctioneer will be lower, and consumers will tend to favour sales conducted in this manner. There will therefore be lesser demand for dealers' services; dealers will tend to drop out of the market. Higher prices will therefore result for those consumers who do wish to avail themselves of the protection offered under a purchase from a licensed dealer.

### 8.2.4 Benefits of the auctioneers exemption

An auction is a public sale at which goods or other property is sold to the highest bidder. Traditionally, auctions have been regarded as the classic "buyer beware" market, where potential buyers forsake warranty provisions in return for lower prices.

If auctioneers were to be licensed and comply with all requirements of the Act, including warranty provisions, then the opportunity for the public to purchase second-hand vehicles at a reduced price at auction would diminish or disappear. It is considered that buyers who choose to purchase at auction do so in the full knowledge that most of the Act's protections do not apply, and nonetheless proceed on that informed basis.

The existence of a secondary, less regulated market provides a benefit to the community as a whole by offering choice to consumers when they wish to purchase second-hand vehicles. If they desire more security in their purchase, for example the provision of a warranty, then they will purchase from a licensed dealer. However, if they are simply after a second-hand vehicle and are not concerned about any potential after-costs, then they have the choice of purchasing either at an auction or from a licensed dealer.

The MTA's submission to the Issues Paper supports this view of the market:-

*"The industry does not view the auctioning of vehicles on behalf of others as unfair competition."*

To inhibit the operation of auctioneers would remove this choice from the market, which would in turn reduce choices for consumers. This is significant from a competition perspective, and the Review Panel considers that the granting of the exemption in favour of auctioneers is of considerable benefit to the wider community.

### 8.2.5 Assessing the costs and benefits of the auctioneers exemption

All submissions received by the Review Panel supported the retention of the exemption in favour of auctioneers.

On the balance, the Review Panel also considers that the exemption should be retained. Regulation of auctioneers in the manner of licensed dealers would impose costs that would ultimately reduce levels of choice for consumers, which is a cost crucial to any analysis of the effect of regulation on competition.

### 8.2.6 Conclusion:- Auctioneers exemption

#### CONCLUSION 24

**The conclusion of the Review Panel is that the exemption for auctioneers should be retained.**

## 8.3 THE CROWN

The Crown was historically not, as a matter of statutory construction, bound by the general words of a statute unless the statute expressly provided that the Crown would be bound, or if the necessary implication of the words was that the Crown would be bound.<sup>90</sup>

However, in 1990 the High Court held in *Bropho v. Western Australia* that there existed only a presumption against a statute binding the Crown, and that the presumption would be overcome if the legislative intent of the statute conveyed an intention to bind the Crown.<sup>91</sup>

To reverse the effect of *Bropho*, the *Acts Interpretation Act 1915* was amended in 1992 to provide that the provisions of all Acts passed after June 1990 bind the Crown unless the Act specifically states otherwise.<sup>92</sup>

In line with this amendment, section 7(2)(c) of the Act therefore specifically exempts the Crown from the requirement to be licensed.

### 8.3.1 Objectives of the Crown exemption

In 1994, the Legislative Review Team appointed by the Minister for Consumer Affairs considered that it was not appropriate or necessary for the Crown to licence itself as a dealer. This is largely due to the view that, in general, the Crown is not a dealer for the purposes of the Act since:-

- it does not purchase vehicles with a view to making a profit on the resale of the vehicle;

<sup>90</sup> *Bradken Consolidated Pty Ltd v. BHP* (1979) 145 CLR 107

<sup>91</sup> See *Bropho v. Western Australia* (1990) 171 CLR 1

<sup>92</sup> Section 20 *Acts Interpretation Act 1915*



- the sale of the vehicles (usually through auction) is not an independent commercial enterprise;
- the selling is conducted by auction periodically (and not by private treaty), and not continuously.

The objective of the exemption is therefore not only to remove the requirement to be licensed from the Crown, but also to reinforce the fact that the Crown does not carry on a business when it disposes of vehicles from time to time.

### 8.3.2 Impact of the Crown exemption on competition

This exemption potentially has some impact on competition within the industry as the Crown disposes of many vehicles, and is seemingly contrary to the theory of competitive neutrality. However, it is understood that the Crown does not own the vehicles in question, but rather leases them from a credit provider.

Therefore, the Review Panel has identified this exemption as a **trivial restriction on competition**.

### 8.3.3 Costs of the Crown exemption

In its submission to the Issues Paper, the MTA noted that as the Crown can obtain new vehicles at a price exclusive of sales tax, it is able to accept a lower reserve price at public auction than can licensed vehicle dealers. The MTA considered that this has the potential to distort pricing mechanisms in the market.

CASA made a submission in similar terms:-

*"The Crown exemption represents a large distortion in the market as they dispose of many vehicles but it is difficult to justify a requirement that they hold a licence."*

### 8.3.4 Benefits of the Crown exemption

The effect of the Crown exemption in the present situation, where the Crown does not own or offer for sale itself the vehicles, is simply to reinforce the view that the Crown does not carry on business as a dealer for the purposes of the Act. The clarity provided by the reinforcement is considered to be of some benefit to the community.

It also provides benefit through the removal of the requirement for the Crown to licence itself in the event that it ever does fall within the definition of a dealer.

### 8.3.5 Assessing the costs and benefits of the Crown exemption

If it is the case that the Crown does not own the second-hand vehicles but rather leases them, then the exemption would not appear to have any real impact on the market. In any

event, difficulties associated with the Crown “licensing” itself even if it did own the vehicles would be sufficient in the opinion of the Review Panel to justify the exemption.

However, that is not a matter that requires consideration by the Review Panel at this stage, and therefore the conclusion of the Review Panel is that the Crown exemption should be retained.

**8.3.6 Conclusion:- Crown exemption**

**CONCLUSION 25**

The conclusion of the Review Panel is that the Crown exemption should be retained.

**APPENDIX 1: SUMMARY OF CONCLUSIONS****CONCLUSION 1**

The conclusion of the Review Panel is that the market affected by the operation of the Act is the market for the systematic sale and purchase of second-hand vehicles

**CONCLUSION 2**

The conclusion of the Review Panel is that the Act has the following objectives:-

4. to minimise the potential for consumer loss through unscrupulous conduct or insolvency, by licensing second hand vehicle dealers and providing access to a compensation fund or insurance scheme;
5. to minimise the potential for consumer loss by prescribing information and contract standards in relation to the sale of second-hand vehicles; and
6. to minimise the potential for consumer loss arising through purchases from a dealer through the imposition on dealers of roadworthiness requirements and a duty to repair certain defects.

**CONCLUSION 3**

The conclusion of the Review Panel is that the identified objectives of the Act remain relevant.

**CONCLUSION 4**

The conclusion of the Review Panel is that the continued regulation of the second-hand vehicle market is justified as the potential benefits to the wider community outweigh the costs.

**CONCLUSION 5**

The conclusion of the Review Panel is that sole reliance on market forces is an inappropriate mechanism for the overall regulation of the second-hand vehicle market.

**CONCLUSION 6**

The conclusion of the Review Panel is that reliance on existing general laws to alleviate the risks existent in the second-hand vehicle market is inappropriate. Rather, the Review Panel considers that these general laws provide an effective framework for regulation of this market only in combination with a licensing or registration system.

**CONCLUSION 7**

The conclusion of the Review Panel is that sole reliance upon the insurance market is not an appropriate alternative to the current system of regulation.

**CONCLUSION 8**

The conclusion of the Review Panel is that the option of greater co- or self-regulation by the industry bodies is not feasible at this time, although the option does exist within the current legislation for this to occur should the industry exhibit the level of maturity sought by Government to justify entering into appropriate agreements

**CONCLUSION 9**

The conclusion of the Review Panel is that negative licensing is not an appropriate alternative to the current system of regulation.

**CONCLUSION 10**

The conclusion of the Review Panel is that the current scope of work reserved under the Act is a justified restriction on competition within this market.

**CONCLUSION 11**

The conclusion of the Review Panel is that the requirement to be licensed is a justified restriction on competition.

**CONCLUSION 12**

The conclusion of the Review Panel is that benefits of the restrictions relating to reputation outweigh the costs. However, the Review Panel would recommend that while the restrictions ought to be retained, they should be modified so that a conviction for a summary offence of dishonesty will only disqualify a person from becoming licensed as a second-hand vehicle dealer for ten years.

**CONCLUSION 13**

The conclusion of the Review Panel is that the current scheme for management and supervision is appropriate in the current market and should be retained.

**CONCLUSION 14**

The conclusion of the Review Panel is that the benefits of the current provisions for the registration of premises support their retention.

**CONCLUSION 15**

The conclusion of the Review Panel is that a scheme of compensation in some form is appropriate in the current market, and the benefits of having such a scheme outweigh the costs associated.

The Review Panel considers that the current scheme as established under Schedule 3 of the Act should be retained and in doing so notes the already existing potential for competition from the private insurance market provided under section 12 of the Act.

**CONCLUSION 16**

The conclusion of the Review Panel is that there are significant benefits arising from the requirement that notices be displayed that exceed the costs incurred by dealers as a result of the requirement, and the restriction should be retained.

**CONCLUSION 17**

The conclusion of the Review Panel is that the requirement to use a standard form of contract is justified as the benefits to the community as a whole outweigh the costs.

**CONCLUSION 18**

The conclusion of the Review Panel is that the retention of the scheme of statutory warranties for the repair of defects is a justified restriction on competition.

**CONCLUSION 19**

The conclusion of the Review Panel is that the statutory warranty in relation to vehicles within the \$3,001 to \$6,000 price range is a justified restriction on competition.

**CONCLUSION 20**

The conclusion of the Review Panel is that the 15-year or 200,000-kilometre restriction is a justified restriction on competition.

**CONCLUSION 21**

The conclusion of the Review Panel is that the restriction on interference with odometers is a trivial restriction on competition and should be retained as the benefits to the community as a whole outweigh the costs.

**CONCLUSION 22**

The conclusion of the Review Panel is that the disciplinary provisions are a trivial restriction on competition and should be retained as their benefits outweigh the associated costs.

**CONCLUSION 23**

The conclusion of the Review Panel is that the credit provider exemption represents a trivial restriction on competition and should be retained.

**CONCLUSION 24**

The conclusion of the Review Panel is that the exemption for auctioneers should be retained.

**CONCLUSION 25**

The conclusion of the Review Panel is that the Crown exemption should be retained.

**APPENDIX 2: CLASSIFICATION OF IDENTIFIED RESTRICTIONS**

<b>Restriction</b>	<b>Relevant Section</b>	<b>Assessment</b>	<b>Final Report Part</b>
Scope of work reserved	3	Serious	6.2
Requirement to be licensed	7	Serious	6.3
General reputation	9(1) & 9(2)	Serious	6.4
Financial reputation	9(1) & 9(2)	Serious	6.4
Incorporated dealer's business to be properly managed and supervised	13	Intermediate	6.5
Registration of premises	14	Intermediate	6.6
Insurance requirement	12	Intermediate	6.7
Compensation fund	Schedule 3	Intermediate	6.7
Notices to be displayed	16 & 20	Trivial	7.1
Form of contract	17	Trivial	7.2
Warranty to repair	Part 4	Intermediate	7.3
Interference with odometers	34	Trivial	7.4
Disciplinary action	Part 5	Trivial	7.5
Credit provider exemption	7(2)(a)	Trivial	8.1
Auctioneer exemption	7(2)(b)	Intermediate	8.2
Crown exemption	7(20)(c)	Trivial	8.3



### **APPENDIX 3: TERMS OF REFERENCE**

The *Second-hand Vehicle Dealers Act 1995* and associated regulations are referred by the Minister for Consumer Affairs to the Office of Consumer and Business Affairs for evaluation and report by September 1999. The review is to focus on those parts of the legislation which restrict competition or which impose costs or confer benefits on business.

Consistent with the Competition Principles Agreement, the review should assess whether any restrictions on competitive conduct represented by the *Second-hand Vehicle Dealers Act* are justified in the public interest by:

- identifying the nature and magnitude of the social, economic or other problems that the Act seeks to address;
- identifying the objectives of the Act;
- identifying the extent to which the Act restricts competition;
- identifying relevant alternatives to the Act, including less intrusive forms of regulation or alternatives to regulation;
- identifying which groups benefit from the Act and which groups pay the direct and indirect costs which flow from its operation; and
- determining whether the benefits of the Act's operation outweigh the costs.

#### **1. METHODOLOGY AND TIMETABLE FOR REVIEW**

The review should adopt the following procedures:-

- Appointment of Review Panel and finalisation of draft terms of reference
- Initial research identifying relevant resources and materials, including materials on any interstate and overseas equivalents
- Preparation of an issues paper
- Release of issues paper for public and industry comment
- Incorporation of comments into consultation draft report
- Preparation of consultation draft report and release for public and industry comment
- Preparation of Final Report to Minister for Cabinet
- Release of report

## **2. CONSULTATION**

The review will consult widely with industry and consumer representatives, educational institutions and relevant government agencies.

## **3. THE REVIEW PANEL**

The review will be conducted by a review panel consisting of the following persons:

- Ms Judy Hughes, *Deputy Commissioner - Policy and Legal, Office of Consumer and Business Affairs;*
- Mr Adam Wilson, *Senior Policy Officer (Competition Policy), Office of Consumer and Business Affairs;*
- Ms Gillian Schach, *Legal Officer, Policy and Legislation Section, Attorney-General's Department;* and
- Ms Sherree Goldsworthy, *Senior Project Officer, Legislation and Policy Development, Transport SA.*

## **4. CONTACT OFFICER**

The contact officer for the review is:

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Senior Policy Officer (Competition Policy)  
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**APPENDIX 4: CONSULTATION LIST AND SUBMISSIONS - ISSUES PAPER**

## Consultation List

- Australian Competition and Consumer Commission
- Australian Small Business Association
- Consumer Affairs Division, The Treasury (ACT)
- Consumers' Association of South Australia Inc.
- Department of Fair Trading (NSW)
- Department of Industry and Small Business (NT)
- Department of Transport, Urban Planning and the Arts
- Insurance Council of Australia Ltd
- Local Government Association
- Ministry of Fair Trading (WA)
- Motor Trade Association of South Australia Inc
- Office of Consumer Affairs (QLD)
- Office of Consumer Affairs and Fair Trading (TAS)
- Office of Fair Trading and Business Affairs (VIC)
- Retail Traders Association of South Australia Inc.
- Royal Automobile Association of South Australia
- Small Business Advocate
- Small Retailers Association of South Australia Inc.
- Society of Auctioneers and Appraisers (SA) Inc
- South Australian Employers Chamber of Commerce and Industry Inc.
- The Law Society of South Australia Inc
- Transport SA

## Submissions Received

- Motor Trades Association
- Consumers Association of South Australia Inc
- Royal Automobile Association of South Australia Inc

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**APPENDIX 5: CONSULTATION LIST AND SUBMISSIONS - DRAFT REPORT**

Consultation List

- Australian Competition and Consumer Commission
- Australian Small Business Association
- Business SA
- Consumer Affairs Division, The Treasury
- Consumers' Association of South Australia Inc.
- Department of Equity and Fair Trading (QLD)
- Department of Fair Trading (NSW)
- Department of Industry and Small Business (NT)
- Department of Premier and Cabinet (SA)
- Department of Transport, Urban Planning and the Arts
- Insurance Council of Australia Ltd
- Local Government Association
- Ministry of Consumer Affairs (New Zealand)
- Ministry of Fair Trading (WA)
- Motor Trade Association of South Australia Inc
- Office of Consumer Affairs and Fair Trading (TAS)
- Office of Fair Trading and Business Affairs (VIC)
- Office of Fair Trading (ACT)
- Retail Traders Association of South Australia Inc.
- Royal Automobile Association of South Australia
- Small Business Advocate
- State Retailers Association of South Australia Inc.
- Society of Auctioneers and Appraisers (SA) Inc
- The Law Society of South Australia Inc
- Transport SA

Submissions Received

- Passenger Transport Board
- Royal Automobile Association of South Australia Inc
- Transport SA
- Australian Competition and Consumer Commission