Auto Distribution: Current Issues and Future Trends
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Part 1 of 4
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[START OF WORKSHOP]

WELCOME REMARKS AND ANNOUNCEMENTS

- **Patrick Roach, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**

PATRICK ROACH: Hello, everyone. My name's Patrick Roach. I am with the Office of Policy Planning at the FTC, and I welcome everyone here today. Before we get going, I have housekeeping matters to take care of, so let me inflict this on you, and then we'll begin.

First of all, I'd like to make sure everybody silences their phones or other devices while we're here. If you need to talk on the phone, out in the hallway would be great.

We have Wi-Fi available for those who want it in the auditorium. There is a pamphlet with the instructions about how to use it available at the desk.

If there's an emergency, listen for instructions over the building PA system. If there's an alarm, and you need to leave the building, the exit to use is out this door through the 7th Street entrance. Make a left for a half a block, and gather across the street on E Street. Everyone will be shivering today if that happened.

The workshop today will be webcast and recorded. I wanted to let everybody who is here know that by attending we are agreeing that your image and anything you say or submit may be posted on one of the commission's websites or social media.

There are restrooms. The restrooms are out the entrances, back around the doorway, and in the hallway behind the stage.

If we keep to the schedule on the agenda, there will be morning and afternoon breaks at 11:00 and at 3:45. Lunch is on your own from 12:30 to 1:45. There's a cafeteria on the ground floor of the building that will be open for lunch. It is kind of back off in that direction.

If you leave the Constitution Center building during the workshop, you'll have to come back in through security screening, so plan ahead for that.

One important note: the Constitution Center does not allow food or drink in the auditorium other than water, so while you're out, don't invest in a big venti latte thinking that you'll be able to sip it all afternoon. That's not going to work.

And finally, most of you received a lanyard with a plastic FTC event security badge. We'll be reusing those, so when you leave for the day, please return your badge to the staff. And that is my housekeeping list.

Our opening speaker today is the chairwoman of the Federal Trade Commission, Ms. Edith Ramirez. And without further ado, I will ask her to make her remarks.

OPENING REMARKS

- **Edith Ramirez, Chairwoman, Federal Trade Commission**

EDITH RAMIREZ: Thank you, Pat, and good morning, everyone. Thank you so much for being here, and welcome to the FTC's auto distribution workshop. As I think most of you who are here today know, the FTC is no stranger to the world of auto distribution. In fact, 100 years ago, when the agency was brand new, our country was in the midst of a major transformation. The newly formed domestic auto industry was at that point rapidly replacing horse-drawn carriages with new horseless carriages, thanks largely to the popularity of the first mass market car—Ford's Model T.

A major report on the auto industry that the FTC produced for Congress in 1939 details that interesting history. More than 1,000 pages long—thankfully we make our reports a little bit shorter these days—the report lays out the story of the early years of the industry, from the expansive growth in the teens and the '20s through the setbacks of the Great Depression. It also highlights the origins of our current system of auto distribution, which has remained remarkably unchanged in the subsequent 80 years, despite dramatic changes that have swept across other retail sectors.

The FTC continues to examine the complex system of automobile sales, and we're still asking whether consumers benefit from that system, or if change is needed. Just as the United

States was experiencing significant changes a century ago, the automobile marketplace may be on the precipice of dramatic change today. Manufacturing upstarts—like Tesla with its electric vehicles, and Elio with its three-wheeled vehicles—both seek to sell their vehicles directly to consumers, rather than through dealer networks, and these are forcing us to reexamine the way that cars are sold. Moreover, evolving trends related to the sharing economy and autonomous vehicles could change the demand for and the sale of cars. So with today's workshop our aim is to explore these issues in greater depth, and examine their impact on consumers.

Aside from a home, a car is frequently the single most expensive purchase consumers make. In 2014, American consumers bought more than 16 million new cars and light trucks at an average price of nearly $33,000 each. And, of course, having access to a vehicle is essential for many Americans to carry on with their daily lives. Yet very few consumers understand the role that state government plays in determining how vehicles are priced, valued, and sold. That's why, on our agenda today, we're focused on how state-based laws and regulations affect consumers, competition, and innovation.

Now throughout the workshop, we'll also be exploring the future of the auto marketplace. Changes gripping the marketplace may raise additional questions about the regulatory structures that we currently have in place, and whether they will best serve consumers. So to set the stage for discussion this morning, what I'd like to do is to briefly discuss the origins of the current system of auto distribution, and then touch on some of the recent work in this important sector, before concluding with some thoughts on today's program.

The early 20th century witnessed a dramatic increase in the use and purchase of automobiles. In 1913, there were approximately 1.25 million motor vehicles registered in the United States. Twenty years later, motor vehicle registrations passed the 25 million mark. Notably though, as car sales grew rapidly, the number of auto manufacturers declined dramatically. By 1937, the so-called big three firms—GM, Ford, and Chrysler—manufactured approximately 84% of the motor vehicles sold in the United States.

With these events as a backdrop, car sales changed as well. As detailed in the FTC's 1939 report, during the first two decades of the 20th century, the same men who owned and operated garages and service stations often sold cars and trucks, typically from the same locations. With rising car sales, those former garage owners began to focus more on selling those cars, often making significant investments in buildings to serve as display areas and sales rooms. Gradually, manufacturers came to deal with retail sellers not as agents, but as independent merchants who took title and resold the vehicles, operating at a franchise agreement with the manufacturer. The basic system of independent franchised auto dealers that operates today was already established industry practice by the early 1930s.

As this system evolved, though, those dealers who had made large investments became concerned that they would be at the mercy of their affiliated manufacturers—especially with few automobile manufactures to turn to as alternatives. Dealers turned to policymakers about what they believed were abusive and coercive practices by manufacturers, and the regulation of auto distribution ensued. Over time, all 50 states passed laws regulating the relationship between auto manufacturers and dealers.

Now while many of these developments were detailed in our 1939 report, our interest in the auto industry did not end there. Nor has it been confined to competition. We've also addressed consumer protection issues as well.

Today, the FTC is the primary federal enforcement agency for most auto dealers, and last year we partnered with 32 law enforcement agencies, and brought a number of enforcement actions, including one against a car dealer for failing to disclose substantial fees for add-ons, like extended warranties, payment programs, and road service. We also pursued a case against a major car manufacturer for telling consumers that their warranty would be voided unless they used original equipment parts and franchised dealers to perform maintenance and repair work—a practice that violates that Magnuson-Moss Warranty Act.

In addition to enforcement efforts like these, the FTC also advocates for consumers in a number of ways. We engage in competition advocacy and outreach to policymakers across all levels of government. We also conduct important research and educate consumers on their rights. For example, the FTC is currently seeking public comment on a proposed qualitative survey to learn about consumer experiences in buying and financing cars at dealerships. And in 2014 and 2015, the commission submitted comments supporting proposed legislation that would affect the ability of motor vehicle manufacturers to sell their products directly to consumers without using franchised dealers. It was the work on those comments that led to today's workshop.

Today our panelists—representing manufacturers, dealers, and consumers—will explore this complex system of regulation governing auto distribution. Our two morning panels will focus on how state laws currently regulate the relationship between manufacturers and their franchised dealers. One afternoon panel will address laws prohibiting direct manufacturer sales to consumers. And in our final panel, we'll hear from experts on how technological changes affecting the industry may impact state auto distribution rules.

With new changes on the horizon for the automobile marketplace, questions about the impact of regulation on competition and innovation will continue. While some regulation may be beneficial and necessary, regulation can have detrimental consequences for consumers if it harms competition or stifles innovation. We must continue to consider whether the state laws under discussion here today are necessary to protect dealers against abuses by manufacturers, or if they serve some other purpose.

There are also many other questions that need answers. How do the laws affect competitive decisions of manufacturers and dealers? Are other interests helped or harmed by particular aspects of state laws? Are the changes affecting the industry today—like the connected and autonomous and semi-autonomous cars on display at last week's Detroit Auto Show—going to have an impact on methods of distribution? These are complex questions with no easy answers, but today's workshop is designed to prompt meaningful dialogue on these and related issues.

So before I wrap up, I do want to take this opportunity to thank the FTC staff who worked really hard to organize this program, including Pat Roach and Ellen Connelly of our Office of Policy Planning, James Frost of the Bureau of Competition, and Nathan Wilson and

Paolo Ramezzana from the Bureau of Economics. I also want to express my gratitude to the speakers and panelists who are joining us this morning and the rest of the day to share their expertise with us.

So now I'm really delighted to turn the floor over to Professor Francine Lafontaine, our former director of our Bureau of Economics, who joins us from the University of Michigan Ross School of Business. Welcome back, Francine. Thank you.

FRAMING REMARKS

- **Francine Lafontaine, Professor, Stephen M. Ross School of Business, University of Michigan**

FRANCINE LAFONTAINE: Thank you so much, Chairwoman Ramirez. It is actually really a delight to be back here for this workshop. I worked with staff while I was Bureau Director up until the end of December, basically, on the creation of this workshop, and I'm really looking forward to the discussion. I am very pleased that people are all here gathered to talk about auto distribution. Bringing this to fruition did in fact require quite a bit of activity from the staff, and, like Chairwoman Ramirez, I want to thank each and every one of them for all their work on that.

When I started working on franchising, which is now about 30 years ago, doing my dissertation, one of the first things that I read, in fact, was a book by someone called Peter Pashigian, who was a faculty member at the University of Chicago at the time. His book was his dissertation. It was published in 1961, and its title was *The Distribution of Automobiles: An Economic Analysis of the Franchise System*. In the preface, he thanked in particular someone called Paul Herzog—and I apologize if that's not quite the right way to pronounce his name—but he was at the time director of research at the National Automobile Dealers Association. And Peter Pashigian was expressing gratitude for his help in getting data from dealers, and also for rekindling his interest in auto franchise dealerships in the process of doing a dissertation, which is a slow and painful process. So I'm very pleased that there are representatives from the dealer association here today who can share with us some of the information that they have gathered over the years.

One of the things that the association does is to keep track of data on dealerships in a way that is particularly useful when one wants to describe some aspects of this industry. I will mention one of the frustrations with dealing with some of those data by giving some statistics that relate to how big franchising is right now in car retailing, and that is, according to NADA, there are 16,400 car dealerships today in the United States. The latest numbers from the Census would put that at 21,000 something, and so there are 5,000 dealerships that I'm missing in between the Census data and the NADA data. That always hurts somebody like me, to just not know where these went. I would really encourage the association and other people that work with data on these dealerships to talk with the Census, and try and figure out where the source of these differences are, and to really try and make these things a little bit more comparable. There are definitional issues—I understand that, and that's probably the source of that—but it's difficult to talk about the numbers when you have these disparities in different places.

Now I want to get back to the world as it was when Peter Pashigian was thinking about franchised dealerships, and that is there were basically only U.S. car manufacturers in the market—six of them at the time, but the big three definitely had become the major force. There was at that time about 33,000—almost 34,000—car dealerships, according to the NADA data, and therefore twice as many as what we have today, so there's been consolidation in that market. In particular, there's been a reduction in the number of very small dealerships that used to exist—the ones that would sell just a few cars, but also gasoline and other things. That number has gone down dramatically.

At the same time, the system of laws that we will be talking about was not as developed. The states had begun by 1960—when he was writing his dissertation—to enact these laws, but the laws were more specific. They were targeting specific issues, and they were not yet as widespread across the states. About 20-some states had enacted such laws at that time.

By 1979, when somebody called Smith did a study trying to assess the effect of franchise laws on the cost of cars to consumers, many more states had established their franchise laws. In particular, 45 states had rules against termination. And when I say termination, they typically include also non-renewal and non-continuation rules. So that transforms a contract that had been of a certain duration into something that is in perpetuity. Also, 26 states had rules against establishing another dealership nearby, so that these would create exclusive territories around the dealerships.

By 2009, when I was working with Fiona Scott Morton—who's also going to be one of our speakers, and is sitting here right now—on a paper together on the prevalence of these laws, we found that all 50 states had these termination and non-renewal rules, and 47 states had rules that led to exclusive territories. We showed, for example, that these had consequences, in terms of the dynamics of this sector, by showing a map that compared what GM's dealership system looked like relative to Toyota, where Toyota's system had been put in place after many of these laws were known to exist, and therefore could adjust to that little bit more. What we saw was that GM dealerships were selling about a half to a third as many cars, on average, as what the Toyota dealerships were, and they were very often much nearer to each other, and not necessarily where the population had grown, in particular. So the point of that is to say that these kinds of laws about termination and non-renewal, as well as exclusive territories, make dynamic adjustments in this franchise system difficult.

Chairwoman Ramirez pointed out that the reason that these laws were put in place, in part, was because of dealership concerns over their investments, and protecting them. There are realities about that that we understand come to play in deciding how we should regulate or think about these industries. At the same time, the question becomes whether that is the right way to think about protecting those investments, and whether there are alternatives that might be preferable for consumers. Our first panel will examine exactly those kinds of issues that I just talked about—the non-renewal, termination, and exclusive territories.

As Chairwoman Ramirez pointed out, we're going to also have a panel that looks at an area that's been very active of late, which is the area of warranty reimbursement for the work performed at car dealerships. That topic is something that's of particular interest to some of us, because the fact that that's the place where the laws have changed gives us, perhaps, an opportunity to see what the effects are, empirically. So if we can put the right kind of data together, it might be one of the places where we can examine the economic effects of these laws.

We're very pleased to have Professor Carlton, who's going to give the keynote at lunch. He's going to talk more generally about these kinds of rules as they occur in other industries, as well, but also about the state action doctrine more generally. This is important, as it broadens a little bit the scope of this particular workshop, but also pins down some aspects of why we have these regulations.

The third panel—the first one after lunch—is going to get to exactly what Professor Pashigian was looking to answer in his dissertation, which is why would manufacturers use a franchise system. Why would they choose to delegate to somebody else, but restrict the number of dealers that they have? That was his main question. That's actually a question I've spent quite some time dealing with in my own work on business format franchising, the other side of franchising. The answer that you get from discussion with industry, as well as from empirical work that I've been involved with, and others have as well, is that there's kind of a trade-off between incentives for the franchise dealer (in terms of investment effort, local tailoring of products, and other things) and control. That's the thing that the franchiser lets go of, to some extent, when they delegate to somebody else. The control comes with this capacity to decide how changes should be put in place, and so it comes with the dynamic aspect that I was just talking about.

You couldn't ask the question of why franchising in the car industry anymore in the US, since the laws do prevent manufacturers from selling directly completely. But we do allow firms like AutoNation, and Warren Buffett has been able to buy a number of dealerships. The reason why we don't allow that for car manufacturers is an important question, one that Tesla, and Elio, and those other firms and other products that are on the horizon, all raise.

So the questions that these new industries, and new technologies, and the changes in the market bring to bear is what are going to be the likely effect of these technologies on the franchise system, and on the sale of cars, and on these laws? But at the same time, how are the laws going to affect the entry and the development of these innovations? That will be the focus of our last panel.

As we discuss all of these questions, the goal is to get – as Chairwoman Ramirez mentioned—people from industry, as well as people who study the industry, to discuss these issues, so that we can start to shed some light on these effects that we are particularly interested in understanding for consumers, in particular, in terms of prices, accessibility, quality, dealer and manufacturer behavior—all of these kinds of issues.

I'm looking forward very much to learning a lot from industry. I found during my days at the FTC that that was one of the blessings of being in that location. That is, firms and representatives would come and talk to us and explain to us various things. We're looking forward to these kinds of discussions here today as well, and to learning more about this system, but also thinking about it critically and seeing where to go forward.

Thank you. With that let me bring together the first panel, who will be moderated by both James Frost and—our two main organizers of the workshop. Thank you very much.

PANEL 1: STATE REGULATION OF DEALER NETWORKS

Panelists:

- **Jim Anderson, President and CEO, Urban Science**
- **Carl Chiappa, Partner, Hogan Lovells US LLP**
- **Aaron Jacoby, Chair of Automotive Industry Practice Group, Arent Fox**
- **Joseph Roesner, President, Fontana Group**
- **Henry Schneider, Assistant Professor of Economics, Cornell University**

Moderators:

- **James Frost, Attorney, Bureau of Competition, Federal Trade Commission**
- **Patrick Roach, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**

JAMES FROST: Good morning, everyone. Indeed, my name is James Frost. I'm an attorney here at the FTC. Sharing the moderator duties with me will be Pat Roach this morning. I do need to give the standard disclaimer that anything that I say today, or anything that Pat says today, will be our own opinion, and is not the opinion of the Commission or any individual Commissioner.

For those of you that are new to this topic, when we talk about dealer network issues, we're really talking about the ability of automobile manufacturers to do one of three things—terminate an existing dealer, add a new dealer somewhere where there isn't one, or change the current shape of the dealer—excuse me—change the area of responsibility or physical location of a particular dealership.

As you might imagine, when issues like this come up, the interests of both dealers and manufacturers can be significant. But if you're not an expert in these issues, what you may not realize is the degree to which the state is also involved in these areas. Today, states directly regulate in this space extensively. And the purpose of our panel today is really to talk about what is the ultimate impact on consumers for these issues, and how do these laws work today within the eyes of the market participants.

Every moderator, when they stand up and talk about a panel, says that they've got a great group of panelists. That's certainly true here. Let me just briefly introduce them to you. Carl Chiappa is a partner at Hogan Lovells. He's been representing automobile manufactures for over 35 years. He has extensive experience litigating issues related to the shape of the dealer network on behalf of his OEM clients. In those contested proceedings, Carl often squares off against Aaron Jacoby, who is a partner at Arent Fox, who has considerable experience litigating dealer network issues on behalf of his dealership clients.

Resolving these cases often requires expert testimony. And today we have two distinguished experts with a great deal of experience in testifying on these topics. Jim Anderson is the founder, president, and CEO of Urban Science. Among his many accomplishments, Jim has testified in over 125 cases related to the shape of the dealer network. Next to him is Joe Roesner, the president of Fontana Group, and likewise has a very long and impressive history of providing expert testimony in contested dealer network proceedings. Finally, Professor Henry Schneider is an economist at Cornell University who has studied and written extensively about the economics of the automobile industry.

The format we're going to follow here is slightly unusual. One of the benefits when you work for the federal government is you can convince people to do things that they ordinarily would never do. I have used that power to benefit all of you today. I've gotten Carl and Aaron to work together in providing you all with a brief background on the current shape of the legal landscape. Getting Carl and Aaron to work together for five minutes may not rank with bringing peace to Northern Ireland, but I thought it would be a useful exercise to try to get some agreement on the things which are not really in dispute before we get into the areas where people want to join issue.

So after that joint backgrounder, I'm going to give each panelist time to briefly present their own views on these issues. And before we get to the question and answer period, if you would like your question to be included in the question and answer period there are question cards available. Please just go ahead and write down your question. We'll be collecting those right after Henry gives his speech. And so we're happy to have your questions as well.

With that, I think I will turn it over to Carl and Aaron to begin.

CARL CHIAPPA: Thank you, James.

AARON JACOBY: Thank you.

CARL CHIAPPA: Well as James says, Aaron and I have agreed to do a joint presentation. Let me see if I can—here we are. One thing you don't know is that there's a large red clock here looking at me, which did not start to tick down during James's opening remarks. That's another advantage of being with the government I suppose.

AARON JACOBY: You're using up time.

CARL CHIAPPA: So Aaron and I have exactly eight minutes to describe to you an overview of the franchise laws that we're going to be discussing today. As you'll see in the PowerPoint in front of you, that is a 60-year history. So we have slightly more than a minute a decade.

These are very complex, very comprehensive regulations. Most of you I suspect are familiar with them. For those of you who are not, we'll give you just a brief look at them, and what's some of the jargon that we use that might otherwise be somewhat baffling.

We're talking about state regulations here—all 50 states, as Doctor Lafontaine just pointed out. There are two and only two federal statutes, which I'll talk about in a moment. But all 50 states now have statutes that specifically regulate the relationship between motor vehicle dealers and motor vehicle manufacturers. We're not talking about statutes that, for example, are relevant to McDonald's.

The first of the federal statutes was the Automobile Dealer Day in Court Act, which was passed in 1956. It simply says that manufacturers must act in good faith toward their dealers. That ended up having a very specific meaning through court interpretation. The statute is still pled, though I think it would be fair to say that today its great benefit is that it grounds federal question jurisdiction when you're not before a state board.

Since the 1970s—and Dr. Lafontaine just mentioned a number of these to you—there was a large group of state statutes passed, beginning with relatively simple provisions. Dealers could not be forced to take cars they had not ordered. There was limitations on non-renewals and terminations.

The rationale for the statutes—and Aaron and I have promised a nonpartisan look at this; the greatest exhibition of detente since Reagan and Gorbachev—was really unequal bargaining power; level the playing field between large manufacturers and their dealers. Many of the statutes also begin with a recitation that this is in an effort to promote the public welfare, because of the significance of automobile distribution for the states.

An important thing to recognize about these statutes is that they override any private contracts. Now that does not mean that the contracts are irrelevant, because they are frequently incorporated into the statutes. But it does mean that these very comprehensive regulations override the state provisions.

One other more recent, early part of the century—2001, I think—federal legislation was the amendment effectively of the Federal Arbitration Act to render arbitration agreements and dealer agreements null unless the parties agreed after the beginning of their dispute to arbitrate.

OK. Since time is going faster than I possibly could have thought it would, let me tell you a little bit about termination provisions. They were a core aspect and an early aspect of the protection afforded to motor vehicle dealers by these statutes. Essentially, they require that a manufacturer wishing to non-renew or to terminate a dealer has to prove good cause.

There are two basic versions of that. One is a multi-factor balancing test. And one is, has there been a material breach of the contract?

Dr. Lafontaine's already told you statutes override the terms of the contract, making them evergreen agreements. For the most part, a dealer does not have to show the normal preliminary injunction standards. There's an automatic stay if a termination has taken place, or a notice of termination has been issued. And in approximately 40 of the states, termination cases are heard by administrative bodies that may be specifically empowered to hear motor vehicle disputes, or may hear all kinds of administrative disputes.

AARON JACOBY: Let's move on quickly to add points and relocations, because as usual, Carl, you've run over your time.

In any event, going through quickly another area of oversight by the state governments is with regard to add points and relocations. What do we mean by an add point? An add point is an additional dealership that will be located in a market area that was otherwise allocated to one or more other dealers. These are not exclusive territories, but when a point is added to the market, because these markets are considered sensitive and important to balance—the time started over again. Look at that.

CARL CHIAPPA: You see that was—a special concession.

AARON JACOBY: There's oversight permitted to determine if that's an appropriate market action by the manufacturer who seeks to add that point. We refer to those as add points. And you'll hear us talking about an add point during the day. So keep that in mind. Add point equals government oversight for that market area.

A relocation is when an existing dealer that is not in a given market area is going to relocate a particular dealership from the market area where it is, to a new market area. And that also is considered a market action. And as with an add point, that market action can receive oversight if other dealers in that market area file what is called a protest.

As with the termination, a protest filed by a dealer in a given market area allows for government oversight. And in a government panel, typically an administrative law judge reporting to a board—similar to what the FTC or any government agency has in place—looks at whether it's the add point or the relocation, and considers a series of good-cause factors that I'll get to in a minute.

When can a dealer protest, and who can protest? Oh, I'm supposed to be manning this. OK. So The RMA statutes define who can protest. And different states do it differently. This is sort of the local control aspect that Dr. Lafontaine referred to.

And any state, as you can see in this slide, decides it slightly differently—California 10 miles, New Jersey 14 miles. Some states, it depends if they're rural, urban, et cetera. And burdens of proof seem to be slightly different in urban areas like Los Angeles compared to rural areas.

Other states do it by percentage of sales, as in Florida. And other states use either a county line or a 15-mile radius, like Texas. Again, these are not marking exclusive territories. They're marking the boundary by which it's decided whether or not there can be government oversight over a market action for either an add point or a relocation.

So the good-cause factors. This is how the hearings are conducted. And when there is government oversight triggered—and it's triggered by a protest by a relevant market area dealer—the decision over whether to allow an add point, or allow a relocation is based on these factors that you see here. It has to do with the dealer's investment, the effect on the market, the effect on the consuming public, the effect on public welfare, the adequacy of competition. And you're talking here about intra-brand competition, because you're moving, let's say, a GM dealer from one market area to a different market area, or a Toyota dealer, et cetera.

Convenience of consumer care for their vehicle with regard to recalls, warranty, service, et cetera. The states want to ensure the customers have adequate facilities to go to, and numerous facilities to go to. And what are the adequacy of those facilities?

And a lot of these factors, as you can see, focus on the public interest—not the interest of either the manufacturer or the dealer—although Carl would like to see that differently I think. And I think either side might like that to be different at one time or another. But the focus of the government is certainly on the consuming public.

Carl?

CARL CHIAPPA: As I said at the beginning, these are very comprehensive regulations. We talked about how, in the beginning, they were aimed particularly at terminations and at add points. But over the last now 40 years about, the regulations have expanded and deepened. So among the earlier additions to the protections of these state laws, were the post-termination obligations, which essentially means that the manufacturer has to buy back certain physical assets of the dealer if the dealer is going out of business. And that may in many cases be whether it's a voluntary termination, or a termination by the manufacturer's initiative.

The very last item—participation in advertising—is also, if we were archaeologists, this would be very low in the layers. There were in the very beginning issues about requiring dealers to belong to advertising associations. And that was planned early on as well.

More recently, there has been significant legislation on the issue of withdrawal of brands, where manufacturers have to pay dealers the value that the franchise had on the day before the withdrawal of the brand takes place. May also have obligations with respect to the rent or the value of the facility that the dealer had occupied.

And you're all aware that there have been many brand withdrawals over the years—Oldsmobile, Mercury, the late and unlamented Yugo. And similarly, proposals to sell franchises, called in our jargon buy-sells. There are restrictions on when a manufacturer can say no, that purchaser is unacceptable to us.

Allocations of vehicles. This is something that normally takes place only in the happy circumstance where the demand is exceeding the supply of the vehicle. But if you're in that situation, there are rules about how that has to be done.

More recently, there has been significant legislation on the issue of incentives, whether manufacturers can require dealers to be exclusive. Warranty reimbursement, labor and parts are legislated in terms of what the manufacturer has to pay the dealer.

Modifications of dealer agreements. There are filings required. There is the great music. And Aaron actually took longer with his three slides than I did with mine. So we'll end with that, and I think move soon to a more partisan discussion.

JAMES FROST: Right. So that concludes the sort of bipartisan part of this. We're now going to move, and go right back to Carl. But now Carl's going to give his own personal views as to what he thinks of all these laws.

CARL CHIAPPA: Yes. And let me stress as James did at the beginning that no client past, present, or—if there are any—future are responsible for anything I have to say here today. These are really my views of how the laws affect things on a practical, daily basis based upon what is now—as hard as it is to believe—37 years of representing automobile manufacturers and distributors.

I guess I'll start by saying that an obvious thing. Dealers are the face of manufacturers to the consuming public. And for many people, there isn't really much of a distinction. They understand the dealers to be the manufacturers. So it's a relationship of high interdependency. And I think that—I'll come back to this later—is something that is perhaps sometimes forgotten.

One of the things that I find challenging about the dealer statutes, especially as they have evolved over the years that I've been doing this, is that they impose a one-size-fits-all standard. And this is true of all regulations, of course. But it's particularly difficult here, because you have manufacturers whose sales are increasing rapidly, manufacturers whose sales are flat, manufacturers whose sales have decreased. You have manufacturers who sell luxury goods, manufacturers who sell volume goods. And all of these statutes apply equally in all of those situations. And so what looks like equal treatment on a piece of paper does not work out to be equal in practice.

The effects of these statutes are very disparate. But they're not only disparate from the brand's perspective. They're also disparate, frankly, from the perspective of the dealers.

The dealer bodies have changed enormously over the years. We now have public companies. We have Warren Buffett, as we've described. We have private equity companies. And so the makeup of the companies whose protections are being afforded by these statutes have changed dramatically.

Additionally, we have a situation where we have an enormously dynamic marketplace. It doesn't take a great deal to see that the internet has transformed the retail business. The question of whether these statutes—which I consider to be a somewhat blunt instrument for this kind of regulation—can keep up with what will be the millennial expectation of finding, going somewhere, and bargaining over it unusual, I think is going to be a big challenge for everyone on both sides of the equation.

Whether we like to say it or not, there are performance issues that manufacturers have to look at. There are weaker-performing dealers. And one of the questions I've always had about the statutes is whether the protection of weaker-performing dealers are in the interest of anyone. Are they in the interest of the consuming public? Are they in the interest of the manufacturer?

But curiously—and I'd like to come back to this—one of the questions I have is, are they in the interest of other dealers? And I think the answer to that may very well be no, that the statues ironically have a negative effect on dealers. And one of the ways it has that negative effect is that there are many dealers who are eager to invest in their franchises.

And one of the things that's happened over the years is that where the early statutes restricted a manufacturer's ability to take negative steps against dealers, more recently what they have done is to restrict the manufacturers' ability to incentivize certain dealer behavior, like superior consumer satisfaction, or upgrading of facilities. I'm not sure that's in the interest of the vast majority of dealers.

Now a classic example of this, it seems to me, are add points and relocations, which are not OEM or manufacturer against dealer disputes. The people who are getting the add points; in the vast majority of cases, the people who want to relocate are the dealers themselves. And the restrictions that Aaron and I described in our quick overview, it seems to me, do not necessarily work in favor of the dealers who are the ones who are going to be the beneficiaries.

Florida is an example of a statute in which the manufacturer must prove that the existing representation is inadequate before it can allow a dealer to relocate. Not, in other words, whether it would be better for the consuming public, or better for the dealers, but whether the situation is OK. If it's OK, then the statute sort of says, well, the dealer shouldn't be allowed to relocate. Unfortunately, that works to the disadvantage of dealers who in some cases have to relocate for one reason or another.

One of the things that's happened over the years is that add points are such lengthy processes, and are so expensive, that in fact now settlement agreements are reached early on. Well there's no spontaneous generation of a dollar, or as Milton Friedman said, there are no free lunches. That money has to come from somewhere, whether reduced investment, or it comes from the dealers, or the manufacturers. And I wonder whether that is also in the interest of the dealers.

As we've said, the add points do not look at competition and the public interest exclusively. They look at that as two factors among many multiple factors. So it seems to me we've got the one-size-fits-all problem. We have the question of innovation, and we have the question of whether it's advantageous to the dealers.

Now terminations. I'm going to say something that will probably cause some of you to question either my veracity, or my sanity, or both. But the truth of the matter is the manufacturer-dealer relationship is not inherently an antagonistic one. My partner Scott Golden likes to say that contracts are negotiated and written and signed, and for the most part they go into a desk drawer and are never looked at again. Well that's true for the vast majority of dealers, and it's true for the vast majority of dealers with respect to dealer statutes. They never have to deal with them.

Now we'll always hear anecdotes about abusive behavior by manufacturers. I can tell you that terminations are things that go through so many levels of review that frankly I find those anecdotes to somewhat strain credulity. But even if you assume that that is not the case, the question is whether these statutes are the best way to handle them. Is it really a good idea to say that a material breach of an agreement is not sufficient to ground termination?

One of the more extraordinary developments is a New Hampshire decision recently that forbade a dealer and a manufacturer to enter into a settlement agreement, because it constituted a waiver of the dealer statute. Well for those of us who think that the Outside Counsel Full Employment Act, is a good idea, those—that's a good idea. But it's a terrible policy issue. And I am now out of time.

Aaron now has [INAUDIBLE]

AARON JACOBY: I phoned it in. OK. I think the point that Carl is making leads to debate around the margins, and with regard to some of the nuances, and whether or not evolution of these laws needs to shift. And I would say that certainly in his view it seems that he believes these laws have now evolved too far in an over-regulated direction.

But laws are always subject to change. They modify over time. And I'd like to look at asking, why regulate in the first place? First of all, this is an important economic sector—the auto industry, that is. And like other important sectors, like health care, telecom, oil shipping, transportation and the auto industry are regulated. They're not different than these other industries. They're considered important.

And while regulatory schemes do evolve over time, the core reason for the regulation remains. And that is to provide an oversight process—that's what these state governments wanted to do; provide an oversight process—to weigh actions that might negatively impact what is a key market sector.

And I think many of us in this room make our living working in this sector. It was already mentioned how many dealerships there are, how many vehicles are sold per year, the importance of personal mobility. This is a very key and important economic sector.

When it's not doing well, it can nearly take the country down, as happened during the Great Recession. When it is doing well, it bolsters the economy. And so it's a very sensitive ecosystem that we all need to treat with a lot of oversight. And that's what's provided by these laws.

Now what do the state governments intend by the enactment and implementation and enforcement of these laws? And to answer that, I thought I'd look to a statement of intent by a state government. Of course, since I'm Californian, I'm picking California, because it's the best state, right?

And what California says in its legislative intent—and I'm just going to read this as a quote—"The new motor vehicle franchise system, which operates within a strictly defined and highly regulated statutory scheme, assures the consuming public of a well-organized distribution system for the availability and sale of new motor vehicles throughout the state, provides a network of quality warranty recall and repair facilities to maintain those vehicles, and creates a cost-effective method for the state to police those systems through the licensing and regulation of private sector franchisors and franchisees."

So I think that's a good statement of why these laws exist, what they're intended to do. And whether or not any particular component of one of these laws carries out that purpose to perfect effect I suppose is always debatable. And Carl and I debate that all the time in court. But the reasoning for the existence in such an important segment of the economy I think we can perhaps all agree on.

When did this all begin? And I think Dr. Lafontaine mentioned, but in case not, I'll repeat that really in the 1950s the states began enacting these statutes. The initial focus of the various states was to curb abuses of the OEMs, and to level the playing field in an area where there was unequal bargaining power. And the reason for that is to provide a stable economic system to provide the various services.

So why not leave the contract negotiations of franchise, franchisee, franchisor to the parties involved? Well there is unequal bargaining power. And when you have one individual dealer against the sole provider of its product—the vehicle—and when the provider of the product is typically giant compared to the individual dealer, there is necessarily unequal bargaining power.

Dealers cannot collectively organize like a union. That's prohibited by the antitrust laws. And it doesn't matter if you're Berkshire Hathaway, or Penske, or AutoNation. It's one dealership agreement at a time. AutoNation does not negotiate its entire company's agreement with a single manufacturer. They have multiple manufacturers. They have multiple dealerships. And each dealership is an individual entity acting on its own.

Even if AutoNation were to be allowed, or if it was possible for them to negotiate one agreement for the whole company, they actually represent a pretty small slice of the overall economy of dealerships. And that would not present a focus for change.

So instead, the state legislative bodies acted. And they developed these statutes, including the relevant market area statutes that we talked about regarding add points and relocations.

Now I think it's important to note these are not veto rights, and they do not create exclusive markets. I'm not sure why that is so often misunderstood, but it is absolutely not that.

This is a government oversight process. And that process allows for analysis of a market action that is taken that may negatively impact this very sensitive ecosystem.

Now we've all decided that personal mobility and having cars is very important. I know we would be the envy of the world in that regard, because there are many places where people would say cars are just not that important. But I'm from Los Angeles, where it's illegal to walk. And so certainly I grew up knowing that cars are important. And I think in the United States as a whole that that remains true. And because of that, this market is very important. And so these actions are subject to oversight.

So what happens with that oversight? Essentially, there's an administrative review process so that if the market action by the manufacturer—whether it's to relocate one dealer to another location, or to add a dealer to an existing market—a dealer can protest that action.

And there is then a hearing process. All of this takes place relatively quickly in litigation terms. And the hearing process considers various good cause factors. And the good cause factors we've looked through. And I'm running out of time.

So essentially, it's a balancing test. The statutes don't predict or dictate outcomes. They simply provide a process. And the process is before a new motor vehicle board or a commission. These are qualified agencies that have significant long-term expertise in the automotive industry. And they are experts at deciding these cases. And that is who implements this oversight process. And now I am out of time.

JAMES FROST: Jim?

CARL CHIAPPA: Want to pass him the clicker?

JIM ANDERSON: In the US, virtually all new automobiles are sold through a network of franchised new vehicle dealers. The primary purposes of the dealer networks are to provide consumers a competitive environment in which to shop, and convenient access to the product for both sales and service. Manufacturers initially appoint a number of well-located dealerships to compete with nearby same-brand dealerships on an intra-brand basis, as well as other brand dealerships on an inter-brand basis. Once established, dealer relocations are frequently governed by state franchise laws, as well as terminations and new add points.

When the individual needs of manufacturers, dealers, or consumers are not met, the system fails. Manufacturers and dealers have to make a reasonable return on their investments, and consumers must be provided superior products, a competitive environment in which to shop, and convenient access to the product for both sales and service to have a sustainable system. The franchise system has served manufacturers, dealers, and consumers relatively well. Generally speaking, the combination of centralized product knowledge, and manufacturer skill of the manufacturer, coupled with the franchise dealer's local knowledge, personal relationships, and sales and service expertise, has served both parties well.

However, in any type of business relationship involving two independent parties, there will be disputes. And they require resolution. With respect to the manufacturer-dealer disputes regarding the dealer network or dealership operations, state franchise laws often play an important role in resolving them. The process however, takes a long time—too long in my mind—and is expensive for both parties. So long as new vehicles are sold and serviced through franchised dealerships, however, there needs to be an effective dispute resolution process.

In the United States, the number, location, and certain operations of automobile dealerships are impacted to varying degrees by similar but not identical state laws. Judicial decisions have generally focused on whether or not a brand's current dealer network is providing adequate competition and convenient consumer care for consumers of the line-make vehicles in question. With readily available data, it is very easy to accurately calculate the effectiveness of inter- and intra-brand competition, as well as customer convenience.

However, the sales data on which these calculations are based are historical, and therefore not a forward look in time. This would not be as big of an issue if the auto industry was not changing all the time. At over 100 years old, the car industry is often thought of as a stable, mature industry. Much to the contrary, the auto business has always been—and I believe will continue to be—a dynamic business in a continual state of flux caused by, one, growth decline and geographic shifts of the customer base; two, competitors entering, relocating, consolidating, or exiting the market; three, dealership ownership changes resulting in different operating strategies in the marketplace; and four, product innovations, including disruptive technology.

A fundamental concept in dealer network planning is to locate automobile dealerships as close as practical to the people who purchase new vehicles. Dealerships are frequently designed to last 40 years or more.

But the US population has always been growing and shifting. In 1900, about 40% of the US population lived in urban America, in contrast to about 80% today. Obviously, if dealerships were placed where the customers were located in 1900, they would not be well located to serve the current customer base that has steadily migrated from rural areas to the cities of America. Population has also shifted from urban to suburban, and most recently back to the core cities. Beginning in the 1950s, there has been a steady migration of the US population from the North to the South.

The dealership landscape has changed continuously as well. Automobile dealerships, companies, are not necessarily small today. The largest dealer group in the US was formed in '96 and owned 293 dealerships in 2014. Today, the top 25 dealer groups own about 9% of the dealerships in the US.

The size of the US automobile market continuously fluctuates. Since 1946, there's not been a period of continuous growth or decline exceeding four years, except for the recent recovery. All other things equal, the better time for a new or relocated dealer to enter a market would be in a growth period. Due to the length of time required to process the add point, it makes sense to hear the case during a recession. However, the question frequently asked in trial is, why would you want to add a dealer during a recession?

In 1900 there were literally hundreds of car manufacturers in the US not here today. I find it interesting to see Detroit Electric and American Electric on the list of brands leaving the US decades ago, as we now see strong resurgence of electrical vehicles.

While some manufacturers have left the US, new competitors continue to enter the market. Start-ups like Tesla most recently; others like Apple, Google; and Chinese and Indian companies are hinting they will enter the market in the not-too-distant future. All new competitors that enter the US market have the opportunity to locate wherever they want, because there are no existing same-line-make dealers to protest. Their location choices typically include the newer, fast-growing, upscale areas in large metropolitan markets where new vehicle buyers continue to move.

Existing dealer networks have not been quick to respond to these demographic and competitive changes, leaving excess capacity in markets with declining population areas, and insufficient capacity in high-growth areas both locally and regionally. An unintended consequence of the state franchise laws is that well performing dealers may have to wait until their performance is degraded by the new competitors entering a market before being able to move to the best locations to serve that market.

Finally, innovation has been a staple in car company diets for over 100 years. From electric headlights over 100 years ago, to safety features in the '50s, and autonomous vehicles just around the corner, innovation—or lack thereof—has created enormous opportunities for inventors, and near certain death for those who don't keep up.

The transaction most new vehicle consumers experience is quite complex. The primary way they deal with this complexity is to comparison shop two or more dealers of the same line make in search of their best value proposition. When I'm asked about alternative go-to-market strategies, I begin with determining how to best provide consumers a competitive environment in which to shop, and convenient access.

Technology is causing unprecedented changes in how we shop today. But it is important to remember that the new car purchase process is complex. As changes to the new vehicle buying process are contemplated, an overriding consideration should be providing a level playing field for all competitors, unlike the situation I previously described, when new brands came to the US. What is good for one competitor should be available to all. Otherwise beware of unintended consequences.

JAMES FROST: Thank you, Jim. Joe?

JOSEPH ROESNER: Yes. I'd like to thank the FTC and Chairwoman Ramirez for inviting me to speak today. I personally have been at the Fontana Group working auto industry for over 25 years. My work has in large part involved dealership network analysis—in which I specifically look at relevant market areas and registration and sales performance given national and local market and economic conditions. I can say without hesitation that the state franchise laws as they are implemented today create a process to review and gauge the reasonableness of the manufacturer-dealer provisions in the franchise contracts, and focus on consumer impact and the public good.

First off, as noted by Aaron, it's key to note that these laws do not prohibit the termination or the addition of dealerships. That's a false premise. They simply provide a framework to review actions so that manufacturers don't act opportunistically, or without good cause, when adding a dealership, or taking the drastic step of shuttering a dealership. These laws help ensure that the manufacturer takes the time and makes the effort to adequately analyze and assess the need to terminate or add representation in the market.

To Carl's point, I think the manufacturers do look long and hard at terminations and additional points. But I think in part that is due to the laws that exist, that an independent finder of fact, that analysis may not actually occur. These laws simply allow for the protest right to be heard before an independent finder of fact. They lay out the criteria for a decision to be made based upon the reasonableness of the action, and whether or not good cause exists for the action.

So why is this important? Dealer manufacturer relationship in the auto business is truly unique. Auto retail is extraordinarily capital-intensive. Buildings, inventory, signage, billions of dollars in real estate. And unlike other franchise businesses, auto dealers can only purchase from one manufacturer. They can't go elsewhere to purchase vehicles.

Why are these provisions needed? They require manufacturers to do the in-depth analyses when considering shuttering a dealership. Franchise laws require them to present data in front of a neutral party.

I would invite any of you to read the take-it-or-leave-it contracts between manufacturers and dealers. In termination cases, heard before a neutral finder of fact pursuant to the franchise laws, the criteria typically central to the decision is whether the franchisee has complied with the reasonable requirements of the contract. Without the neutral finder of fact to determine reasonableness, the sales and service agreement, if so desired, could be forced as written.

Let me give you an example. Manufacturer sales and service agreements will typically call for dealership to have sales of at least at or above what would be expected at an average market share, calculated against some benchmark as nation, region, or—currently most commonly—state. Because this is an average, at any given time approximately 50% of dealerships will be above such average, and approximately 50% below such average.

In a contractual provision that by definition results in half of the contracting parties, no matter how strong their absolute performance, always to be a material breach, reasonable? Any given moment, there are provisions that approximately half of the dealer body are not meeting—and that's not an exaggeration. Literally impossible for the entire dealer body to be performing adequately at any point in time given those provisions.

You may ask, why would a dealer sign a contract like this? And as pointed out by Aaron, that's a great question. And the reason is antitrust. Sensible dealers would simply band together and negotiate their contracts with manufacturers. I think we could all agree that this would solve many of the problems.

But this is specifically prohibited by antitrust laws. Even the largest automotive retailing companies don't have the bargaining power vis-a-vis the manufacturers. Manufacturers work intentionally to make sure no dealer group has that kind of bargaining power. Through framework agreements, manufacturers specifically limit dealer companies' market power.

Bottom line, this is an issue that's far more complex than at first blush. As long as this imbalance exists between dealers and manufacturers, because of antitrust you have to create some balancing provision to create a level playing field, manufacturers and retailers.

A provision requiring all dealerships to be at or above average is problematic for other reasons as well. Analysis is needed to take into account differences between the benchmark and local market being analyzed. These differences can include the appropriateness of the assigned area of responsibility, demographic characteristics, relative number and mix of dealerships, competitive dealerships, commute patterns of consumers, relative popularity of leases, manufacturer incentive programs, manufacturer share of advertising voice relative to other manufacturers, allocation of vehicles provided to the dealership relative to other dealerships. And the list goes on and on.

So in the absence of the ability of the dealers to get together and negotiate with their manufactures, what do the franchise laws do in this instance? They provide that an independent, unbiased finder of fact weighs the various factors that can influence a dealership's sales relative to the manufacturer requirements, and based on that makes a decision of whether or not there's good cause to terminate a dealership agreement.

Similarly, in additional point—or add point cases—the criteria typically central to decision by the independent finder of fact is whether or not action is good for the public welfare. And this analysis of the need for additional points or relocation, manufacturers and/or their analysts typically will measure the market performance against the highest of a national, regional, state, or local standard.

In one of the more egregious cases I've seen, the market of the dealership involved was performing above both nation and the regional averages. It was among the highest performing in the state for the brand. In light of this, the manufacturer argued that the appropriate benchmark should be the market itself, that the market was experiencing lost opportunity, because every census tract in that market did not have market share equal to the market as a whole.

Well that case has not yet been decided by the independent finder of fact allowed for the statute. It is illustrative of the need for independent review. In the relationship between manufacturers and dealers, the manufacturer sets the facility guidelines, the size of facility commensurate with the market, the use of facilities, the amount of training. Many manufacturers control this compliance by tying incentive payments to having correct facilities and investment in place.

Because of the uniqueness and the intensity of capital, and the cost of that investment, the facilities required in the auto industry can run into billions of dollars in the case of the public companies. Therefore, by providing stability and hindering arbitrary manufacturer behavior, the franchise laws lower the cost of capital in the auto retailing market.

Because of the highly competitive nature the market, those savings are passed along to the ultimate consumer, buyers of vehicles, in the form of additional investment or lower cost. Evidence of this is in the risk factors sections of the SEC filings of publicly traded companies. It is recognized that the existence of these statutes result in lowering of risk, which therefore adds additional stability to the market. Creating stability is indeed in the public good. I can't imagine anyone would not agree with that. Thank you.

JAMES FROST: Thank you, Joe. Henry?

HENRY SCHNEIDER: Can you pass the clicker down?

OK. Thanks for having me on this panel. I'm Henry Schneider. I'm an economics professor at Cornell University. I'm going to provide what I'm hoping is an outsider's perspective as an economist on these issues. And so I'm just going to start by saying that I think dealers have some legitimate concerns. But generally speaking, the state regulations are generally a bit restrictive from an economist's perspective on this industry. So that's going to be my general tone.

So as I mentioned, dealers do have some legitimate concerns in this industry, in the sense that they're making large investments in their businesses in terms of facilities and training and advertising and branding, and all these kinds of things. And one of the aspects of these investments is that these investments have value primarily in their relationship with a car manufacturer. So the car manufacturer wants to terminate a franchise, or add another franchise nearby, or something of that nature, that investment is not easily repurposed, and loses a lot of its value. So this is something that is obviously a concern for anybody making an investment of that nature. And dealers certainly would be in that category.

So having said that, it's not clear to me why, as taking a sort of an outsider's perspective, why long-term contracts can't more or less address this issue, as it does in many other types of industries. That's not to say that exclusive territories should be ruled out in any way. But that kind of thing can be included in contracts.

In addition to that, you have a reputational concerns, especially on the part of car makers. And if they were to act opportunistically in too aggressive of a manner, that's going to make it hard, obviously, for car makers to attract new dealers, new folks to come and invest in their network. It's going to make it hard to convince existing incumbent dealers to continue to invest in their network. And so there are reputational concerns that should discipline car makers from acting too aggressively. So that's, I think, how I would see things from my viewpoint.

The costs of these state regulations, I think, can be large in some cases. Sometimes they're relatively benign. But sometimes there are issues. And I'm going to talk through some of these costs.

So first, there's the most obvious point is there's been huge changes in this industry, as one or two panelists have already mentioned. The top two lines is the market shares of GM and Ford. And we can see that over the last couple of generations there's been a precipitous decline in their market share as imports have come in and taken a healthy fraction of this industry.

The regulations essentially add sand to the gears, and slow down the process, and make it more expensive. And as a consequence, dealer networks have been slow to adjust. And you can see this is a map of the Pittsburgh area. The white dots are GM dealerships as of the last few years. The black dots are Toyota dealerships. And you can see that even though GM and Toyota at this point have market shares in the US that are relatively similar, there are way more GM dealerships than Toyota dealerships.

And I think the way that I would think about this is you can look at how the imports have come into this country, and set up the dealer networks, is how a new franchisor, car franchisor, would come into the market and set it up in what they perceive as a semi-efficient way to distribute their product. And you can see that generally speaking there are far fewer points of sale. And different choices of locations as well.

So one of the costs of having more points of sale for at least some car manufacturers and dealers is it makes it hard, for example, to reach economies of scale. Some networks would benefit from some consolidation, as has slowly been happening in this industry. Larger dealers allow more variety or choice of cars on the lots. There are all kinds of savings that you can get from being larger in terms of back office costs, financing terms, and so on. It's a complicated issue how large you want your dealer to be in terms of market power versus scale. But generally having more flexibility, I think, would be beneficial.

Here's another example, maybe a more extreme example. If you look at the luxury segment, you can see the first bar in these two graphs is Cadillac. And you can see on the left – yes—your left, Cadillac has almost 1,000 points of sale compared to the other luxury makes, which have 200 to 300 points of sale.

And the consequence is that Cadillac sells on the order of 200 new cars per franchise on average, whereas the other may sell 600, 700, 800, even over 1,000 new cars per franchise. And there are certain economies of scale and cost savings that result from a larger scale. Presumably those costs are passed on to some degree to consumers.

One of the other consequences of these regulations is obviously they protect dealers, and they give dealers a bit of market power. And the consequence of having market power, as an economist you would say the prices are too high. If prices are high, then fewer car sales occur. This is not in the interest of consumers, not in the interest of car makers to some degree.

Now you might point to profits per new cars is on the order of $1,000 dollars, $1,200 on average. And you might say that's a fairly small number. But in fact, a new car sale tends to bring in a trade-in, and that used cars sold at new car dealers tend to be a profitable business. Each new car sale also brings in a lot of repair work, either under warranty or off warranty, which again is quite profitable. And generally speaking, dealerships are a very nice investment in terms of return on investment, or return on assets. And I think that's a testament or an indication of having some market or monopoly power in their local area.

This is not to say that exclusive territories or things of that nature are necessarily bad. It's just that the regulations sort of entrenched these practices, and don't give enough flexibility, in my view.

So there is evidence exclusive territories do give some benefits, especially to new types of new firms, and new types of franchisors to help them get off the ground. But often, these franchisors have a history that they tend to phase out these protections over time, as the firm just gets more established. And this has not happened in car making.

I think this is my last slide.

The other argument that's sometimes given, and I think we've heard it on this panel, is that car makers and dealers play a very important role in the economy—especially local communities. They represent $700 billion in annual sales. New car dealers are a large fraction of state sales tax revenue and retail employment. And so therefore they deserve some kind of special protection.

But again, from as an outsider's economist perspective, my feeling would be that if you want to subsidize or protect local communities or economies, there are much more efficient ways to do that than to effectively have a subsidy paid by car makers, or especially car shoppers, and filtered through car dealerships. It's not a particularly efficient or fair approach to protecting communities and economies. So that's what I think is an outsider economist perspective. Thank you.

JAMES FROST: Thank you, Henry. Reminder—if anyone has questions, we'll be collecting those. Just pass your cards to the aisle. I'll get started on the question and answer session here.

I guess given that the FTC is interested ultimately in the impact of all these laws on consumers, I actually think I'd like to go down the panel and get everyone's view as to what the impact of the current regulatory structure is on US consumers, as opposed to on manufacturers or dealers. Carl, if you just want to start with that.

CARL CHIAPPA: Sure. I think from my point of view, any type of comprehensive regulation of this sort interferes with freedom of contract, that causes what Joe would call stability but I would call the incessant preservation or attempted preservation of the status quo, is ultimately not going to be great for consumers. The truth of the matter is it goes back to my point about the words on a page, as opposed to what happens in practice. Because manufacturers are in very different stages of their evolutions, but they're all subject to these same statutes.

The fact of the matter is we simply cannot respond to the marketplace the way we would like to. I think population shifts become very, very difficult to respond. If you take a state like New Jersey, New Jersey's add point provision has a protected area of 14 miles. New Jersey is, I believe, the most densely populated state of the United States. 14 miles is a lot.

In Texas, where the add point statute covers an entire county—it covers something like Harris County—we see add point protests from dealers who are 25 and 35 miles away from the add point. Well, we already know that that's further than consumers will actually travel, typically, to have their cars serviced.

So I think that we have the problem that these statutes don't create stability so much as inflexibility. And the two things can look alike, but they are very, very different in practice.

I think, moreover, we're in the situation that Jim talked about, where the buying process for America has always been an issue. Because we are not a country that culturally engages in a lot of bargaining. When we bargain even for a house, we use intermediaries. One of the reasons I think people find the process of bargaining for a car so difficult is in part because it's so unfamiliar to us. Well if it's been unfamiliar up until now, it's going to be more unfamiliar in the future to millennials, who are used to buying everything online.

The other thing is the innovation of the products. What are we going to do, for example, with the ability to remotely service cars? I think again the statutes—it's a template that makes it very difficult for the manufacturers to address the issue of what do we do in the future, when in fact we can beam a solution to a problem for a car wirelessly. Which means it doesn't have to go to the dealer, the customer doesn't have to spend the time to do it. But the truth is, it does have a negative effect on the dealers. So I think overall that's the issue.

JAMES FROST: Thank you, Carl. Aaron.

CARL CHIAPA: See? But the clock didn't go down. It was the special law of productivity.

AARON JACOBY: We need someone with a cane to yank. Those were good and interesting points. With regard to the effect on consumers, and also responding to a couple of things that Carl just said, I think the evidence is that the right amount of competition for intra-brand competition within a market area is good, keeps prices down, dealers compete against each other, et cetera.

But the preservation that everybody is talking about—and by the way it is preservation. It's not exclusive. So that's just a wrong premise. But the preservation that Carl is mentioning is to ensure that the distribution channel remains sufficient to service recalls, for example. We need sufficient dealers to service that, but not so many that it causes dealers to struggle within a given market area, because that can put one or both dealers in that market area out of business.

Addressing the point about slow reaction time to market shift—I know that my kids tease me if I react slower than five seconds to just about anything. They're probably text messaging me right now and wondering why I haven't bought them something. But in any event, we're adults, and we can deal with oversight.

An example of oversight that slows things down but might be necessary, the FTC reviews virtually every major transaction in the United States through a Hart-Scott-Rodino filing. Do we want that to go away? Do we want to have unfettered access to closing deals that might be anti-competitive? Or do we want to allow some period of time for the FTC to review it?

Well we're adults. We can be patient. These are not excessive proceedings. And if Carl's involved, he will ramrod a hearing through in six months. I can assure you of that. So slowing a deal down is not a reason, or slowing a market action down is not a reason to eliminate something.

I think the last thing that you mentioned is about innovation, which I suppose is related to market shift. The innovations that are happening in the industry—internet sales, direct sales, just as examples—autonomous vehicles—those are things that are not truly covered by a lot of the existing regulations. And everybody in the marketplace—regulators, lawyers, et cetera are trying to figure out how those should be applied.

I don't think any of us want autonomous vehicles, direct sales, et cetera to be totally unregulated. And we don't want them to be so over-regulated that we can't budge in the marketplace. But the right amount of regulation is probably right. California's trying to figure that out with autonomous vehicles. Whether they got it right or not is a different matter, but a month or so ago they came out with regulations. The Federal Transportation Agency is saying it's going to come out with federal regulations on the topic.

Will we be over-regulating? I don't know. But some regulation is necessary to make sure that it's safe, et cetera.

The direct sales issue. There's an issue of service and recalls. If there are only a handful of dealerships throughout a country as large as the United States, what will we do if there is a recall? How will we cause that to happen? If we go above 30,000 or 40,000 vehicles a year for Tesla, for example, and let's say they're doing 300,000 vehicles a year, how would we handle a recall that occurs?

And I understand that they would say, and Carl might say, well, we'll download the recall. And they'll hit an app on their car, and it will be downloaded. Not all recalls are related to electronics. Some are related to the physical components of the vehicle, whether that's steering or brakes, et cetera. And so that would be my response to both the consumer issues and Carl's issues.

JAMES FROST: Jim.

JIM ANDERSON: I would say in general the impact of the laws on consumers is in a marketplace that is dramatically changing, which I've described in many ways today. If the manufacturer is not allowed to respond in a timely manner, that means that there'll be less competition, or less selection in the marketplace, meaning less convenience.

In general, I see these laws taking one to two years, sometimes three years, to hear a full case from beginning to final conclusion. And in markets with 10 or 20 dealers to the same line make that are rapidly growing or rapidly declining in population count or customer count, that means you'd never catch up.

In addition, beyond the changing, increasing or decreasing, size of the market—and this is in response somewhat to what Joe has said as well—I've not ever seen a dealer that's, let's say, in rank 49 out of 100 be up for termination. I've never seen that. I can't recall ever seeing a dealer up for termination that wasn't in the bottom 5%, or bottom 2%, or bottom 1% of the whole state. And most often than not it's the lowest one in the state.

Just like in college, if your honor point average drops below a C average, below a 2.0, you get some friendly notices from the dean saying you're on probation. You have a problem. You must improve, or we won't allow you to graduate. I think manufacturers do the right thing when they advise their dealers that they're either above average or below average, and the degree to which they're below average and the rank they hold in that state, so that they understand whether or not they are doing a good job from the consumer point of view, and whether or not they need to improve, and whether or not they need to worry about whether they have long-term viability. I think that's a good thing. But by no means are terminations of dealers a common thing in the marketplace.

JAMES FROST: Joe?

JOSEPH ROESNER: I agree with Jim. They're not a common thing in the marketplace. And it typically is the bottom dealers. But I think that the state statutes are working to that in that regard. And in other words, they do give an independent process to look at those. And I think it helps for reasonable actions to be more likely to be brought.

In regards to the effect of these laws on consumers, look at the auto industry today. We're at all-time highs as far as the amount of new vehicles being sold. It's not a bad system. It's working well. The gross profit that dealerships realized on new vehicle sales has shrunk tremendously. From 1998, I think it was about 6 1/2%, and it's down to less than 3 1/2% on the front end of the deal.

It's not like, as Mr. Schneider here, or Dr. Schneider, is not a monopolistic situation at all. In today's world, the consumer can get on the internet, and from numerous different sources research exactly the price that is being charged by the manufacturer to the dealer, and the incentives that are out there. It's a very competitive world right now.

Now in regards to the used vehicles—because Dr. Schneider made the point that there's still a lot of profit in used vehicles—well, why is that? I mean the consumer wants a place to get rid of his or her vehicle.

There are a lot of other options out there. I mean, you can sell it on Craigslist. There are numerous places. The consumer, if they wanted to, could sell their vehicle.

But the dealers today provide a means to trade in that vehicle. If the consumers are choosing that, there's obviously a value being represented there to them. The dealers are making money, but a lot of those vehicles are wholesaled or gotten rid of. It is an outlet to get rid of those used vehicles. And I would say that the dealers right now are doing their jobs, and providing a very good service to the public in the system as it is now.

It is a good time to be a dealer. The dealers are making in general good money right now. But remember back in 2009. And remember the tough times.

Dealers are required to make investment in their dealerships, and willing to make investments in their dealerships. In a Toyota dealership in my town, you can get coffee, and lunch, and a big espresso—however many different types of cream you want in it, and flavoring. Well do we need that? No. But it obviously represents a value.

Would that dealership be willing to invest without some type of independent finder of fact looking at it? You could put another dealership in at any time. Probably not. So the consumers are being well served by the laws as they exist now. Thank you.

JAMES FROST: Henry?

HENRY SCHNEIDER: OK. So let me touch on just a couple points. So my point about market power, or monopoly power. I don't mean to imply that dealers have some kind of strong monopoly in, say, a Microsoft sense, or something along those lines. My view is if you look at the return on assets or investments, dealers generally do very well. And whether you look at the margins of individual business units within a dealership, some are more profitable, some are less profitable. But the fact that the overall profits of a dealer tend to be pretty good basically can mean nothing other than that there is at least some market power. If there were intense competition at the dealer level—either intra-brand or inter-brand—you would see tighter margins and so on.

And I'm not arguing that a dealer should make no profits. Certainly comfortable profits in order for dealers to be able to make investments in their properties and so on would be in everybody's interest for sure.

On the issue of the effect on consumers, I think, as an economist, I would think about this as you have an industry. There are three parties in this industry. You have the car maker, the dealers, and consumers. And you have a certain amount of surplus, or you might think of that as profits, to go around between these three parties. And it's a question for regulators or society through voting and so on to figure out how do you want to divide up those profits between those three parties.

And these regulations, especially state regulations—I don't want to argue this too strongly—but to some degree protect the investments and the profits of the dealer networks. And so it tilts the balance a little bit toward dealers.

And it's a question of is that the priority? Do you want to protect those investments? Do you want to give dealers equal bargaining power with manufacturers? Is that something that regulators should be in the business of?

And so that's sort of I think a key question. How do you want to weight the interests of those three parties? And right now, there's a certain weight being placed on dealers. And that's my point. Thank you.

PATRICK ROACH: Can I be heard? There we go. Good. I've got a pile question cards here. Here's some of them I think touch on some things that have been talked about before. But here is something that perhaps takes the discussion in a new direction. And let me restate it a little bit and direct it to everyone.

It says, "The boards hearing these disputes are governed by dealers in many cases who protect other dealers." This is the view of the questioner. "Shouldn't the boards not be comprised of dealer participants? How is that objective?"

JAMES FROST: Let's go with Carl. But let's go for a minute each on this one.

CARL CHIAPPA: The fact of the matter is that dealers are a very big presence on many of the boards, if not at the actual level of a hearing, then at the level in which the hearing officer's recommendation goes up. And the fact of the matter is that I do think it's somewhat problematic, because it's the rare case in which two classes of litigants with at least somewhat divergent interests have one class of the litigants deciding the cases, or at least reviewing the cases. And obviously if we start with statutes which are protective of dealers, to have them then reviewed and enforced and interpreted either immediately or intermediately by one of the classes of litigants is obviously, from the point of view of the OEMs, is quite problematic.

JAMES FROST: Aaron, you share that view?

AARON JACOBY: I do not.

CARL CHIAPPA: I'm shocked.

JAMES FROST: Well, tell us why.

AARON JACOBY: It is certainly true that dealers are on boards. In some states, the dealers are not allowed to participate in boards that are considered dealer actions. California would be one of those. But they are on boards.

I think it's relatively common for boards of sub-agencies to include industry players. So I don't think that's uncommon. The governor of a particular state often appoints these members of the board. So they've somehow proven themselves, hopefully not solely by other means.

But let's not ignore the role that the process plays. The board does not directly hear these disputes. There's a judicial process with an administrative law judge that hears the matter, and issues findings of fact and conclusions of law after well-reasoned arguments, evidence, witnesses by both sides.

JAMES FROST: Aaron, is that true in all cases? Or is there a lot of diversity across states?

AARON JACOBY: There's some diversity across states. There are some states that have a court proceeding. Most states would have an administrative proceeding. So the administrative law judge comes up with findings of fact, conclusions of law, presents those to the board. And the board then accepts or rejects that decision.

There's also an appellate process that follows that. You can do a writ of administrative mandate to a court in your state. And then it goes through the whole court system as well. So there's a lot of oversight over the overseeing committee.

Another piece is, let's look at the—I don't have statistics with me. But I think on this stage we could agree that as a practical matter, manufacturers win most of these contested proceedings most of the time. And typically a point is allowed. Typically a relocation is allowed.

And terminations are probably the most difficult for manufacturers. But when they are looking at the weakest dealers, even those are allowed—when it's the type of dealer that Jim was referring to earlier—the weakest one or two in a given zone. So I do not agree that having dealers or industry players be part of a commission or board is any sort of negative.

JAMES FROST: Jim, your view?

JIM ANDERSON: I guess I look at it the other way. I think to avoid all possibility of conflict of interest, we as professionals also frequently have to decline the opportunity to participate in some sorts of events. And I think these hearings are important. There are a lot of important things on the table—the dealership, the success of the manufacturer, but most importantly the consumers being taken care of, or not being taken care of in the marketplace. And so to avoid all conflicts of interest, I would say anyone directly involved in the problem should not be part of the decision-making process.

JAMES FROST: OK. Joe?

JOSEPH ROESNER: I can tell you that I think it's rare that the boards consist of dealers. It's normally between some finder of fact, administrator law judge, or sometimes in the court system.

But in the cases that I have been involved in, the few that were before primarily dealer boards, I think the dealers took it very seriously. And there was legal counsel for the state in the room. And the two that I can think of, they allowed an additional point, and allowed a relocation.

So I don't think that they are in any way, shape, or form—or the majority, and that's what makes the decision—they take it very seriously, and look at all aspects of the law, and judge it just like any other finder of fact would. I can see how Jim and Carl might think that there be some bias there. But that hadn't been my experience. And it is rare that these are heard before boards consisting of dealers.

JAMES FROST: Henry, anything to add?

HENRY SCHNEIDER: I just have a very quick comment. My background doesn't let me just speak to this very much. But anything that would allow too much influence by dealer networks wouldn't necessarily be good. But I don’t know enough to say whether this is too much influence.

JAMES FROST: All right. We are almost out of time. I'm going to ask one more question out of, I don't know, the 30 that I have to do.

More and more dealerships are being acquired by these large companies. People are saying that therefore Berkshire Hathaway can take care of itself. So is the trend of public ownership, of dealership networks, mean anything to the continuing importance or viability of these laws? Or is that issue not something that we need to be thinking about? Again, let's do 30 seconds on that one. Carl.

CARL CHIAPPA: Well I suppose that if we look back on the rationale of the statutes, that in effect there was an unequal bargaining power, unequal playing field, Warren Buffett is a different player than a mom and pop store from the 1950s. Now obviously there'll be the response that this is one source of a product. But if you're Warren Buffett, I suppose you could just buy the source.

JAMES FROST: Aaron.

AARON JACOBY: I don't think that it makes much difference with regard to these regulations. And to the extent that we're simply looking at increased market power based on either Berkshire Hathaway, or AutoNation, or companies of that type, the statistics—I actually printed something on that, because I thought this question might come up—they control very little of the market.

First of all, I just want to say they do not control the market in any sense. But in terms of number at dealerships under their ownership, we have 1,060. And that's out of 31,266 points of representation. There are only 16,400 or so dealers, but they represent points of sale in that number—31,266. 1,000 of those are owned by public companies. It's a drop in the bucket.

JAMES FROST: Jim?

JIM ANDERSON: I think the percentage is relatively small. I have a statistic that had 7% or so, or 9%, of the dealerships being in that category. But in any event, I think it all depends on how they're operated.

I know how some of these organizations that we've talked about have been operated. And some are very well, and some are more focused on Wall Street and their stock price. So long as the consumer is the one that's in front of the line in who they are trying to serve, I haven't seen a big negative impact from public ownership.

JOSEPH ROESNER: I would agree with Jim. As his slide showed, it's a small percentage—7% to 9%. I think that as I pointed out, these public companies recognize as a risk factor that the repeal of these statutes would affect them as well. And having those statutes in there helps lower their cost of capital, and is good for the consumer in that regard.

The benefit maybe is versus a mom and pop, where the only source of income is that one store, there's some diversity of risk, because each of the stores is part of an overall organization. But still, the strength in that relationship is with the manufacturer.

JAMES FROST: Last word, Henry.

HENRY SCHNEIDER: Yeah. So I think the consolidation, the public companies, the larger dealers clearly are going to have a better ability to invest, to handle risk, to negotiate with manufacturers in a more sophisticated way. So basically, they seem better able to handle themselves compared to the small mom and pops or other smaller dealers.

JAMES FROST: All right. We are unfortunately out of time. We could easily spend all day just on this topic. But I want to thank all of you, and thank you for coming. We're going to take a 15-minute break. We will be back here at 11:15. Thank you.

[APPLAUSE]

[SHORT BREAK]