Auto Distribution: Current Issues and Future Trends
Workshop hosted by the Federal Trade Commission
January 19, 2016
Part 2 of 4
Full Transcript available on workshop webpage: https://www.ftc.gov/news-events/events-calendar/2016/01/auto-distribution-current-issues-future-trends

PANEL 2: WARRANTY REIMBURSEMENT REGULATION

Panelists:

- **James Appleton, President, New Jersey Coalition of Automotive Retailers**
- **Daniel L. Goldberg, Partner, Morgan, Lewis & Bockius LLP**
- **David Sappington, Eminent Scholar in the Department of Economics, University of Florida**
- **Richard Sox, Partner, Bass Sox Mercer**

Moderators:

- **Nathan Wilson, Economist, Bureau of Economics, Federal Trade Commission**
- **James Frost, Attorney, Bureau of Competition, Federal Trade Commission**

NATHAN WILSON: Good morning. My name is Nathan Wilson, and I'm a staff economist here at the FTC. Along with my colleague James Frost, an attorney in our Office of Policy and Coordination, I will be moderating today's panel on warranty reimbursement regulation. To briefly introduce this topic, all automobile manufacturers offer warranties to consumers when they buy a new car or truck. The states have historically regulated how repairs provided—excuse me, covered by these warranties are provided. Many states' laws allow only new car dealers themselves to perform warranty repairs.

Some states also regulate how the dealers are reimbursed for the warranty service they provide. In some cases, the state warranty reimbursement laws require that the reimbursement rate for service reflect the rates that the dealers charge to their retail, i.e. non warranty consumers. Historically, this has been especially common for the labor component of charges. Starting about a decade ago, however, many states enacted new laws requiring manufacturers to also reimburse their dealers for parts at the retail rates. Where such retail reimbursement laws are in force, dealers have the option, but not the obligation, to submit evidence of pricing for their non-warranty work, in order to set the warranty reimbursement rates. A number of the retail reimbursement states have also regulated whether manufacturers may attempt to recover some of the higher costs induced by the retail rate regulation.

Similarly, many states impose time limits on when manufacturers may audit their dealers warranty service logs, or challenge submitted warranty claims. Just as with our last panel, our interest today is in whether or not such direct regulation ultimately is in the interest of U.S. consumers. This is a question about which there is considerable difference of opinion within the industry, and these differences are very well reflected in the diverse views of our distinguished group of panelists. They are Jim Appleton, the President of the New Jersey Coalition of Automotive Retailers. Jim is also the immediate past chairman of the Automotive Trade Association Executives. New Jersey has been among the most active states in changing their warranty reimbursement laws, and Jim is deeply steeped in the background of these policies.

Richard Sox is a partner at the law firm of Bass, Sox & Mercer, which focuses on the representation of motor vehicle dealers. He has considerable litigation experience in these areas.

Daniel Goldberg is a partner at Morgan, Lewis & Bockius LLP, and is a fellow in the American College of Trial Lawyers. He, too, has considerable experience in writing about and litigating issues related to auto distribution.

Finally, Dr. David Sappington is an eminent scholar in the Department of Economics, as well as director of the Robert F. Lanzillotti Public Policy Research Center at the University of Florida. Doctor Sappington recently prepared an expert report on behalf of manufacturers in a recent action challenging the constitutionality of some of these reimbursement laws, a case in which both Richard and Dan were also active participants. To begin our discussion today, each of our panelists will give a brief presentation of their views, after which, we will turn to a question and answer period. For this, we very much invite questions from the audience. Jim?

JAMES APPLETON: Thank you. So why do almost all states in the U.S. regulate warranty reimbursement? Well, there are two reasons. The first should strike a familiar chord here at the FTC. Federal antitrust law prevents dealers from engaging in collective bargaining with automakers, so dealers and manufacturers must negotiate out in the open where decisions that affect the public and consumer interest are made by democratically elected state representatives, and that's a good thing. The second reason, without state franchise laws, dealers and consumers would be at the mercy of powerful automakers. And no business person in their right mind would ever invest the millions it takes to open a new car dealership.

Public policy in 50 states is designed, not to protect dealers, but to foster investment in the franchise system of neighborhood new car dealerships, because this system promotes competition between and among brands. And not just for new and used car sales, but also for vehicle financing, customer paid service, and even for manufacture paid warranty repairs. Consumers benefit from this competition. Better hours of operation, pleasant customer waiting areas, courtesy transportation, and, of course, cost. Even the dealers' well-documented, charitable, and civic involvement is driven by competition for sales and service, regardless of whether it's customer paid, or warranty work paid by the manufacturer.

That's why the courts and elected legislatures have consistently recognized that the extensive network of 17,000 franchised new car dealers all across the U.S. serves the public interest, promotes competition, and gives consumers ready access to warranty service from skilled technicians working out of properly equipped, conveniently located service facilities. The fact that these dealerships are independently owned, and that the dealers must be paid fairly, ensures that consumers will be treated fairly.

Understand this very important point. When automakers see warranty, they see expense. And experience tells us they will try to reduce that expense by shifting costs to consumers or to dealers. But when a new car dealer sees warranty, they see revenue, and, therefore, an opportunity to serve, to act as an advocate, to ensure their customer gets the full value of the warranty they've already paid for. Now let's talk about how the warranty business works, in the real world.

Study a dealership financial statement. You'll see that dealers make nothing, or often lose money on new car sales. They make two to 3% on used, 6% on parts, and maybe 8% on service. Examine every dollar that comes through the parts department at a dealership, for example, and here's what you'll find. $0.66 goes right back out the door to the manufacturer to pay for parts and the cost of goods sold. $0.16 goes to personnel expenses, $0.05 goes to variable expenses, $0.07 goes to fixed expenses, and that leaves just $0.06 as net profit before taxes in the dealer. Manufacturers mandate facilities, special tools, equipment, and training to carry out warranty repairs, which cost a lot of money, but that investment benefits consumers because neighborhood new car dealers are standing by to fulfill the warranty promises made by manufacturers, promises that the consumers have already paid for.

So when manufacturers don't pay retail on warranty parts—or warranty repairs to the dealers—they're not just cheating the dealers, they're cheating the consumers too. We surveyed New Jersey GM dealers and found that about 35% of all repairs are warranty. That is free to the customer and paid by the manufacturer. So when GM underpays their dealers on 35% of their parts and service work, the dealers take a loss where they must shift costs to the remaining 65% customer pay jobs. By unilaterally mandating a discount, manufacturers place a financial burden on dealers that inevitably results in losses for the dealer, or higher prices for everyone else.

So how did the reimbursement methodology used in many states to calculate retail come about in the first place? State laws requiring automakers to pay retail on warranty date back to 1977 in New Jersey, but it wasn't until 1991 that Bob and Elaine Robertazzi, the courageous mom and pop owners of Liberty Lincoln in Clifton, New Jersey, challenged Ford Motor Company and eventually proved the powerful automaker was underpaying dealers and shifting cost to consumers in what federal district court Judge Maryanne Trump Barry called a shell game. Still, dealers were frustrated. Automakers continued to devise burdensome reimbursement procedures in order to thwart dealer demands for fair compensation. And by the late 1990s and early 2000s, many legislatures were fed up too. They arrived at this hundred consecutive repair orders methodology, mostly out of frustration with automakers, who were quick to say what retail wasn't, but never offered a reasonable formula to meet their obligations under the law. So here we are, almost 40 years later, retail reimbursement laws were first enacted in 20 years since the courts, and many state legislatures started to try to force compliance. And the sad truth is that automakers continue to game the system because they know that every penny saved on the warranty, is a penny earned at the expense of consumers and car dealers.

Let's look at two common strategies the automakers use today to shift cost. Surcharges and manipulation of parts pricing and labor times. It's interesting. Thirty-seven states accounting for about 75% of all US auto sales require manufacturers to pay retail, but the manufacturers don't bake that price into the cost of the car. Instead, they up the surcharge dealers only in the states where they actually are forced to comply with the law, effectively charging consumers twice for warranty.

In New Jersey, GM agreed to pay dealers retail, but then turned around and imposed a surcharge on dealer invoice—a GM imposed charge intended to compensate them for what they say is their additional cost of doing business. We estimate GM collected $6.5 million in surcharges in New Jersey in 2014, and paid out just $3.2 million for reimbursement in excess of the 60% mark-up they themselves acknowledge is retail. In other words, GM collected $3.3 million more in surcharge money from dealers and consumers than they paid out. So GM made $3.3 million on their increased cost of doing business in New Jersey. You know, nobody ever asked how much does a manufacturer mark-up the cost of parts or a new car, but everyone knows exactly how much a dealer does.

The retail end of the business is completely transparent, while the wholesale end of the business is cloaked in secrecy. Here's another example of manufacturers' self-dealing and price manipulation. A replacement fuel tank at a North Jersey Ford dealership lists for $3,400 and it costs $315 to install. A total of just over $3,700, but that's when the customer is paying for the job. But in October of 2014, Ford announced a recall of 205,000 '07 and '08 Ford Edge and Lincoln MKX vehicles with defective fuel tanks. Now, all of a sudden, since the manufacturer is paying for the repair, the cost of the part drops to less than $1,200, and labor time is slashed to $250.

With just a few keystrokes, Ford reduced dealer compensation and helped itself to a generous discount of more than $2,200 on each repair. That's a discount that was worth $460 million, almost a half a billion dollars. Their defect, their mistake, but dealers and consumers pay. This is a powerful example that really illustrates the public policy concerns at play here.

Let me wrap up by simply saying the conflict between dealers and manufacturers plays out at the state houses all across the U.S., not because dealers want it that way, but because antitrust laws prevent dealers from engaging in collective bargaining with automakers and because the public and consumer interests are best served by having these policy debates in public, and decided by democratically elected state representatives. It's not really important what manufacturers earn or even how they chisel the dealers. What's important, though, is that the FTC understand this conflict and recognize that the agency is being used. That the automakers efforts to unravel state franchise laws, and avoid fair payment to dealers, won't benefit consumers, just enrich manufacturers. That's unfair to dealers, it's unfair to consumers, and it undermines the public interest in competition and highway safety.

NATHAN WILSON: Thanks very much. Rich?

RICHARD SOX: Thank you, Nathan. I'd like to thank the FTC for inviting me to appear on this panel. As my introduction said, we've got a lot of experience in this area. And our experience tells us that the basis for the dealer's pursuit of warranty reimbursement rates equal to market driven retail prices, was that overhead cost for dealers were continuing to increase over time, while the manufacturers were suppressing the warranty reimbursement rates.

For over 40 years, all of the major manufacturers—and that's an important point, all of them—had unilaterally determined that the parts mark-up to the dealer should be capped at 40% and were unilaterally dictating hourly rates to be paid to dealers. Dealers told us, in many cases, it appeared that same brand dealers, within the same market, had been approved for widely varying hourly labor rates for performing the same warranty work.

Yet, over time, these very same manufacturers were placing increased demands on the dealers to expand their dealership facilities, as Commissioner Ramirez has referenced earlier, to exclusively represent a single brand at great cost. These facilities were required to be larger than ever, and be built with very expensive materials. Engineering, construction, and architectural costs skyrocketed for the dealers. The bottom line is that dealers were being required to incur exponentially higher overhead costs, and yet those warranty reimbursement rates were remaining the same.

In addition to the substantially more expensive facilities being required by manufacturers, due to the increasing sophistication of the vehicles themselves, dealers were now required to purchase special tools and diagnostic equipment that, in some cases, cost as much as $25,000 per unit, per service stall to properly repair a vehicle. It cost a dealer, on average, $30,000 to send a technician to be trained and certified by the manufacturer. Modern day vehicle repair technicians have post-secondary degrees and command a salary of on average between $60,000 and as much as $120,000 per year. That didn't used to be the case. Vehicles are more sophisticated and require more sophisticated and expensive repairs.

Dealers were also being required by manufacturers to maintain a fleet of new vehicles to be provided to each warranty customer to utilize while their vehicle was being repaired. This required dealers to purchase additional vehicles from the manufacturer and then proceed to write down the value of those vehicles each month that those vehicles were in the loaner fleet.

So the manufacturers made more money by having more cars required to be purchased from them, and yet the dealers had to take a loss on those same vehicles in order to meet the manufacturers’ needs to provide a loaner vehicle to the customers. All of these additional overhead costs are generally a benefit to the consumers, no doubt, but as dealership costs increased, the manufacturers were continuing to suppress the payment for parts at a mark-up of 40% and a labor rate that they unilaterally determined. As Mr. Appleton correctly points out, it's important for everyone to remember the mark-up on the cost to the dealership of parts should not be confused with profit.

The dealership's margin on parts and labor is used to pay many of the dealership's overhead costs before a nickel drops to the bottom line. Importantly, dealers have no choice but to provide warranty work on its manufacturer's vehicles. They are required, by contract, to provide warranty service on any vehicle brought into the store, whether they sold that vehicle to the customer or not.

Yet there is no certainty for the dealers as to how many warranty repairs they will be making, and the value of those warranty repairs, or the size of those warranty repairs. The manufacturers do not and cannot guarantee any level of warranty work to their dealers, yet they require all of those overhead costs. There are currently at least 40 states wherein the state legislature has independently determined that manufacturers were not reimbursing dealers for warranty work at rates which were fair and appropriate. Those state legislatures each vetted this issue, independently, and determined that a market driven retail rate was fair and reasonable and in the best interest of consumers. As Mr. Appleton mentioned, after many of these state legislators required manufacturers to reimburse dealers at rates equivalent to retail, manufacturers made it virtually impossible for dealers to obtain an increase in their parts mark-up and labor rate based upon the dealerships customer pay repair work.

So as a result, 22 state legislatures had to include a specific formula in the franchise laws, by which the dealers would submit the equivalent of their retail rates. These formulas vary from state to state, but are generally based upon the dealerships collecting some number of consecutive repair orders—customer pay repair orders—and then taking an average of the parts mark-up and the labor rate for each. In addition, certain non-warranty like repairs, such as fluid and filter changes, are expressly excluded from that calculation as non-warranty like repairs.

Our firm has assisted hundreds of dealers in the submission of warranty reimbursement claims, under these laws. In practice, the dealers submit both the repair orders used in calculating the average parts mark-up and labor rate, along with the intermittent repair orders that didn't apply because they contained non-warranty like repairs. After submission, the manufacturer either accepts the requested increase in reimbursement, or raises questions related to the submission. In many cases, the manufacturers make a counteroffer for a lower reimbursement rate.

Dealers are certainly within their rights to negotiate the parts mark-up increase and the labor rate increase, and often do. Where the dealer and manufacturer cannot agree that the statutory calculation has properly been made, most states provide for administrative appeal to resolve the issue. As was mentioned earlier, some manufacturers have used surcharges to circumvent the clear intent of the warranty reimbursement laws. The manufacturers were, in essence, giving with one hand, and then taking with the other. As a result, some 15 states have added an express prohibition on surcharging a dealer to recover the increased warranty reimbursement being paid to the dealers at retail rates. In addition to the example Mr. Appleton provided regarding General Motor's surcharge, we're aware of, other manufacturers such as Ford and Nissan doing the same thing.

Now it's critical for this record, today, to reflect pertinent decisions by the federal courts addressing the warranty reimbursement at retail and surcharge prohibition laws. In the interest of time, I'm not going to cite song and verse for each of these cases, but suffice to say that, since 1994, there have been no less than eight separate federal court cases addressing these issues under laws in six different states. In the earliest of those cases, Acadia Motors versus Ford, the court ruled that if the state legislature said that manufacturers must reimburse dealers at retail for parts and labor, then that's exactly what the legislature meant and that the manufacturers could not attempt to get around those laws.

In contrast, other courts have found that, if the state law doesn't clearly require retail reimbursement, but instead uses phrases like reasonable or fair, then that doesn't necessarily equate to retail. So it's important that that be clarified. With regard to surcharge prohibitions, the federal courts have consistently found that surcharge is directed only to those dealers that sought increased warranty reimbursement were a violation as they eviscerated the legislative intent to increase the reimbursement to dealers. And then, lastly, and I'll conclude with this point. Beginning with the Acadia case in Maine in 1994, continuing with the Gwadosky case in 2005, and culminating with the Currey case in Connecticut last year, the First Circuit Court of Appeals and the federal Second Circuit Court of Appeals have repeatedly determined that these laws do not violate either the contracts clause, the due process clause, or the commerce clause of the United States Constitution. Thank you.

NATHAN WILSON: Many thanks, Richard. Turn it over to Dan.

DANIEL L. GOLDBERG: Let me take a brief step back from warranty reimbursement, for a moment, and ask you to consider the following. How often is it do state or even federal legislative decisions involve setting minimum prices on products? When there are monopolies that are granted, whether they are public utilities or regulated insurance companies, what the legislators generally do is try to set a cap on prices.

So my quiz for you is name an industry, surprise what it's going to be, where the legislature, number one, adopts minimum pricing that certain buyers have to pay for products and services. Number two, where the largesse—the beneficiary of this legislative largesse are auto dealers, which contrary to what you hear, are not victims. According to the NADA statistics, on average, across the country, they make over $1 million in net profit a year. And where, number three, the legislature also take the next step of insulating that regulation from the politics of the situation by saying manufacturers cannot recover the increased costs imposed by those laws from the state that imposed them—from within a state that imposed them.

There's been some reference already to the historic unequal bargaining power, and some reference to the size of auto dealerships. To put a little bit of a finer point on that, average dealerships in the country now generate $50 million of revenue a year, are profitable, and the Fortune 500 dealer entities now generate billions of dollars. On average, the six largest dealer groups generate over $10 billion of revenues a year. That's according to their filings with the SEC.

Now you've heard statements made well, it's still the small dealer, you've got to negotiate one on one. No. Manufacturers, this is well known, like to have a policy which, if possible, is nationwide in purpose and effect. They don't go out and negotiate the amount that they're going to reimburse dealer A for warranty parts and dealer B a different rate. They like to have a uniform map. So dealers, whether large or small, get the benefit. They get a free-rider on the negotiating power of these enormous dealer groups.

So what about warranty? Is there some conflict in fact between what the market forces say about warranty? From a manufacturer's perspective, warranties help sell the new vehicle. That's what they're there for. So manufacturers compete with each other to try to increase the warranties that are offered. The only way that that can be done sensibly, is by having the dealers do a good job on the warranty work. Because manufacturers are dependent on the dealers to do the warranty work. Manufacturers are prohibited by most state statutes from doing it themselves or from naming independent repair shops to do the warranty work. So there is a confluence of interest in making sure that dealers are properly incented to do the warranty work.

Dealers are properly, therefore, given a profit or a mark-up. That was in the manufacturer's interest before these warranty reimbursement laws. And what did it result in? What it resulted in is not manufacturers providing parts, as it often happens with warranties on products, providing the parts for free to the dealer. Here, dealer, you need a new set of X, Y, Z parts, here they are for free. Install them, and we'll pay you for your labor. No. What happened as a result of the negotiations between manufacturers and dealers is that manufacturers pay a 40% mark-up, as you heard Rich say. That was before the situation of these retail reimbursement laws the situation.

And, from a dealer's perspective, again, these warranties are great for dealers. Why? A, they help them sell the new vehicles. B, they provide a captive audience for consumers to come in, because, during the first at least several years, now longer in many cases, that the consumer owns the car, they will bring it back to the dealer so the dealer has the opportunity to impress the consumer on its warranty and repair abilities. It starts to, therefore, get the non-warranty work that flows from it, with no need to advertise because it got a captive audience for these consumers. It keeps the consumer coming back to the dealership and exposing the consumer to the showroom, so you make the next sale. All kinds of benefits. It troubles me when I hear dealers complain that they are kind of the victims of having to do warranty. Warranty is a profit center, and always has been a profit center for dealers.

So what happened here with respect to these state laws? As cars improved, and the amount of warranty, therefore, decreased. How do you make sure that your revenues and your profits on warranty keep up with what they were historically? Look for the one source of revenue that a dealer gets from a manufacturer. There's only one that is required. It's the payment for the warranty. So go to the state legislators and get those laws. And you've heard references to the lead-ins to the state laws and so forth.

I quote from an article by two brilliant people, Francine Lafontaine and Fiona Scott Morton, "The net result of all these laws is to raise profits for car dealers…. Dealers represent an identifiable source of employment and tax revenue, while even large manufacturers can site manufacturing plants in only a limited number of states. The result is that new car dealers have an advantage over auto manufacturers when it comes to political leverage in state legislatures, and thus states enact laws that extract rent from manufacturers and redistribute it to franchise dealers."

Now as I say in addition to that excess cost that it's costing the manufacturers, the manufacturers, in many states, there are now I believe 19 of them that prohibit recoupment in the state. So it's not a question of a dealer saying you owe me an additional $2,000 and the next invoice comes back and they're charged $2,000. It's a question of a manufacturer saying state x, New Jersey, cost me an additional x million dollars a year because it enacted these regulations. So I'd like to put a surcharge on the vehicles and identify it as something, so that when consumers go to buy the car they know that they are paying an extra whatever it is, $125, because of the warranty reimbursement that has been enacted in the state, a simple thing that would allow the voters, those affected by the regulations, to have some political say in the process. But these recoupment bars basically say to the manufacturers you are prohibited from recovering the increased costs caused by the statutes from within our state. And therefore, as David Sappington will address, the enormous costs have to get reflected somewhere else in the system. All of which results in things that are adverse to consumers. I'll stop there. My time is up.

NATHAN WILSON: Perfect timing. Many thanks. David?

DAVID SAPPINGTON: Thank you, Nathan. It's certainly a privilege to be here, and I appreciate the opportunity to speak on this distinguished panel.

[WHISPERS]

I see my role on this panel much as Henry did on the first panel. If could get the slides to work, I could proceed, but I guess economists don't know how to work tech—there we go. So I see my role as bringing some economic perspective to the panel, and, in particular, the perspective of a regulatory economist. And I think the golden rule for a regulatory economist is that competition is the ideal form of consumer protection. And no matter how well intentioned regulation or legislation might be, it's cumbersome, costly, and subject to error. And I have great respect for regulators. I've had the privilege of serving with regulators, and I have great admiration for them, but their job is just impossible. So whenever possible, it's ideal to rely upon competition to protect consumers rather than turn to regulation or legislation.

So the fundamental question then before us is what is the source of market failure, the lack of competition, that warrants government regulation or legislation in the interaction between automobile manufacturers and automobile dealers.

And as we've heard a bit this morning, I think the basic story that tries to justify these regulations is that if we have a setting where there's a huge dominant manufacturer and a small dealer who is beholden to the manufacturer, it may turn out to be the case that manufacturer would abuse that power, and, in fact, withhold payments for warranty work, for example, from the dealers. And consumers would be harmed in the process, because dealers would not have the proper incentives to do the warranty work properly. Now that's a story that one might tell, but that's not the way I perceive the industry, and I think a more realistic depiction of today's industry is that, in fact, we have many manufacturers competing against one another to reach customers.

They do so through their dealers, but those dealers notice now in this new picture are not tiny little entities, as Dan has mentioned, they are in fact major players, major economic entities. So I think the better way to now view the industry is that we have teams of manufacturers and dealers working together, competing against one another, to attract consumers and make sure they can both sell cars. And so it's in the interests of both manufacturers and dealers to pursue the best interests of consumers. Otherwise, they will lose business to other manufacturer-dealer teams.

So a more realistic picture in my view of today's industry is that we do have substantial competition in the industry and this competition seems very likely to motivate manufacturers and dealers to work together to agree upon warranty reimbursement terms as a part of the overall package of terms that govern the interactions among these entities, in a manner that will best serve consumers, because failure to do so will leave them in a setting where they lose customers to other manufacturer-dealer teams.

And so, consequently, in my view, it is not apparent that we really need government intervention here to force these manufacturer and dealer teams to agree upon warranty terms that will serve consumers. It's competition that will do this itself, and, in fact, that's the better way in general to run an industry when possible. It's also not apparent to me that the dealers need the protection that they may have back in the 1950s. Again, for the reasons that Dan has already mentioned, and I won't go through the details, but if you just look at the statistics, revenues at the dealerships are increasing fairly regularly over time with exceptions like the great recession. If we just take a look at profit, Dan has already mentioned, there's a substantial profit of the dealers these days.

In addition, if we just take a look at the list of dealers who are now currently on the Fortune 500 list of the nation's largest corporations, we do see the dealers showing up there. So that picture from back in the 1950s really does not capture the industry today, in my view. And one other element of the interaction is that dealers today serve and sell the cars of many different manufacturers. So in fact they're not beholden to a particular manufacturer. So we do have a more level playing field, and therefore whenever possible—again, the golden rule of regulation is to let competition do the job wherever possible.

And part of the reason for that golden rule is that, when we try to do regulation, it's a very, very difficult process. So, for example, the first thing you need to determine is well, what is the right rule to insist upon to tell the manufacturers to the rate at which they need to reimburse their dealers for warranty work? Well that's not an easy question to answer, but the legislators seem to have done so by saying, well the right rule is to make sure the payment is the same for warranty work as the dealers are getting for non-warranty work. It's not clear to me that's the right answer. Because, for example, perhaps the manufacturer should be treated as sort of a large supplier of work for warranty work and, therefore, dealers often give discounts to their large customers. Perhaps a discount is reasonable for the manufacturers. It's not an easy question to answer, but again it's one that I think the market is better able to determine rather than regulators or legislators.

And even if you can see that that is the right rule, somehow, the legislators came up with the right rule, you then have to look at the details of how the rule is being implemented and, in fact, the way it is being implemented leaves room for the dealers to, essentially, not count discounts and sales that they make to their retail customers when calculating how much they're receiving on average for their retail work. And so, in fact, what they're actually receiving is above—I'm sorry—below what their calculated rates are. And so what we see over time is what's happened is that prior to the enactment of the rules in Florida, which happened in 2008, at the time before and rules were enacted, the dealers were getting larger rates of reimbursement for their retail work than for their warranty work.

But, more recently, because of this ability of the dealers to take out their discounts and sales from their calculated rates, now in fact the manufacturers are paying more for warranty work than the dealers are getting from their non-warranty work. So, again, this is just an indication of how complicated and difficult regulation is in practice, and sometimes it does not have the intended effect.

And the amount of money we're talking about here is not trivial by any means. I did a quick back of the envelope calculation—just for the four manufacturers for which I had data—and calculated how much more they are paying because of the laws in Florida than they would have paid absent the laws. And just between 2008 and 2012, for these four manufacturers, who accounted for just below 50% of the new car sales in Florida, over that five year period the increased cost due to these laws of warranty service was $80 million.

So if we extrapolate that to all the manufacturers in all the states over all the relevant time period, that's a huge amount of money. And we all know that's got to show up somewhere. Consumers are eventually going to pay some or all of this increase, and so it's not at all clear that these laws really are working in the best interests of consumers.

So in summary, from the view of a regulatory economist, market competition is the ideal form of consumer protection. Regulation and legislation are imperfect substitutes for competition. And, therefore, should be avoided whenever there is a reasonable possibility that competition can do the job. And, perhaps, a corollary of the golden rule is that when in doubt, leave. Or when in doubt, do without the regulation because competition should be the one in charge of the industry operations. And, in my view, the competition is quite pronounced in the auto industry today. And, therefore, other than serving to transfer wealth from manufacturers to dealer, it's not clear what role these rules are playing. And so, in fact, these rules have the substantial potential to distort market outcomes to the detriment of consumers.

NATHAN WILSON: Thank you very much, David. We're now going to turn to the question and answer portion of this panel. And at this time, I'd like to again stress that we very much welcome questions from the audience. Please submit them as was described in the previous panel. So the first question that I'd like to raise drills deeper into things, I think, some of our panelists have already touched upon: the impact of these warranty laws on consumers, our ultimate focus here today. So, in particular, it's pretty clear that the warranty laws impact interactions between manufacturers and dealers, but how does that translate to the consumer? If one state, for example, changes their reimbursement law and another does not, what types of effects on consumers might we expect? Would there be differential ones? Would they be shared? I would like to hear from our different panelists what their views on this question are. Perhaps in two minutes or less.

JAMES APPLETON: I'll do my best. Well, look, I think we all understand why dealers like these—or that dealers do like these franchise laws, and I think we understand now better why the manufacturers despise them. But I have no doubt that once the FTC finishes a full and fair study of this area, particularly the warranty area, that you'll have to conclude that these laws, although they're obviously not perfect, are good for consumers.

And, ultimately, that's the first panel, I don't think I heard the word consumer twice. And, at this point in time, I think we're getting down into a discussion about these laws. The assumption from the academics and from the manufacturers is that these laws were enacted to protect dealers, and this is just a fiction.

I've been involved in four separate different legislative initiatives in the state of New Jersey over the last two decades, and I can tell you I never went in front of a legislative committee and said we should pass these laws because they're good for dealers. I was always forced to go in front of a legislative committee and argue why they were beneficial to consumers, and it's never clearer than in the warranty reimbursement area. In the warranty reimbursement area, once that car is sold to the dealer, not to the consumer, once that car is sold to the dealer, that manufacturer wants no more expense associated with that car. And they will fight, and they will claw, and they will cheat wherever and whenever possible to avoid making further payments on those cars. And dealers, on the other hand, act in their own interest by attempting to garner as much and compete for as much warranty business as they can. Now consumers benefit from the system.

And let's be clear, the Professor's economic arguments are very sophisticated and way above my pay grade, but I know one thing for sure. Economic players in the marketplace will do what's in their interest every time, 100% of the time. And the dealers economic interest is aligned with the consumers, when it comes to warranty repairs, and the manufacturers' is not. Manufacturers see every penny spent on warranty claims as expense.

Whereas dealers see every penny spent on warranty claims as an opportunity. And so the benefit—the downside of some states regulating this area and some states not, is that cost-shifting occurs within the dealership. And what winds up happening in a dealership environment where 35% of all work in the shop is warranty, and 65% is customer paid. In states like mine, New Jersey, where the manufacturers are obligated to pay a fair retail rate, there is an equity. Consumers don't wind up paying twice. Consumers don't wind up overpaying for customer paid work, and dealers are able to compete.

And, at the end of the day, what the law is intended to do is encourage investment, not to protect dealers' investments, but to encourage investment in the franchise system. Because the franchise system promotes competition, the franchise system promotes economic benefits at the local level, and most importantly the franchise system gives consumers ready access to independent and qualified warranty and safety recall service. Without manufacturers being obligated to pay dealers fairly for that work, they would not be able to make the investment in the community, which state legislatures have insisted –

I know the counselor Goldberg was concerned about the fact that there are so many different state laws and all the rest. Well now we have this pesky 10th Amendment, and this pesky 10th Amendment tells us that the states should be in a position to regulate for the health, safety, and welfare of their citizens, as they see best. And that's what we've seen all across the country. And the implication that somehow dealers have more political influence at the state house—let me tell you something. Last year we had a very vocal, very high profile battle in the state of New Jersey over a franchise bill. Automakers spent $600,000 in paid media and they spent another 400,000 in contract lobbyists. Now the dealer association spent a hell of a lot less than—

DANIEL L. GOLDBERG: Can we get a little equal time here? I thought you said two minutes, Nathan.

NATHAN WILSON: Yeah.

JAMES APPLETON: I'm sorry. I didn't know you were trying to get my attention. I apologize.

DANIEL L. GOLDBERG: Thank you.

RICHARD SOX: We're going down the line?

NATHAN WILSON: Why don't we go back and forth? Dan, do you want to jump in?

DANIEL L. GOLDBERG: And I'll try to keep it to my two minutes. When you look at the legislative process for these statutes, you won't find any consumer groups that were banging on the door of the legislature and say our dealers in this state are not performing warranty well. We need the dealers to perform better warranty, and, therefore, please pay them more. You won't find any history showing that, before and after these retail reimbursement statutes were enacted, that somehow the quality of warranty improved.

And I would warrant that if you tried to do a study between customer satisfaction of warranty in states that did not have retail reimbursement, and states that did, you won't find a difference. Why not? Because there is a strong aligned view. Manufacturers, as I said earlier, want warranty to be done well so the customers are satisfied and will buy the next brand of their brand of vehicles. Dealers want consumers to be satisfied so they will come back and use that dealership. So there is no reason to think that the marketplace is not more than adequate, particularly given the changes in the relative leverage of dealers, that the marketplace is not adequate to ensure that those aligned interests result in adequate, proper, fair, and profitable, as they always have been, warranty reimbursements.

NATHAN WILSON: Rich?

RICHARD SOX: Thank you. The issue, and facts are stubborn, stubborn things. Courts have looked at the evidence—sworn testimony, documents—and have repeatedly found it's not just an issue of are the cost of the warranty work being covered at the dealership level. Those costs are going to be covered one way or the other. The dealer has to provide those services. It's in their best interest to provide the customers with the best warranty service they can.

So those costs have to be covered somewhere, and what the courts found was those costs were beginning to be covered by the customer pay—the non-warranty folks coming in and having work done on their cars. And so this was an effort to balance that by making the manufacturers pay their fair share of the warranty work under their warranty to relieve the pressure on the customer pay side. That's in several court cases. Again, after evidence has been looked at by the judges in those cases. And I'll stop there.

NATHAN WILSON: All right. David, do you have anything to add?

DAVID SAPPINGTON: Yes. I'll just follow up quickly on Richard's point. Again, to quote some very famous, distinguished economists who are sitting here in the room: if the problem is that the retail, the non-warranty customers, are paying too much, this particular law doesn't seem to do a particularly good job of solving that problem. Because, again, the way the law is set up, if the dealers get a higher payment for their non-warranty work, they're then allowed to charge more for their warranty work. So, in fact, this law provides an incentive to increase the prices charged for non-warranty work. So, again, it's just another illustration of how regulations, even if they're well intentioned, don't always achieve their standard purpose.

And, Nathan, just to get back to your question, which is clearly exactly the right one. How are consumers affected by these type of laws? And part of the difficulty is that we—this is extremely hard to measure, as Francine talked about this morning at the very outset, measuring these things are difficult because it's so difficult to get really good data. But what we've seen over and over time in different industries is that, when regulators do step back and repeal the legislation, we just see dramatic improvements in industry performance.

I don't think there's a better example than in the railroad industry, for example. Regulators tried for many, many decades to sort out the problems in that industry and impose all sorts of regulations to try to make the industry work, but in 1980, they essentially gave up and said we're going to deregulate the industry instead with the Staggers Act. And there's been just dramatic improvements in that industry since, and this unlimited potential in many industries that is only unlocked when you take away the regulations. And, again, when in doubt, do without the regulations.

NATHAN WILSON: Thank you. And that actually segues quite nicely into my next question, which is that in other industries where we see a seller supplying to a network of independent retailers, we don't necessarily expect to see laws governing price levels, in order to maintain functioning markets. What exactly is unique about the car market that would otherwise keep reimbursements unacceptably low?

JAMES APPLETON: Well, we—

NATHAN WILSON: Again—

JAMES APPLETON: You already spoke. I'll try to keep it to two minutes this time. Sorry. We already spoke a little about the unique aspect of the car business, which is the public interest in warranty and highway safety. There's a close link between having a ready network of independent franchisees in the community, who are not financially interested in denying warranty claims, but are rather financially interested in seeking them out and performing. So I think that's the major point that he made.

NATHAN WILSON: OK. Dan? We'll do it in the same order. Do you have anything to add?

DANIEL L. GOLDBERG: I think the thing that is unique about the auto industry is what I referred to before, and that is the remarkable political power that the dealers have in every state. And I'll put it this way, if the elevator operators had had the same political power that dealers did, we wouldn't have self-operating elevators.

NATHAN WILSON: OK. Richard? David? Do you know anything to add?

RICHARD SOX: Yeah. I would just emphasize what Jim said in terms of what's one of the very unique things about this industry is that a vehicle is a dangerous instrumentality. It is something that, if it's not repaired correctly, it can cause death. And the state legislators, as Aaron mentioned in the last panel, found that governing that relationship and governing the repairs of those vehicles is critical to the public safety in the state. And I also want to point out that there was mention of price-fixing in one of the opening statements. And, if you read these laws carefully, you will understand this is not price-fixing at all. This is tying the warranty reimbursement to a market-driven rate that is going to be different for every dealer depending on the market, and the cost of doing business in that market, and maintaining facilities, and conducting those repairs in those markets.

NATHAN WILSON: Thanks.

DAVID SAPPINGTON: Nathan, I'll defer to individuals on the panel who are more informed about the details of the auto industry than I am. But my perception is that there really is not something fundamentally different about the auto industry, in terms of basic economic issues. And so I think we would then need to look for other explanations for why we see this large difference in regulation. And I think Dan's suggestion in that regard, the political influences, deserve serious attention.

NATHAN WILSON: Thank you. I'd like to now to turn to a question that we've received from the audience.

JAMES FROST: Multiple times—

NATHAN WILSON: From separate people. It's not just one insistent person. I'd like to hear the panel's thoughts about allowing non-franchised dealers to perform warranty work, perhaps independent mechanics, or chain repair shops. Perhaps two minutes again per person?

JAMES APPLETON: Sure. Let me just back up a second on—I drew a blank earlier on the price control question. I just want to be clear.

I can't tell you how much I disagree with the premise that there is price control in this market. You have a free market, 65% of the business consumer paid. And you have a captive market, 35% of the business which is warranty paid.

Dealers don't have a choice where they buy the parts. Dealers don't have a choice about taking that work or not taking that work. So what we do in the state legislatures is, they decide that in order to fairly compensate that 35% of the work, they will survey what is happening on the other side. There's no control about what happens on the other side. So price control is an inapt characterization of the way these statutes work.

I'm sorry, what was your question?

[LAUGHTER]

Oh could independents—very quickly on independents—I don't think either manufacturers or consumers would welcome that business model. As we've said already, the cost to dealers is extraordinary for training, special tools, equipment, facilities. To disperse those costs across a much wider network might result in more access for consumers to service, but would it result in better quality? And I think the clear answer is no.

There's an ecosystem that it is involved in the automotive industry, where there is an optimum, maybe sub-optimum, maybe slightly more than optimum number of sales and service locations which serve the public interest. They don't serve the dealer interest. They shouldn't be here to serve the manufacturer interest. They're here to serve the dealer—the consumer interest.

NATHAN WILSON: Thanks. Dan?

DANIEL L. GOLDBERG: Well, I guess I would say in that regard, we ought to let the marketplace determine who can adequately perform warranty. If a manufacturer says, great, for certain kinds of warranty work, we're happy for consumers to have more points of access. And so as long as an independent repair shop can establish to us satisfactorily that they can do a good job on warranty, we will appoint them, because it may be closer to a particular consumer.

I believe that the European Union block exemption allows for just this kind of a process. That is, an independent repair shop who can establish they are able to adequately, properly, safely perform the warranty, they're allowed to do it. Why shouldn't the marketplace allow that to happen? And then, a manufacturer can determine whether that makes sense or not, or whether it disperses the warranty work too much, and therefore, will dissipate the quality of warranty work that's done for consumers. Let the marketplace decide. Let there be some experimentation in the marketplace, so that we can determine these things.

And I know one of your panels kind of will talk about what happens in the future. We're talking about more car-sharing in the future. When Google and Apple decide to come into this marketplace, or existing manufacturers say, you know, the millennials, they really want to share the vehicles. Maybe there doesn't need to be somewhere down the road, even a retail sale.

Maybe manufacturers continue to own the vehicles and work out sharing arrangements for consumers, so the manufacturers do the warranty work themselves. Who knows? But why should this part of the industry be mired in the 20th century, when all other aspects of this industry are proceeding into parts unknown, which are not wedded to this historical model?

NATHAN WILSON: Thanks. Richard?

RICHARD SOX: I'll be brief, because I think Jim covered the point well. I would just say that it's easy for the manufacturers to suggest that the market should drive this pricing. When the dealers have already incurred the costs of constructing those repair facilities and manning those repair facilities at the demand of the manufacturers, based upon expected units in operation, and repairs that the manufacturer tells the dealers, we expect you're going to be making on average this number of repairs per year based on sales in your market.

So they've incurred the cost, and now, it's easy for the manufacturer to say, well, now we want the market to dictate. Well, those costs, again, have to be covered. And the state legislatures and the courts have determined that this is the fairest way to do that, and not put it on the backs of the customer paying non-warranty repairs that are made at the dealership.

DAVID SAPPINGTON: Nathan, I think the most direct answer to your question is, we don't know whether this is a good idea or a bad idea. But again, that's what markets are for, to try out different modes of operation. And if it works, it'll catch on and everyone will do it. If it doesn't catch on, no one will do it. And so we don't, again, know what the potential is until we try it.

NATHAN WILSON: Thank you. So seguing slightly to a different topic, where there are new laws which tie warranty reimbursement rates to retail charges, we understand that there are some dealers who do not take advantage of the higher rates guaranteed to them by statute. Why might that be? And if some dealers do not take advantage of these new laws, because they fear repercussions from manufacturers, why don't those constraints apply to everyone?

JAMES APPLETON: Well walk on to any playground. There are kids who are bullied, and there are kids who are not. There are kids who stand up and fight for their rights, and those who don't. And it's no different when you become adults, and you enter the business world.

Let me tell you, automakers are not nice people. They don't treat their dealers respectfully. And if you think I'm exaggerating, think about this, the sole supplier has the ability to withhold product that is desirable, has the ability to come in and audit your dealership, and claw back through an open account.

If you don't know what an open account is, it means you have to maintain an account which the manufacturer has access to at all times. They can come in. They can take money out of that account. You have no recourse. You can't stop them from taking the money. And then, you have to claw that money back. So it's warranty audits, incentive audits.

And if you think that the manufacturers don't use their superior power over the dealers to enforce their will, let me tell you about one thing that happened just at the end of last year.

General Motors has a pay plan for their dealers, where in New Jersey they agreed to pay a specified mark-up on parts used in warranty repairs and a labor rate. What GM did at the end of last year is they went out to dealers in the Northeast, not just New Jersey, went out to dealers, and they said, if you have the temerity to ask for full retail over and above the amount that we say is OK to pay, then two things are going to happen. One, we're going to take you off the labor rate payment that you have currently. And we're not going to give you automatic cost of living increases on your labor rate. And we're going to come in and audit you on your labor rate.

You know, look, I'm from New Jersey. It's hard to shock me. But that looks like racketeering to me. It's strong arming. It's using your superior economic strength over a weaker business partner to exact your will—extract your will from them. If you think it's—and if you think that the manufacturers are good-willed, you're wrong.

NATHAN WILSON: Thanks, Jim. Dan, I'm going to guess you have a response.

DANIEL L. GOLDBERG: Well, once again we're hearing about the auto dealers as victims. And I dare say that AutoNation, Penske, Group 1, Sonic, Asbury Automotive, and Lithia Motors would not all be involved as they have been over recent years at buying up more and more dealerships only to find that every time they buy a dealership, they're once again going to be a victim. It doesn't happen. Dealerships are very attractive purchase opportunity.

And in terms of fearing repercussions, it's really quite interesting. And you shouldn't legislate by anecdote, obviously. But we hear these anecdotes. I submit to you that there is another reason why a lot of them—why a lot of auto dealers have not put in for the retail rate. And that is because they were already paid what they regarded as a fair return. Not only the 40% that many manufacturers offered, but some offered to reimburse warranty parts at MSRP for those parts, more like a 67% return on the parts.

And auto dealers may well say, hey, I'm content with that. I think that's a fair return. If there are a lot of dealers who are not in fact putting in for the retail reimbursement, doesn't it make you scratch your head and wonder how necessary these retail reimbursement laws were? I'll stop there.

RICHARD SOX: It's just the opposite. I think the question proves what again, courts after looking at lots of evidence and state legislatures have found over long periods of time, that the manufacturers have an economic power over their dealers. And that's why some dealers are afraid to pursue the retail rates, because the manufacturers, in writing, over and over again, have told dealers, don't do this. Don't do this. And so a lot of them are scared to do it. And some of them, as Jim said, stand up for their rights. And they do that.

Now, as it relates to public companies, what's not being mentioned here, and it's important for the record. Every public company is required by manufacturers to sign what's called a framework agreement. Framework agreement limits the amount of business that that public company can do with that manufacturer, so that they are limited in their economic power by virtue of those framework agreements. So they are not all powerful. They don't come close to rising to the power of the manufacturers.

DAVID SAPPINGTON: Nathan, I wish I could wrap it up by telling you the exact answer to your question. But I really don't know. There are interesting competing theories here. But I do think this is an area where there could be some very relatively simple empirical research to try to find out why this is going on. Just have, perhaps, an anonymous survey, perhaps conducted by the FTC to ask dealers who are not asking for reimbursement why they're not. And if you could guarantee their anonymity, I believe you could get to the answer to your important question.

NATHAN WILSON: Thank you. Now, I'm going to turn from thinking about the state of the world today to thinking about how things might look as we start to move forward in time. Auto manufacturing and distribution, like other sectors in the economy, are becoming increasingly reliant on computers. For cars in particular, how should we think about software updates being handled? Are there any reasons why software updates should not be done over-the-air at manufacturer's discretion?

JAMES APPLETON: Well, I think the guide star for the FTC, for the automakers, I know for the dealers, has to be what's best and most convenient for consumers. If ever significant numbers of over-the-air updates can be made, then they should be made in a manner that is most efficient and most beneficial to the drivers of the vehicle. And I don't think there are any dealers that would object to that approach.

But let's keep in mind that the reason these franchise laws require reimbursement at a retail rate for warranty is because there needs to be investment. And we need to encourage investment in this independent network of franchised new car dealers that sits in the community ready, willing, and able to serve the needs of the consumer. If manufacturers are willing to stand down on what are considered oppressive and over the top facilities demands, as a result of technological changes that may or may not ever take place, then I don't think you'll hear any complaints from the dealer communities about being able to build smaller dealerships, hire fewer people, and engage in less intensive training for their employees. It's about the consumers.

NATHAN WILSON: Thank you.

DANIEL L. GOLDBERG: Well, I agree with part of what Jim said.

JAMES APPLETON: Uh, oh. I must be wrong.

DANIEL L. GOLDBERG: And that is—

JAMES APPLETON: I must have said something wrong.

DANIEL L. GOLDBERG: And that is to the extent that I can get a software update on my vehicle over-the-air, I should be able to get it the same way I get my update on my Apps on my smartphone. It alerts me that I have an update. I push a button, and it's updated. I don't have to bring it to the Apple store. I don't have to pay somebody, some middle man, for it. And I get it. That's the way that over-the-air repairs should happen.

And I think that the FTC needs to be very attentive to this issue. Because in a letter six months ago to certain congressmen, NADA took the position that the security concerns—there aren't security concerns when I get updates here—security concerns means that certain features, attributes, or systems must be limited or delayed, quote "a secure physical point of access to service vehicles is critical." Well, guess what they propose is that physical point of access for my over-the-air update?

So as we look down the road at the ability to do over-the-air repairs, it should be—and this is where Jim and I absolutely agree—it should be what is the most convenient, beneficial, for the consumer. And if the consumer can get it by pushing a button, and not having to drive to a dealership, and not having to absorb either directly or indirectly through the system commissions to the dealer for not doing anything, then we agree. That's how it should happen.

RICHARD SOX: I would just add—I'm aware of that letter as well. And I think you took some of that out of context. I believe NADA's concern, and it would certainly be mine in my own vehicle, is I don't want someone to have access to changing something in my vehicle that could cause harm to the vehicle and cause me harm as the driver. And I think that's the focus, is the safety of the vehicle and making sure that whoever has access to the computers in that vehicle are qualified and responsible. That's all I would add to that.

NATHAN WILSON: Thanks.

DAVID SAPPINGTON: So I think on this issue, we all—there is a substantial amount of agreement. It's got to be the consumer's interest that dictates the answer to this issue. And then also, I do think that it's got to be the joint action of the manufacturers and dealers working together to decide what is best for consumers. And again, I don't think we want the government telling them it has to be done this way, or it can't be done that way. Let the market decide what's the best way to do it, with the goal of consumer interest in mind.

NATHAN WILSON: Thank you. Well, having found an area successfully where folks broadly agreed, let me turn to one where I suspect there may be slightly greater differences. So if we were to follow David's advice and liberalize the system of warranty reimbursements and warranty exclusivity laws, what would be the expected impact, looking perhaps 10 years out, on dealers, on manufacturers, on consumers?

JAMES APPLETON: Well, look, the laws that are in place are designed to encourage investment in an extensive network of dealers that stand ready in the community to carry out the promises that the manufacturers have made, and which consumers have already paid for. What's the logical impact of changing those laws? There'll be less encouragement, and less desire, to make that investment.

And you know, I think when you listen to the panel this morning, and when you listen to this panel, there seems to be some thread running through this that maybe we'd be better off with fewer dealerships? Is this—? I mean, consumers don't see it that way. You know, 17,000 dealers competing across the U.S. for customer business is a better model than 22 manufacturers. Maybe 17,000 isn't the right number, but the marketplace should determine that, with the consumer's best—with the appropriate mechanisms in place to protect the consumer's best interest.

And that's what these warranty laws do, is protect the consumer interest in an extensive network of independent franchisees who stand ready, willing, and able in the community to carry out the promises the manufacturers make, which the consumers have already paid for.

NATHAN WILSON: Thank you. Dan?

DANIEL L. GOLDBERG: Man, I don't know what it would look like in 10 years if these laws were gone with respect to warranty reimbursement. But I think there's a high likelihood it would be different from what it is now. And that difference is going to be driven by the market forces that we've talked about.

In terms of encouraging investments, you know, in every other industry where there's a distribution system and a need by someone down the distribution chain to invest, the marketplace takes care of it. The showrooms for appliances—you can go down all your major consumer goods. And the manufacturers have a strong interest in making sure that there is investment along the distribution chain, because that's how they get their products to consumers.

The thought that the marketplace is somehow incapable and needs state intervention, I think, is born of a bygone era. And I would love it if in 10 years, we were back and had the opportunity to see what those 10 years meant without having these laws, which as I say keep us wedded to a historical distribution and warranty repair system.

NATHAN WILSON: Thank you. Richard?

RICHARD SOX: The premise that this is all based upon a bygone era is false. We all still purchase vehicles. It's the second largest purchase we make in our lives other than our home. It's still something that can kill you and your passengers if it's not repaired properly. That hasn't changed. And that's not going to change.

These costs, again, have to be paid somewhere. And so the answer would be, if you went back to the days of the manufacturer dictating the rates of reimbursement, you would have the cost shift to other customers purchasing products and services from the dealership.

NATHAN WILSON: Thanks. And I guess that means David, you get to sum things up for us.

DAVID SAPPINGTON: I'll do what I can. Again, I think it's extremely difficult to predict exactly what would happen if we took the gloves off and just let the market work for 10 years. But I do think that there is sufficient competition in the industry that the manufacturers and dealers would then have the right incentives to get together and make sure they're doing what is best for consumers.

And I do think that if a manufacturer were foolish enough to try to expropriate the investments that dealers have already made, when the gloves come off, I think that manufacture is going to be punished by the marketplace in the long-term. And that manufacturer won't be able to attract the best dealers in the future, and therefore won't be able to just sell their vehicles to consumers. So I do think the market would discipline manufacturers against this legitimate concern.

And I do think that, although we can't predict what things would look like in 10 years, we can be relatively confident that the arrangements that would come about through market competition will best serve customers.

NATHAN WILSON: Thank you very much. And thank you all very much. I think this has been a very informative, interesting panel. And with that, I would like to release everyone for lunch.

[APPLAUSE]

JAMES FROST: If we could have the panelists down here please for a lunch, and everyone else—

[LUNCH BREAK]