



UNITED STATES OF AMERICA  
Federal Trade Commission  
WASHINGTON, D.C. 20580

Office of Policy Planning  
Bureau of Competition  
Bureau of Economics

May 7, 2015

Senator Darwin L. Boohar  
35<sup>th</sup> Senate District  
P.O. Box 30038  
Lansing, Michigan 48909-7538

Dear Senator Boohar:

Thank you for requesting comments from the Federal Trade Commission (“FTC”) staff<sup>1</sup> regarding Senate Bill 268 pending in the Michigan legislature and relating to the sale and servicing of automobiles. This bill would create a limited exception to current provisions of Michigan law that have been interpreted to prohibit automobile manufacturers from selling new motor vehicles to consumers except through independent franchised dealers. In our view, current provisions operate as a special protection for dealers—a protection that is likely harming both competition and consumers. We therefore appreciate this opportunity to provide our views as to the probable impact of the proposed legislation on competition and consumers.

As we discuss below, FTC staff view Senate Bill 268 as likely to promote competition and benefit consumers, compared to a blanket ban on direct manufacturer sales to consumers. The bill would permit manufacturers of a category of vehicles known as “autocycles,” under limited circumstances, the flexibility to choose whether to sell such vehicles directly to consumers, through dealers, or through some combination of the two. In our view, however, the bill does not go far enough. Rather, the narrow scope of the bill would largely perpetuate the current law’s protectionism for independent franchised dealers, to the detriment of Michigan car buyers. FTC staff believe Michigan’s consumers would more fully benefit from a complete repeal of the prohibition on direct sales by all manufacturers, rather than the enactment of any limited, selective set of exceptions.<sup>2</sup>

FTC staff offer no opinion on whether automobile distribution through independent dealerships is superior or inferior to direct distribution by manufacturers. Rather, staff’s principal observation is that consumers are the ones best situated to choose for themselves both the

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<sup>1</sup> This staff letter expresses the views of the Federal Trade Commission’s Office of Policy Planning, Bureau of Competition, and Bureau of Economics. The letter does not necessarily represent the views of the Federal Trade Commission or of any individual Commissioner. The Commission, however, has voted to authorize staff to submit these comments.

<sup>2</sup> Our opinion is limited to bills addressing blanket restrictions on manufacturer sales and service to consumers. We do not attempt to comment or review the myriad additional provisions of Michigan law that regulate the relationship between automobile manufacturers and their independent dealers.

vehicles they want to buy and how they want to buy them. Automobile manufacturers have an economic incentive to respond to consumer preferences by choosing the most effective distribution method for their vehicle brands. Absent supportable public policy considerations, the law should permit automobile manufacturers to choose their distribution method to be responsive to the desires of motor vehicle buyers.

## I. Interest and Experience of the Federal Trade Commission

The FTC is an independent administrative agency charged with working to protect consumers by preventing anticompetitive, deceptive, and unfair business practices, enhancing informed consumer choice and public understanding of the competitive process, and accomplishing this without unduly burdening legitimate business activity.<sup>3</sup> To secure these goals, the FTC has played a significant role in promoting competition and consumer protection law and policy through law enforcement, the study of industries and business practices, and through competition advocacy, which may include specific comments to legislators or regulators concerned about the likely competitive impact of pending legislative or regulatory measures.<sup>4</sup>

Competition is at the core of America's economy, and vigorous competition among sellers in an open marketplace gives consumers the benefits of lower prices, higher quality products and services, and greater innovation.<sup>5</sup> The goal of our advocacy program is to enhance understanding of the competitive process and provide a framework for thinking about public policy issues from a competition and consumer protection perspective. We urge decision makers to consider: (1) the likely competitive impact of proposed legislation or regulations; (2) how they might affect consumers; (3) what justifications might exist for any restrictions on competition; and (4) whether less restrictive alternatives would fulfill public policy goals while adequately protecting consumers. These considerations can be especially important when heavily regulated industries encounter new or disruptive products, services, and methods of sale.<sup>6</sup>

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<sup>3</sup> See Federal Trade Commission Act, 15 U.S.C. § 45.

<sup>4</sup> Sections 6(a) and (f) of the FTC Act authorize the FTC “[t]o gather and compile information concerning, and to investigate from time to time the organization, business, conduct, practices, and management of any person, partnership, or corporation engaged in or whose business affects commerce,” and “[t]o make public from time to time such portions of the information obtained by it hereunder as are in the public interest . . .” 15 U.S.C. § 46(a), (f).

<sup>5</sup> See *Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 695 (1978) (“The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers.”); *Standard Oil Co. v. FTC*, 340 U.S. 231, 248 (1951) (“The heart of our national economic policy long has been faith in the value of competition.”).

<sup>6</sup> See, e.g., Comment from FTC Staff to Brendan Reilly, Alderman, City Council, City of Chicago (Apr. 21, 2014), available at [http://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-honorable-brendan-reilly-concerning-chicago-proposed-ordinance-o2014-1367/140421chicagoridesharing.pdf](http://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-honorable-brendan-reilly-concerning-chicago-proposed-ordinance-o2014-1367/140421chicagoridesharing.pdf); FTC Staff Comments Before the District of Columbia Taxicab Commission Concerning Proposed Rulemakings on Passenger Motor Vehicle Transportation Services (June 7, 2013), available at [http://www.ftc.gov/sites/default/files/documents/advocacy\\_documents/ftc-staff-comments-district-columbia-taxicab-commission-concerning-proposed-rulemakings-passenger/130612dctaxicab.pdf](http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comments-district-columbia-taxicab-commission-concerning-proposed-rulemakings-passenger/130612dctaxicab.pdf).

In carrying out its mission, the Commission has developed considerable expertise in analyzing markets for the sale of motor vehicles. For example, in 1988 and again 2014, FTC staff submitted advocacy letters opposing limitations imposed by Illinois law on the hours of operation of auto dealerships.<sup>7</sup> The FTC also used its enforcement authority to protect competition in motor vehicle sales in the late 1980s, when it issued a complaint against several motor vehicle dealerships in the Detroit area and the Detroit Auto Dealers Association (“DADA”) for imposing anticompetitive restrictions on hours of operation.<sup>8</sup>

In 1986, the FTC’s Bureau of Economics issued a report on the effect of state regulations in retail motor vehicle markets that restrict the establishment of new motor vehicle dealerships near existing dealers selling cars of the same make.<sup>9</sup> The report found that these state laws harmed consumers because they caused motor vehicle prices to rise. In addition, in 2001, then-Commissioner Thomas Leary expressed concern about the same kind of decades-old state laws now at issue in Michigan—laws that insulate motor vehicle dealers from competition from automotive manufacturers. While dealers at one time tended to be small businesses, he observed, in 2001 they were frequently much larger entities, and the once highly concentrated motor vehicle manufacturing industry had become far more competitive. Commissioner Leary questioned, therefore, whether this kind of regulatory protection for dealers could still be justified, especially because it tended to interfere with the development of new and potentially more efficient methods of motor vehicle distribution, such as e-commerce.<sup>10</sup>

More recently, in 2014, FTC staff submitted comments in connection with proposed bills in Missouri and New Jersey addressing restrictions on manufacturers’ direct distribution of motor vehicles in those states.<sup>11</sup> This comment echoes the views expressed in those comments.

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<sup>7</sup> Comment from FTC Staff to James Oberweis, State Senator of Illinois (March 26, 2014), *available at* [http://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-illinois-state-senate-regarding-senate-bill-2629-which-would-repeal-certain/140327illinoisautostaffcomment.pdf](http://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-illinois-state-senate-regarding-senate-bill-2629-which-would-repeal-certain/140327illinoisautostaffcomment.pdf); Comment from FTC Staff to James R. Thompson, Governor of Illinois (Dec. 22, 1988), *available at* [http://www.ftc.gov/sites/default/files/documents/advocacy\\_documents/ftc-staff-comment-governor-james-r.thompson-concerning-s.b.1870-limit-auto-base-rental-charges-alter-allocation-costs-and-risks-damage-or-theft-and-ban-long/v890008.pdf](http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comment-governor-james-r.thompson-concerning-s.b.1870-limit-auto-base-rental-charges-alter-allocation-costs-and-risks-damage-or-theft-and-ban-long/v890008.pdf).

<sup>8</sup> These dealers had reached an agreement, orchestrated by the DADA, to limit the number of hours that they would be open for business. The FTC concluded that the agreement was anticompetitive, a conclusion that was later affirmed by the U.S. Court of Appeals for the Sixth Circuit. *See Detroit Auto Dealers Ass’n v. FTC*, 955 F.2d 457 (6th Cir. 1992).

<sup>9</sup> Robert P. Rogers, Bureau of Econ., Fed. Trade Comm’n, THE EFFECT OF STATE ENTRY REGULATION ON RETAIL AUTOMOBILE MARKETS (1986) [hereinafter “Bureau of Economics Staff Report”], *available at* <http://www.ftc.gov/sites/default/files/documents/reports/effect-state-entry-regulation-retail-automobile-markets/231955.pdf>.

<sup>10</sup> Thomas B. Leary, Comm’r, Fed. Trade Comm’n, State Auto Dealer Regulation: One Man’s Preliminary View, Speech at The International Franchise Association 34th Annual Legal Symposium (May 8, 2001), *available at* <http://www.ftc.gov/public-statements/2001/05/state-auto-dealer-regulation-one-mans-preliminary-view>.

<sup>11</sup> Comment from FTC Staff to Rep. Michael J. Colona, Missouri House of Representatives (May 15, 2014), *available at* [http://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-missouri-house-representatives-regarding-house-bill-1124-which-would-expand/140515mo-autoadvocacy.pdf](http://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-missouri-house-representatives-regarding-house-bill-1124-which-would-expand/140515mo-autoadvocacy.pdf); Comment from FTC Staff to Assemblyman Paul D. Moriarty, General Assembly, State of New Jersey (May 16, 2014), *available*

## II. Discussion and Analysis of the Pending Bill

### A. Michigan's Ban on Direct Manufacturer Sales

The Office of the Attorney General of Michigan has interpreted current Michigan law to prohibit automobile manufacturers from selling their products directly to consumers. These activities, it is maintained, can be carried out only through independent franchised dealers.<sup>12</sup> In October 2014, the legislature passed and the governor signed legislation that made wording changes to strengthen Michigan's statutory prohibitions on manufacturer direct sales to consumers. At that time, however, the governor said that "[a] healthy, open discussion can and should be had over whether the current business model in Michigan should be changed" and encouraged the legislature to engage in such debate.<sup>13</sup>

A blanket prohibition on manufacturer sales to consumers is an anomaly within the larger economy. Most manufacturers and suppliers in other industries compete with each other not only on the price, quality, and features of their products and services, but also on the cost, speed, service and efficiency of their sales and distribution systems. These manufacturers make decisions about how to design their distribution systems based on their own business considerations and in response to consumer demand. If a manufacturer concludes that using independent distributors to sell its products will best serve consumers and its own needs, it is free to contract for those services. On the other hand, if it decides that direct sales work better for its products, it can deal with consumers directly. Many manufacturers choose some combination of direct sales and sales through independent retailers.<sup>14</sup> The competitive process gives the manufacturer the incentive to pick the distribution option that it believes will be the most responsive to consumers. Typically, no government intervention is required to augment or alter these competitive dynamics—to the extent a manufacturer faces robust competition from other manufacturers, the market weeds out inefficient, unresponsive, or otherwise inadequate distribution practices on its own.

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at [http://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-new-jersey-general-assembly-regarding-assembly-bills-2986-3096-3041-3216-which/140516nj-autoadvocacy.pdf](http://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-new-jersey-general-assembly-regarding-assembly-bills-2986-3096-3041-3216-which/140516nj-autoadvocacy.pdf).

<sup>12</sup> Letter from Matthew Schneider, Chief Legal Counsel, Dep't of Att'y Gen., to Hon. Richard D. Snyder, Governor of Michigan (Oct. 21, 2014), available at [http://www.michigan.gov/documents/snyder/HB\\_5606\\_Signing\\_Letter\\_472039\\_7.pdf](http://www.michigan.gov/documents/snyder/HB_5606_Signing_Letter_472039_7.pdf). In Michigan, with limited exceptions, a manufacturer cannot directly or indirectly own, operate, or control a new motor vehicle dealer (Mich. Comp. Laws § 445.1574.14(1)(h)), or sell any new motor vehicle directly to a retail customer other than through franchised dealers (*id.* at § 445.1574.14(1)(i)). In addition, with limited exceptions, a manufacturer cannot own a motor vehicle service and repair facility, or authorize a motor vehicle service and repair facility to perform motor vehicle warranty repairs and recall work. Mich. Comp. Laws § 445.1574.14(1)(p), -(q). The latter prohibition does not apply to a motor vehicle dealer performing service or repair work on motor vehicles under the terms of a dealer agreement. *See* Mich. Comp. Laws § 445.1564.4(4).

<sup>13</sup> Letter from Governor Rick Snyder to Michigan Legislature (Oct. 21, 2014), available at [http://michigan.gov/documents/snyder/HB\\_5606\\_Signing\\_Letter\\_472039\\_7.pdf](http://michigan.gov/documents/snyder/HB_5606_Signing_Letter_472039_7.pdf).

<sup>14</sup> Computer manufacturers are one example of this hybrid distribution system, and popular clothing brands are another, but there are many more.

Economists have long been interested in why firms choose to sell their products through a network of independent entities, to “vertically integrate” (engage in retail sales themselves), or to do some combination of the two.<sup>15</sup> A large body of literature has shown that the decision is very context specific. In some circumstances, such as when local sales and promotional efforts are hard to measure but important for the firm’s success, a firm may conclude that it is desirable to use highly incentivized independent representatives.<sup>16</sup> In others, however, reliance on independent dealers may fail to achieve the best outcome for either the upstream producer or the consuming public. The vast majority of existing work by economists suggests that allowing firms in competitive marketplaces to make the decision for themselves leads to better outcomes for consumers.<sup>17</sup>

When manufacturers respond to competitive pressure by choosing to vertically integrate, consumers usually benefit through lower prices and/or higher quality.<sup>18</sup> In contrast, when the government intervenes and outlaws vertical integration, consumers often experience worse service and higher prices.<sup>19</sup> It is not that vertical integration is always superior. Preventing firms

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<sup>15</sup> One of the first papers focusing on this “make or buy” decision was Ronald Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937). The literature has since expanded dramatically. Recent surveys touching on both theory and empirical evidence include Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 *J. ECON. LIT.* 629–85 (2007); and Timothy Bresnahan & Jonathan Levin, *Vertical Integration and Market Structure*, in *HANDBOOK OF ORGANIZATIONAL ECONOMICS* 85 (R. Gibbons & D.J. Roberts, eds., 2012).

<sup>16</sup> A book-length treatment of the theory explaining why can be found in Jean-Jacques Laffont & David Martimort, *THE THEORY OF INCENTIVES: THE PRINCIPAL-AGENT MODEL* (2009).

<sup>17</sup> This conclusion was reached in two separate recent surveys of the literature: Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, in *HANDBOOK OF ANTITRUST ECONOMICS* (Paolo Buccirossi, ed., 2008); and James C. Cooper, Luke M. Froeb, Dan O’Brien, & Michael G. Vita, *Vertical Antitrust Policy as a Problem of Inference*, 23 *INT’L J. INDUS. ORG.* 639–64 (2005).

<sup>18</sup> This is not to suggest that vertical integration can never harm competition, as may be the case where it is used to impair competition from rival suppliers or customers.

<sup>19</sup> Efficient vertical integration by upstream manufacturers can benefit consumers in a variety of ways. First, it can remove the incentive for a manufacturer as well as a dealer to each mark up the price of the product on its way to the consumer. This results in lower prices and increased sales to consumers. Discussion and details are available in Dennis W. Carlton & Jeffrey M. Perloff, *MODERN INDUSTRIAL ORGANIZATION* 523–27 (2d ed. 1994).

Second, integration by a manufacturer into distribution can enable manufacturers to better match their products with the preferences of consumers. For example, although manufacturers have an incentive to increase overall sales of their products, particular dealers may be most interested in making sales from their inventory, which may cause consumers to have to visit multiple dealerships to establish what product best fits their needs, resulting in relatively high search costs. When consumers’ search costs are a large determinant of their purchasing patterns, a manufacturer can have a strong incentive to make direct sales so that it is simpler for consumers to find what they want. See Comment from FTC Staff to James Oberweis, State Senator of Illinois 5 (March 26, 2014), available at [http://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-illinois-state-senate-regarding-senate-bill-2629-which-would-repeal-certain/140327illinoisautostaffcomment.pdf](http://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-illinois-state-senate-regarding-senate-bill-2629-which-would-repeal-certain/140327illinoisautostaffcomment.pdf) (discussing and summarizing literature on the impact of search costs). For some empirical evidence on the importance of search costs in the automotive industry, see Fiona Scott Morton, et al., *What Matters in a Price Negotiation: Evidence from the U.S. Auto Retailing Industry*, 9 *QUANTITATIVE MARKETING & ECON.* 365–402 (2011). For a more general review of the economic theory and evidence connecting search costs to prices, see Michael Baye, et al., *Information, Search, and Price Dispersion*, in *HANDBOOK ON ECONOMICS AND INFORMATION SYSTEMS* 323 (T. Hendershott, ed., 2005).

from using independent retail networks, when that is what they want to do, also can have negative competitive consequences. The common message in both situations is that the competitive process effectively aligns the interests of firms and consumers on the issue of distribution method. In order to make their product as attractive as possible, firms choose the distribution method that can bring their product to market as efficiently as possible.

Specific evidence to support these views can be found in many industries, including retail automotive markets and industries like gasoline retailing. Past studies by both academic researchers and FTC staff have concluded that state-imposed restrictions on automobile manufacturers' ability to negotiate with their dealers increased the prices paid by consumers without leading to notable improvements in service quality.<sup>20</sup> Similarly, studies have found a causal link between laws that inhibit gasoline refiners' ability to operate or own retail stations, and higher prices.<sup>21</sup> In our view, the well-developed body of research on these issues strongly suggests that government restrictions on distribution are rarely desirable for consumers. When they are adopted, at a minimum, such restrictions should be clearly linked to specific policy objectives that the legislature believes warrant deviation from the beneficial pressures of competition, and should be no broader than necessary to achieve those objectives.<sup>22</sup>

Those who support a blanket prohibition on direct manufacturer sales have made a number of arguments that FTC staff find unpersuasive. Perhaps the central concern reflected in the current laws regulating the manufacturer-dealer relationship is that government intervention is required to protect independent dealers from abusive behavior by their suppliers. But a blanket prohibition of direct manufacturer sales is not a narrowly crafted provision to protect franchised

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Third, past work by economists has shown that vertical integration can aid firms in responding to uncertainty or evolving business environments by establishing clear lines of authority between their manufacturing and sales personnel, especially when new firms are attempting to enter an established market. A survey of the theoretical motivations for vertical integration can be found in Timothy Bresnahan & Jonathan Levin, *Vertical Integration and Market Structure*, in HANDBOOK OF ORGANIZATIONAL ECONOMICS (R. Gibbons & D.J. Roberts, eds., 2012). Empirical evidence of integration's impact on firms' ability to respond to events can be seen in recent studies such as Sharon Novak & Scott Stern, *Complementarity among Vertical Integration Decisions: Evidence from Automobile Product Development*, 55 MANAGEMENT SCIENCE 311–32 (2009); and Silke Forbes & Mara Lederman, *Does Vertical Integration Affect Firm Performance? Evidence from the Airline Industry*, 41 RAND J. ECON. 765–90 (2012).

<sup>20</sup> In particular, see, E. Woodrow Eckard, Jr., *The Effects of State Automobile Dealer Entry Regulation on New Car Prices*, 24 ECON. INQUIRY 223–42 (1985); and FTC Bureau of Economics Staff Report, *supra* note 9.

<sup>21</sup> J.M. Barron & J.R. Umbeck, *The Effects of Different Contractual Arrangements: The Case of Retail Gasoline*, 27 J.L. & ECON., 313–28 (1984); Michael G. Vita, *Regulatory Restrictions on Vertical Integration and Control: The Competitive Impact of Gasoline Divorcement Policies*, 18 J. REG. ECON. 217–33 (2000); and A.A. Blass & Dennis Carlton, *The Choice of Organizational Form in Gasoline Retailing and the Cost of Laws that Limit that Choice*, 44 J.L. & ECON. 511–24 (2001).

<sup>22</sup> Our comments here echo prior comments discussing similar issues. FTC Staff Comments Before the District of Columbia Taxicab Commission Concerning Proposed Rulemakings on Passenger Motor Vehicle Transportation Services (June 7, 2013), available at [http://www.ftc.gov/sites/default/files/documents/advocacy\\_documents/ftc-staff-comments-district-columbia-taxicab-commission-concerning-proposed-rulemakings-passenger/130612dctaxicab.pdf](http://www.ftc.gov/sites/default/files/documents/advocacy_documents/ftc-staff-comments-district-columbia-taxicab-commission-concerning-proposed-rulemakings-passenger/130612dctaxicab.pdf) (discussing taxicab rules and suggesting that “any restrictions on competition that are implemented should be no broader than necessary to address legitimate subjects of regulation, such as safety and consumer protection, and narrowly crafted to minimize any potential anticompetitive impact.”)

dealers from abuse in their franchise relationships. Such a prohibition is categorical, going well beyond the many other statutory provisions that protect dealers from such abuse. It extends to every entity engaged in manufacturing, assembling, or distributing new motor vehicles, even a manufacturer that has never entered into a franchise agreement.

Advocates for existing dealers also argue that manufacturers that sell directly to consumers will not provide them with adequate service. This argument presupposes that automobile manufacturers in a competitive environment will act contrary to their economic self-interest. If consumers greatly value post-sale service and would be unlikely to purchase or recommend any automobile without a reasonable assurance of quality future service, then any manufacturer will have an incentive to supply such service or else see its sales decline to the benefit of its rivals. This competitive pressure is a strong motivation for manufacturers to either provide good service themselves or continue to contract with an independent service provider, such as a dealer, to do so.

Finally, advocates for a categorical ban on direct sales argue that direct-selling manufacturers would charge higher prices to consumers. In their view, consumers benefit from the “intra-brand” competition between dealers of the same brand of vehicle. In other words, rival dealers in the same area that sell the same make and model of car compete for business and competition between them can lower prices for car buyers. Manufacturers, they maintain, would not be subject to the same competitive pressures.

This view is inconsistent with modern economic learning and with the Supreme Court’s widely accepted observation that strong “interbrand” competition—competition between rival manufacturers—can suffice as a source of downward pressure on price.<sup>23</sup> Manufacturers in a competitive market face acute pressure to keep prices low to keep buyers from shifting their purchases to a competing manufacturer’s product. Thus, forcing firms to use inefficient distribution methods can result in higher prices and other forms of consumer harm. As described above, this is not merely a theoretical possibility. Statistical evidence shows that states that have placed strong limitations on gasoline refiners’ ability to operate their own retail outlets tend to have higher prices than those that allow refiners to use whatever combination of dealer and company-operated stations they prefer.<sup>24</sup>

A continuing ban on direct sales by manufacturers perpetuates the current closed system of motor vehicle sales in Michigan. The system limits competition among existing, well-established manufacturers, all of whom must sell through the established network of independent auto dealers. A direct sales ban deters experimentation with new and different methods of sales

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<sup>23</sup> *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19 (1977) (“Interbrand competition is the competition among the manufacturers of the same generic product [...] and is the primary concern of antitrust law. [...] In contrast, intrabrand competition is the competition between the distributors, wholesale or retail, of the product of a particular manufacturer. [...] [W]hen interbrand competition exists, [...] it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.”).

<sup>24</sup> Michael G. Vita, *Regulatory Restrictions on Vertical Integration and Control: The Competitive Impact of Gasoline Divorcement Policies*, 18 J. REG. ECON. 217–33 (2000).

by current auto manufacturers, and also by future entrants to the market. Michigan's consumers are paying the price of such a dictate. The essential mechanism that drives markets—the interaction between the supply by manufacturers and the demands of consumers—is being curbed. The market is less responsive to consumer preferences and less innovative in anticipating their evolving needs.

Again, FTC staff offer no opinion on the question of whether motor vehicle manufacturers would be best served by selling their products directly or through independent distributors. Nor do we express a view as to whether any particular motor vehicle manufacturer should succeed or fail. Our principal point is this: absent some legitimate public purpose, consumers would be better served if the choice of distribution method were left to motor vehicle manufacturers and the consumers to whom they sell their products.

## **B. Proposed Bill to Ease a Manufacturer Sales Ban**

Your request for the FTC's views and comments refers to Senate Bill 268 in the Michigan legislature. This pending bill would not remove what has been interpreted as a categorical manufacturer direct sales ban. Instead, the bill would carve out a limited exception to the current law's prohibitions for a defined category of motor vehicles. In our view, this bill (as indeed any effort to loosen or reduce the blanket prohibition) is a step in the right direction for competition and consumers.

### **1. The Proposed Bill**

Senate Bill 268 would apply to the category of motor vehicles known as “autocycles,” which are defined under existing law<sup>25</sup> as follows:

“Autocycle” means an enclosed motorcycle that is equipped with safety belts, rollbar, windshield, wipers, steering wheel, and equipment otherwise required on a motorcycle, and which has not more than 3 wheels in contact with the roadway at any 1 time.

The operative language of Senate Bill 268 would add a new subsection (4) to Mich. Comp. Laws § 445.1574 that would expressly permit manufacturers of autocycles to engage in sales and service of these products in Michigan:

The manufacturer of new or used autocycles may engage in the direct retail sale, purchase or exchange of, or deal in or make repairs to, those autocycles. As used in this subsection, “repairs” includes general repairs, warranty work or repairs, or recall work or repairs.

In addition, the bill would modify several prohibitions under existing law:

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<sup>25</sup> Mich. Comp. Laws § 257.25a.



- The current prohibition against a manufacturer directly owning, operating or controlling a new motor vehicle dealer<sup>26</sup> would be modified to permit “the ownership, operation or control by a manufacturer of autcycles of a new motor vehicle dealer or a used motor vehicle dealer that is engaged in purchasing, selling, exchanging, or dealing in autcycles manufactured or assembled by that manufacturer.”
- The current prohibition against a manufacturer selling a new motor vehicle directly to a retail customer other than through franchised dealers<sup>27</sup> would be made subject to the new subsection (4) above.
- The current prohibition against a manufacturer authorizing a non-franchised motor vehicle service and repair facility to perform motor vehicle warranty repairs and recall work<sup>28</sup> would be modified to permit “work on an autcycle that was manufactured or assembled by the manufacturer.”

## 2. Benefits of the Proposed Bill

Removing the direct sales and service ban for the autcycle motor vehicle category would eliminate an obstacle to market entry in Michigan by a new manufacturer. Elio Motors has announced plans to manufacture an innovative low-cost, high-mileage, enclosed three-wheeled vehicle. The firm plans to manufacture the vehicles at a facility in Shreveport, Louisiana, beginning in 2016. As of March 29, 2015, it had accepted more than 41,000 reservations for the vehicles. Elio Motors does not intend to establish an independent dealer network. Warranty service will be provided through the Pep Boys auto service chain.<sup>29</sup>

Distribution of Elio products is planned through a series of company-owned retail sales centers and a smaller number of regional company-owned “Marshaling Centers.” Customers will place orders at the retail centers and the orders will be filled overnight from the Marshaling Centers that will maintain product inventory. Basic models of the Elio vehicles stored at the Marshaling Centers will be configured with optional equipment selected by the customer and then delivered to the retail center for pickup by the customer. This distribution method, which maintains product inventory at locations away from the sales outlets, and tailors final product assembly to the configuration chosen by the customer, is an important part of the firm’s business plans to drive down the consumer price of its products. By fitting cars with only those options that the customer chooses, Elio plans to avoid charging for options “packages” containing costly items that customers neither need nor want.<sup>30</sup>

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<sup>26</sup> *Id.*, § 445.1574(1)(h).

<sup>27</sup> *Id.*, § 445.1574(1)(i).

<sup>28</sup> *Id.*, § 445.1574(1)(p)(iv).

<sup>29</sup> Elio Motors, <http://www.eliomotors.com> (last visited March 30, 2015). See Elio One-Page Specs Sheet, [http://www.eliomotors.com/One\\_Page\\_Specs\\_Sheet.pdf](http://www.eliomotors.com/One_Page_Specs_Sheet.pdf).

<sup>30</sup> Tech Talk v60 – The Elio Customization Process (March 18, 2015), <http://www.eliomotors.com/tech-talk-v60-the-elio-customization-process/> (last visited March 30, 2015). CEO Paul Elio has explained that he sees packages of options as bad for the interests of consumers: “As a customer, if I want the leather seats, I have to buy the fancy radio and the fancy wheels whether I want to or not. And if you look in your vehicle right now, there’s several

The proposed bill would help clear the way for an innovative product and distribution method not yet available to Michigan consumers. Moreover, the bill is not specific to Elio Motors; it would also permit other manufacturers of motorcycles to reach customers directly in the event consumer demand grows in this market segment. The proposed bill, therefore, would enhance competition in a new product category and would provide tangible benefits for Michigan consumers.

### **III. Conclusion**

Although Senate Bill 268 would likely facilitate innovation in new products and distribution methods in the motorcycle category of motor vehicles, it would leave in place existing law for other forms of motor vehicles. In other words, a blanket ban on direct manufacturer sales would remain in effect for the products that make up the vast majority of motor vehicles sold in Michigan today. FTC staff believe that current law, interpreted to ban direct manufacturer sales of motor vehicles, is very likely anticompetitive and harmful to consumers. Its breadth cannot be justified as a way to protect franchised dealers from abuse in their franchise relationships, and the other arguments offered in its defense appear to be contrary to a significant body of economic study and FTC experience.

The proposed bill carves out a limited exception to current law. In FTC staff's view, any effort to loosen or reduce a blanket prohibition on direct manufacturer sales may prove beneficial. However, we note that innovations in distribution methods (including the kind planned by Elio Motors) could be undertaken for a much broader range of motor vehicle products than just motorcycles.

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thousands of dollars of stuff you neither need nor want." Tavarish, Interview with CEO Paul Elio, <http://carbuying.jalopnik.com/elios-ceo-explains-how-he-can-sell-an-84-mpg-car-for-6-1677743693> (last visited March 30, 2015). *See also* New York International Auto Show: Elio Press Conference, <https://www.youtube.com/watch?v=RJUXhK4pHx8&feature=youtu.be> (published April 2, 2015) at 11:25 – 14:15.

We urge the legislature to consider abandoning the direct sales prohibition in Michigan's existing law, and instead permit manufacturers and consumers to reengage the normal competitive process that prevails in most other industries. Such a change would facilitate the development of new methods of distribution, benefitting the motor vehicle buyers of Michigan.

Respectfully submitted,

Marina Lao, Director  
Office of Policy Planning

Deborah Feinstein, Director  
Bureau of Competition

Francine Lafontaine, Director  
Bureau of Economics