UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
ATLANTA REGIONAL OFFICE

June 9, 1999

The Honorable George W. Miller, Jr.
Chairman, Finance Committee
House of Representatives
532 Legislative Office Building
Raleigh, North Carolina 27601-1096

Dear Chairman Miller:

The Atlanta Regional Office of the Federal Trade Commission(1) is pleased to respond to your April 28, 1999, request for comments on Senate Bill 420, "An Act To Clarify The Dealers and Manufacturers Licensing Law" (S.B. 420) and Senate Bill 419, "An Act to Clarify Motor Vehicle Dealer Transfer Rights" (S.B. 419), currently being considered by the North Carolina Legislature. Both bills would amend existing North Carolina law (2) governing how motor vehicle manufacturers distribute their automobiles in North Carolina and the relationship between motor vehicle manufacturers and dealers by prohibiting manufacturers from owning or controlling a dealership in North Carolina except in limited circumstances.

The proposed legislation would further shield motor vehicle distribution from market forces and thus could increase prices to consumers. In general, most distributors know that if they attempt to charge more than the competitive price or offer poor customer service, manufacturers can move their business to new distributors that are willing to charge lower prices or offer better customer service. Or, in the alternative, the manufacturer can distribute its products on its own. The current North Carolina law, which is further tightened by both bills, eliminates this competitive pressure by making it extremely difficult for manufacturers to alter their distribution system. The staff believes that the likely result of such a restrictive distribution system will be increased consumer prices.(3)

The Commission is an independent administrative agency responsible for maintaining competition and safeguarding the interests of consumers. In the course of research, investigation, and litigation of antitrust and consumer protection matters, the staff applies established principles and recent developments in economic theory and empirical analysis. Upon request, the staff of the Commission also analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy.(6) Commission staff also has gained experience relating to the motor vehicle industry through many investigations and cases.(7)

Current North Carolina Law Governing Motor Vehicle Dealerships

Current North Carolina law regulates the relationship between a motor vehicle manufacturer and a dealer. Generally, it is unlawful for a manufacturer: (1) to coerce a dealer to accept delivery of any motor vehicle not ordered, (2) to threaten to cancel a dealer's franchise, (3) to prevent the transfer of a dealership, (4) to grant additional franchises, or (5) to terminate a franchise without good cause, etc. The statute vests with a state commissioner the authority to enforce the provisions of this regulatory scheme. The current statute also provides existing motor vehicle dealerships with administrative avenues for challenging a decision by a dealer's manufacturer to establish a competing dealership in the same "relevant market area" (RMA). In addition, North Carolina currently restricts a manufacturer from owning or controlling any motor vehicle dealership in a relevant RMA already served by the same line or make from the manufacturer.

Additional Restrictions Contained in Both Bills Governing the Relationship Between Motor Vehicle Manufactuers and Dealers May Have Anticompetitive Effects

S.B. 420 and S.B. 419 further regulate the structure of the motor vehicle market and relationship between motor vehicle manufacturers and dealers. There are four provisions in the two bills that the staff believes may have anticompetitive effects and thus harm consumers.

First, S.B. 420 amends the current law by prohibiting a manufacturer from owning, operating, or controlling a retail dealership anywhere in the state, as opposed to the current restriction on locating a wholly-owned dealership anywhere in the relevant RMA.(8) There is an exception to this restriction during periods of transition of ownership from one independent dealer to another and in those relevant market areas in which no other person can be found to operate a dealership.

S.B. 420 has the effect of eliminating entry by the manufacturer into distributing its products itself. As a general proposition in a competitive marketplace, a manufacturer should be permitted to establish whatever mix of wholly-owned and independent outlets that the manufacturer finds most satisfactory. Manufacturer-owned dealerships might be able to operate with cost-savings that would lower the costs of vehicles to North Carolina consumers.

Second, S.B. 420 prohibits a manufacturer from limiting the number of franchises of the same make of motor vehicle that a dealer may own or operate within North Carolina and from placing any other restriction or condition on ownership or operation of a franchise, unless the same limitations, restrictions or conditions are placed on all of its other franchisees.(9) This provision prevents the manufacturer from responding to the competitive marketplace in the most efficient manner.

The ability of a manufacturer to use vertical restrictions, including its determination of which and how many distributors to use, has been recognized by the U.S. Supreme Court as a legitimate marketing tool.(10) For example, the competitive conditions that exist in one part of the state may not exist in another part of the state. Interbrand and/or intrabrand competition may be strong in some areas, but not as strong in other areas. The manufacturer may need to respond differently depending upon specific competitive conditions, and this provision eliminates the manufacturer's ability to engage in this type of conduct.

Third, the proposed amendment to S.B. 420 would further limit two provisions that already restrict a manufacturer's ability to ensure that the best efforts of a dealer go into promoting and selling a particular line of motor vehicle. Proposed amendments to Sections 20-305(11) and (25) further restrict the use of exclusive relationships between a motor vehicle manufacturer and a dealer by eliminating use of exclusive dealership arrangements even when their use may be reasonable.

Because exclusive arrangements may be pro-competitive, it may be unwise to restrict their use. For example, exclusive dealerships could allow a manufacturer to achieve certain efficiencies in the distribution of its products by inducing competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products to the consumer.(11) Rather than restricting the ability of manufacturers and dealers to determine the best manner to sell their products, it is generally preferable to entrust market participants to make these decisions. If any such exclusive arrangement has anticompetitive effects, the antitrust laws could be used to eliminate the offending arrangement.

Finally, S.B. 419 and S.B. 420 interfere with a manufacturer's ability to determine the best seller of its products. S.B. 419 amends the current law by prohibiting a manufacturer from exercising a right of first refusal that it may have with a particular dealer to object to the dealer's sale of its franchise to a new dealer.(12) Specifically, the amendment eliminates a manufacturer's right of first refusal (if a franchise agreement contains one) in a transfer situation, even if the manufacturer determines that the continued existence or the location of the dealership is no longer viable or that the existence or location is no longer consistent with the manufacturer's distribution or marketing plans. As discussed above, the ability of a manufacturer to use vertical restrictions has been recognized by the Supreme Court as a legitimate competitive tool. By eliminating the use of this provision in the franchise agreements, the amendment proposed in S.B. 419 interferes with the competitive functioning of the marketplace. Furthermore, S.B. 420 amends the current law by prohibiting a manufacturer from objecting to the sale or transfer of ownership of a dealership unless it can show poor character or lack of financial ability.(13) This amendment would further restrict the manufacturer's ability to control who can best distribute its products.

Conclusion

In summary, S.B. 420 and S.B. 419 could have adverse competitive effects on the motor vehicle market by restricting the ability of manufacturers to structure their businesses as they deem necessary to meet the competitive demands of the marketplace. We believe that both bills are likely to harm consumers to a greater degree than is the case with the current statute.

Sincerely,

____
Andrea L. Foster, Acting Director

____
Harold E. Kirtz, Senior Litigator
Atlanta Regional Office
Federal Trade Commission

1. This comment represents the views of the Atlanta Regional Office of the Federal Trade Commission, and not necessarily the views of the Commission itself.

2. N.C. Gen. Stat. § 20-301 et seq. (1998).

3. In 1986, the Commission's Bureau of Economics published a study of the "Effect of State Entry Regulation on Retail Automobile Markets" that reviewed the regulation of retail motor vehicle dealerships. The report focused on relevant market area (RMA) laws, like the current law in North Carolina, that limit the number of same-brand dealers within a geographic area. The report found that such laws generally limit manufacturers' freedom to expand, thereby increasing both the cost of distributing motor vehicles and the prices paid for them. Consumers may find fewer opportunities to shop among the dealerships for a particular brand for better prices and may have to travel farther and expend more time in the course of their shopping.(4)

4. R. Rogers, <u>The Effect of State Entry Regulation on Retail Automobile Markets</u> 7 (1986). After the release of that Bureau of Economics Staff Report, the National Auto Dealers Association requested that a consulting firm prepare a report, which challenged the conclusion that prices of automobiles would rise as a result of RMA laws in areas of growing population. That report for NADA also discussed the theoretical arguments that RMA laws are desirable. Attachment 2 is a Bureau of Economics paper that responds to, and disputes, the NADA report. (5)

5. Price increases resulting from RMA laws are mostly likely to occur in counties or metropolitan areas experiencing increases in population (and therefore increases in demand). The results of this FTC study are consistent with other studies showing that increased prices result from RMA laws. See E. W. Eckard, Jr., "The Effects of State Automobile Dealer Entry Regulations on New Car Prices," <u>Econ. Inq.</u>, 223-42 (Apr. 1985) and Smith, R.L., "Franchise Regulation: An Economic Analysis of State Regulations on Automobile Distribution," <u>J. L.and Econ.</u>, 125-57 (Apr. 1982).

6. The staff of the Commission has commented in the past on the effects of motor vehicle dealership laws, including to the Governor of the State of Illinois, House Bill 776 (Sept. 8, 1989); the Committee on Economic, Community and Consumer Affairs, Florida Senate, Florida Statute Sec. 320.642 & .645 (Mar. 29, 1988); Wisconsin State Senate, Senate Bill No. 466, An Act Relating to Various Changes to the Fair Dealership Act (Feb. 19, 1988); and Judiciary & Consumer Affairs Committee, Wisconsin State Senate, Senate Bill 47 (June 19, 1987).

7. See, e.g., General Motors Corp., 123 FTC 241 (1997); Mitsubishi Motor Sales of America, 123 FTC 288 (1997); Ford Motor Company, 122 FTC 69 (1996); Santa Clara County Motor Car Dealers Assoc., 120 FTC 1032 (1995); Detroit Auto Dealers Assoc., Inc., 119 FTC 891 (1995), 118 FTC 78 (1994), and 111 FTC 417 (1989); Nissan Motor Corp., 117 FTC 1075 (1994); General Motors Corp./Toyota Motor Corp., 116 FTC 1276 (1993) and 103 FTC 374 (1984); General Motors Corp., 102 FTC 1741 (1983); Ford Motor Company, 102 FTC 1732 (1983); and American Honda Motor Co., Inc., 99 FTC 305 (1982).

8. S.B. 420, § 20-305.2.

9. S.B. 420, § 20-305(35). In fact, a proposed amendment in S.B. 420 to § 20-305(9) could prohibit manufacturers from ensuring that the motor vehicles that they produce are appropriately serviced and repaired by the dealers. This amendment may prohibit manufacturers from requiring the purchase of computer equipment or special tools with which to service or repair motor vehicles. As a result, it may be hard for the dealers to properly service or repair new motor vehicles with all of their added software equipment unless they use the equipment or tools designed for that use.

10. Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36, 54-5 (1977) ("Vertical restrictions promote competition by allowing the manufacturer to achieve certain efficiencies in the distribution of [its] products . . .. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products. Service and repair are vital for many products, such as automobiles . . .").

11. Id. at 55. On the other hand, exclusive arrangements might facilitate collusive activity where interbrand competition is weak and could raise competitors' costs by foreclosing or disadvantaging competing firms from obtaining the inputs - here, motor vehicles - they need to compete.

12. S.B. 419, § 20-305(18).

13. S.B. 420, § 20-305(4).