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FTC Workshop Participants
Office of the Secretary
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex B)
Washington, DC 20580

pdf file via FTC website

Re: Auto Distribution Workshop, Project No. P131202

Dear FTC Workshop Participants:

I sincerely thank the workshop organizers for the opportunity to write expressing my views of the current US vehicle distribution system.

Background

I am a retired engineer who for the most part has had positive experiences with dealerships. Moreover, prior to March, 2012, when I became a Tesla Motors, Inc. (TSLA) investor, I had very little knowledge or even awareness of the patchwork of State laws that govern vehicle distribution in the US.

However, since the time of my initial TSLA investments, I have done much research on the history of Federal and State auto distribution statutes as well as their role in today's marketplace. I discovered multiple periods between the 1920's and the late 1950's where the dealer/manufacturer relationships were asymmetrical -- with the manufacturers holding the strong upper hand (Hewitt 14-37) (Lafontaine and Morton 238-239). Moreover, during times of excess capacity, manufacturers at times engaged in what many saw as unfair practices. As a result, the original statutes were drafted and served a legitimate purpose of protecting locally owned dealerships from abuses of power mainly by the "Big-Three." (Hewitt 38-52)

Today, however, the exclusive control of the Big-Three is long gone. There is a richly competitive inter-manufacturer environment with dozens of participants (Wikipedia contributors , "Automotive industry") actively vying for customers. Yet the laws have not only remained in place, but have even been strengthened over the years. Perhaps most distressing are the recent language changes, or attempted changes, that have been targeted at Tesla to expand the scope of the laws beyond their original intent -- protection of *existing* dealerships from their over-powerful manufacturers (Pitti). Since Tesla has never had independent dealerships, they clearly fall outside the scope of the original statutes -- as the languages of which often thereby attest.

¹ Personal information redacted from public display. This information is visible on all signed paper documents.

Again, most of my dealership experiences have been positive. Moreover, if all of the franchise laws were vacated, I believe that most manufacturers would choose to maintain the majority of their dealership arrangements. That said, I think it is wrong to force this arrangement on both manufacturers and consumers. I strongly believe that we should repeal most of the restrictive regulations that are anticompetitive. Increased competition should give consumers more choices at better prices. And, any dealership that is providing competitive services should do just fine without statutory protections.

Discussion Topics (FTC workshop contributors)

Dealership Location

Protecting dealership territorial security was one of the original primary goals of the statutes (Hewitt 34). However, in today's market, I see little use for government intrusion into this aspect of auto distribution -- other than **rentier protectionism for the dealer**. Moreover, in a changing market (*e.g.*, 2009 Great Recession), these restrictive laws can only hamper an industry's ability to respond to new economic environments resulting in inefficiencies that drive negative outcomes for all stakeholders -- consumers, dealerships, manufacturers and investors (Lafontaine and Morton 242-246).

Business location selection is a multifaceted process. One must consider land costs, utility costs, accessibility, competitor proximity, *etc.* Excluding common zoning regulations, non-auto industry businesses seem to be able to handle their business location decisions without this type of regulatory assistance. In fact, I suspect that most would find this "assistance" intrusive.

It seems clear that the statutes restricting dealership location are meant to serve existing dealerships -- exclusively. Ultimately, they lock in protectionist advantages for these businesses simply because, "They got here first!" They constrain competition -- the true engine (or motor, if you will) of capitalism -- thereby creating market inefficiencies at the expense of all other stakeholders.

Consider the hypothetical case where a gas station located on the corner of an intersection is the only gas station in the area. If a second gas station comes in across the street, the competition between the two will almost invariably result in significant consumer benefits -- lower gas prices, better selections of foods and drinks, cleaner restrooms, *etc.* It is a real win for consumers that these gas stations' owners haven't spent millions of dollars on campaign contributions and lobbyists in order to obtain subsequent government mandated territorial exclusivity protections.

I suspect that these protectionist types of activities would run afoul of antitrust/trade restraint laws were they not imposed by government actions. Perhaps this could be a topic for the workshop. *I.e.:*

1. Would existing dealership location restrictions be legal under current antitrust/trade restraint laws if not enacted via government statute?
2. If not, then in order to supersede antitrust/trade restraint laws, is the restrictive statute enacting government entity required to provide any sort of *reasonable basis justification*?
3. If so, who is the responsible party for determining the validity of the reasonable basis justification? State judiciary? Federal judiciary? FTC? Some combination of the three? All of them?

For me, these have been long-standing questions. My hope is that they are of sufficient general interest to merit discussion in the workshop.

Warranty Services and Reimbursement

Many of the current statutes dictate warranty service reimbursements between dealerships and their manufacturers (Lafontaine and Morton 240). Why would the government insert itself between these two businesses? Why the auto business in particular? Why not set the reimbursement rates & prices between all businesses? Clearly this would be absurd. So, we're back to, "*Why the auto business in particular?*" I think that the likely argument would center around public safety. *I.e.*, the government would mandate certain minimum reimbursement rates in order to assure incentive for the dealerships to in fact do the work. However, it seems to me that *all warranty work exceeds the umbrella of public safety*. Perhaps reimbursement mandates limited to *safety* related work would be a more appropriate scope for government regulations.

In any case, it is the dealerships and their lobbying organizations that hold sway in most State legislatures today. This gives dealerships significant advantages in determining reimbursement rates with the State's ability to arbitrarily set whatever rates it chooses into law. Any excesses in this regard will, of course, ultimately fall to the consumer.

The National Automobile Dealership Association ("NADA") tells us that current franchise arrangements provide increased consumer safety largely driven by the reimbursement statutes. However, in reading about the appalling GM ignition switch scandal where dealerships received technical service bulletins on the problem as early as December, 2005 (Blau), one has to question the efficacy of this system.

Moving on, there is a new type of remote repair/upgrade that has come to light with the Tesla service model. The Tesla fleet is in constant contact with the manufacturer thereby providing myriad data for both vehicle problems as well as general usage. In fact, the Tesla Autopilot function uses data from the portion of the fleet equipped with that feature to improve itself via a daily neural-net type of "learning" based on customer corrections that are recorded by the vehicle & transmitted back to Tesla. I believe that this type of remote repair/upgrade function is outside of the scope of the current statutes & I see no benefits in modifying the statutes to include them – other than an additional dealership rent.

Direct Sales

The laws prohibiting direct sales originally acted as remedies to the asymmetrical relationships between existing dealerships and their respective manufacturers. In the early 1900's and again after WWII, vehicle manufacturers needed all their capital for manufacturing expansion investments. Consequently, it was to their advantage to contract with independent dealerships for their vehicle distribution and sales. In an atmosphere of unrestrained competition, local business people made significant investments (a significant portion of which that were "sunk cost") in these dealerships to the benefits of the manufacturers, the consumers; and, of course originally, to the dealerships themselves.

Moving on, after WWII, there was a huge level of pent-up demand for new vehicles. Carmakers found themselves with enormous capital expenditures ("CAPEX") demands for what amounted to breakneck expansions of their manufacturing capacities. With the dealerships funding distribution operations, manufacturers were able to pour maximal resources into the expansions. Thus, ultimately delivering the much sought-after new vehicles to their franchise dealerships not only sooner than they would have done under any other type of arrangement, but at higher volumes as well. This was capitalism working at its best. Driven by innate self-interest, Adam Smith's "invisible hand" was optimally positioning capital and labor,

thereby creating an efficient, bountiful economy. An economy that was serving a broader swathe of American society than ever before. An economy that was providing a rapidly increasing standard of living not even thought possible in the prior generation.

Unfortunately, as pent-up demand was satisfied, manufacturers realized that they had expanded to a transitory level of peak demand. In the early 1950's, post-war expansions waned along with the need of the associated CAPEX spending. And, by the mid-1950's, further expansions were by and large curtailed for a time.

Yet, even coming down from the pent-up peak demand for new vehicles, the strong, post-war economy drove an albeit smaller, but still healthy, level of new vehicle demand. And, while manufacturers were no longer blessed with 100% utilization of their peak demand manufacturing capacities, they still enjoyed healthy revenues and profits; and, consequently, soon had the resources to make investments in other new areas. Unfortunately for all, the combination of excess capacity and growing cash hoards changed the relationships between the manufacturers and their dealerships. Manufacturers began forcing dealerships to accept more vehicles than they could sell (Hewitt 30-37). Additionally, dealerships -- with those enormous sunk costs -- found themselves frequently under manufacturer threat of termination if they failed to meet what appeared to many as increasingly unreasonable demands². The dealerships rightfully cried "foul" and looked to Federal and State governments for protections to remedy these manufacturer excesses. Restrictions on direct sales by the manufacturers was one of the provisions of many of the resulting protections.

While restrictions on direct sales by manufacturers with *existing* dealership relationships may have appeared fair in the late 1950's, I do not believe that they should have been written without an expiration clause of some kind. They constitute a government-imposed restraint of trade by limiting a logical form of potential competition. In hindsight, a temporary patent type of protection would seem a more logical solution. In any case, a **key point** to be made is that **the statutes' original intents were strictly limited to manufacturers with existing dealerships. It is perfectly clear, even to the most casual observer, that Tesla Motors, never having had any dealerships, should NOT be restrained by any direct sales prohibitions.**

Be that as it may, I find myself back with a very similar set of questions previously asked in the Dealership Location section of these comments. They are:

1. Why have these prohibitions against direct sales by manufacturers persisted?
2. As a trade restraint that limits competition, are they not required to have some sort of ongoing *reasonable basis*?
3. If so, what is that basis today?

Note: The current rationale put forth by NADA seems completely absurd on its face. From the faux "competition" that completely disregards manufacturers' wholesale pricing abilities (Manne, Ahdieh and Atkinson 3), potential Colgate pricing (Dorfman) and double marginalization problems (Lafontaine and Morton 238), to the support of

² And here we see the dark side of capitalism where that same innate human trait -- self-interest -- drives businessmen to try to take advantage of each other usually with the common, ubiquitous justification of, "Well, that's just business." And on a larger scale, we see a 70,000-page tax-code & powerful businesses and industries (what Adam Smith called the Mercantile class) buying special interest influence and favors resulting in a system of crony- or rentier-capitalism. Alas, I despair.

local advertising and even Little League teams, the arguments put forth to date are not compelling in the least.

Furthermore, it is utterly clear that the consumer would prefer additional avenues of purchase. An Austin Business Journal poll showed that 86% of respondents thought that Tesla should be able to sell directly to consumers (Drake); a Triangle Business Journal poll, 97% (Wall); and lastly, a Los Angeles Times poll, 99% (Fessler).

So, we have unpopular, anticompetitive, government regulations with questionable reasonable basis that a super-majority of the public does not want. Yet, they stay in place year after year. This seems to validate a recent distressing Princeton and Northwestern universities study -- "Testing Theories of American Politics: Elites, Interest Groups, and Average Citizens" -- in which the authors stated:

The central point that emerges from our research is that economic elites and organized groups representing business interests have substantial independent impacts on US government policy, while mass-based interest groups and average citizens have little or no independent influence. (Gilens and Page)

And the "elites" that are keeping these unpopular statutes in place? The auto dealerships of course. Jeffrey Dorfman, professor of economics at The University of Georgia, writes:

Auto dealers are not looking to help consumers; rather, they simply want to capture more profits for themselves. The proof is the money the auto dealers are spending to secure their victories in state legislatures. The only reason to spend money to secure legislation is because that legislation will capture profits that will more than replace the money spent. If consumers end up winning as part of that process, car dealers certainly will not mind, but that is not their aim.

We economists call such behavior rent seeking. (Dorfman)

Particularly galling is the fact that, ultimately, it is we consumers that are forced to pay for all this special interest influencing via higher new vehicle and service pricing. For the Texas 2013 legislative session, Tesla spent \$7,500 on campaign contributions and between \$160,000 - \$345,000 on lobbyists; the dealerships; \$2,510,000 on campaign contributions & \$780,000 on lobbyists (Lobby Watch contributors). With Tesla being outspent somewhere between 10:1 & 20:1, neither Tesla, nor the legislature's constituency, got any relief on Texas's anticompetitive, rent-seeking, new vehicle direct sales prohibitory regulations. It seems that Texas was NOT "open for business" in 2013. And, the "particularly galling" part -- we consumers paid about \$3,500,000 in higher new vehicle sales and services prices to keep a system we do not want safely in place. Moreover, this does not include the estimated additional 8.6% (Bodisch) antiquated, large inventory, dealership business model tax for which we have no alternatives.

Another disadvantage to consumers is that being locked into a 60+ year-old business model creates significant barriers to new advancements and innovations in business practices. *E.g.*, in the typical franchise model, the manufacturers build the bulk of their vehicles with a distribution of colors and options that they hope will be a somewhat close match to what consumers will want. This business model leads to:

1. Dealerships carrying large inventories (which come with their own associated accounting costs) that require huge real estate investments & ongoing utilities costs.
2. Customers that end up buying some options that they do not want and going without others that they do want.
3. End of the model year heavily discounted sales on the dealer for any leftover inventory. And these vehicles are typically the least desirable color/option sets for consumers.

In contrast, Tesla's build-to-order model provides the customer with the exact set of colors and options that they choose. The benefits of this model include no huge inventory carrying costs; and, even more importantly, the low cost benefits of relatively tiny stores and service centers in comparison to the much higher costs that come with huge sprawling car lots equipped with stadium level lighting. Again, these are significant costs that the consumer ends up paying. In fact, a 2009 Department of Justice ("DOJ") study estimated that when compared to a competitive build-to-order system, the current franchise business model increases consumer vehicle costs about 8.6% (Bodisch).

Finally, looking at Tesla Motors in particular, I think a franchise distribution system with commission based sales incentives would be ruinous for Tesla. The two main problems are:

1. The public is still very naïve to Tesla's products. In fact, customer education, rather than sales, is the primary mission of today's Tesla stores.
2. Tesla vehicle maintenance requirements, with only 20% of the moving parts of comparable internal combustion engine vehicles ("ICEV's"), would disrupt most of today's dealership business models that typically get ~50% or more of their revenue from their service departments.

In considering the first point, Tesla vehicles would have a big incentive problem with the sales staff of any multi-line dealership. Electric Vehicles ("EV's") are a huge technology shift from the well-known ICEV. I can easily imagine a customer/salesperson dialog like this...

Customer: *What kind of engine..., I mean **motor** does this electric car have?*

Salesperson: *It's called a 4-pole, 3-phase, AC induction motor. Very efficient.*

Customer: *What kind of mileage does it get?*

Salesperson: *97 miles-per-gallon **equivalent**.*

Customer: *Equivalent?*

Salesperson: *[Fairly lengthy explanatory discussion ensues...]*

Customer: *How long does it take to charge?*

Salesperson: *Well, that depends. [Fairly lengthy explanatory discussion ensues...]*

Customer: *What type of transmission does it have?*

Salesperson: *No transmission – just a single step-down gear.*

Customer: *What about oil changes, other maintenance?*

Salesperson: *No oil changes. [Fairly lengthy explanatory discussion ensues...]*

Customer: *How do longer road-trips work?*

Salesperson: *[Fairly lengthy explanatory discussion ensues...]*

The problem for the salesperson is time. Do to the learning process involved, the salesperson will have to invest a relatively huge amount of time with a typical customer that is new to Battery Electric Vehicles ("BEV's"). Furthermore, the new customer will be much more likely to want to leave the showroom (very bad in traditional sales) in order to have enough time to process all the new information. A typical salesperson could possibly sell three or more ICEV's in the same amount of time required to sell a single BEV. Thus, the salesperson is strongly incented to steer the customer to familiar ICEV's. For this reason alone, the typical franchise model, at this time, could not possibly work for Tesla. It becomes obvious why Tesla product specialists do NOT work on commission. Sometime down the road, when the typical customer is already familiar with BEV technology, perhaps a franchise distribution would work for Tesla; perhaps ten years from now, Tesla will choose such a system. But, in today's market, it would be business suicide.

The second problem area is that a Tesla BEV requires very little maintenance. For the dealership, these vehicles are not going to produce the same follow-on revenue stream that any other ICEV will produce. Again, for today's dealerships, BEV's just do not offer the same incentives as ICEV's.

Lastly, Tesla is a relatively new car company still building its brand. In light of the problems detailed above, this even further cements the absolute necessity of Tesla's vertical integration of distribution, sales and service.

New Developments and Future Trends

While I find the new car sharing services and autonomous vehicles very interesting, I can't help but wonder how shared ownership scheduling vehicle time will work. The daily morning, lunch and evening rush hours occur because so many people need their vehicles at the same time. The main advantage that I foresee is that the shared vehicle will almost certainly have a higher utilization rate than personally owned vehicles. Consequently, the passenger's costs per mile should be lower with the shared vehicle.

Also, when it comes to maintenance, do you divide the costs per person, or by usage? How do you handle unattributed damages? How do you handle insurance for an ownership group that has drivers with different driving histories (assuming the vehicle is not completely autonomous) and credit ratings?

Perhaps I'm seeing so many potential problems with group ownership simply due to my age group (55-60).

On the other hand, I'd love a personal autonomous car! And, I find Tesla's autopilot neural-net fleet learning with daily enhancements to the feature absolutely fascinating! We really are living in interesting times.

January 17, 2016

Page 8 of 10

Summary Closing

Back to today's automotive distribution statutory environment...

The state franchise laws have kept a decades-old vehicle distribution business model frozen in time since the late 1950's. It is a failing iceberg in the ocean of a modern economy. The bulk of its stakeholders (sans the dealerships and the politicians they finance) cry out for change. To continue insulating this model from market forces by state fiat will only serve to draw out the inevitable changes, putting off yet again the yields of a more competitive environment – new long awaited consumer choices and lower prices.

I believe that many in the FTC see these auto distribution laws for what they are – mostly outdated and costly rents – thus, the organization and hosting of this workshop. My hope is that this workshop will help spur the obvious, pro-competition, consumer-oriented changes that have been so needed for so very long.

I again thank those in charge of the workshop for giving me the opportunity to comment.

Sincerely,

/s/ Jack M. Burgess

cc: Signed paper copies with cover letters sent to...

The Honorable Jeff Merkley, United States Senate, Salem OR District Office

The Honorable Ron Wyden, United States Senate, Salem OR District Office

The Honorable Elizabeth Warren, United States Senate, Springfield MA District Office

The Honorable Peter DeFazio, United States House of Representatives, Eugene OR District Office

The Honorable Kate Brown, Governor of Oregon, State Capitol Building, Salem, OR

The Honorable Sara Gelser, Oregon State Senate District 8, Salem, OR

The Honorable Dan Rayfield, Oregon State House District 16, Salem, OR

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