

# OBSERVATIONS FROM ATTENDING THE FTC WORKSHOP

Auto Distribution; Current Issues and Future Trends

A Federal Trade Commission Workshop

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**Follow up Comments by Mark D. Johnson, President of MD Johnson, Inc.**

For those of you that were not aware of the recent workshop held in the FTC building in Washington DC on January 19, 2016, the Commission held what was to be an information gathering or exploratory meeting regarding the current state of the New Vehicle distribution system. I had the good fortune to attend with a dealer friend and some of his staff as well as with well known dealer lawyer Jeff Roberts. I consider myself fairly well informed and well read but was not prepared for the discourse that occurred over the 8 hours or so of panels and presentations that occurred.

## ***FTC Pre Determined Opinion on Automotive Distribution***

During Chairwoman Ramirez's opening remarks I learned that the FTC ***has*** a stated position that the current system of auto distribution is:

- Protectionist, special interest legislation.
- Restrains trade.
- Increases the costs of vehicle ownership to consumers over a direct distribution model.
- Is outdated, antiquated and in need of revision or dissolution.

The workshop which was billed as I stated, *exploratory* and designed to be a *fact-finding mission*, was indeed not conducted or organized in that manner. It was

disappointing to say the least that the meeting was orchestrated to carefully modify and direct all dialogue in a manner that muted obvious facts known to any practitioner of automotive retail. This included careful selection of panel members and an even more care was taken to not include any practitioners, i.e. dealers, CFO's, public company Presidents, factory personnel, etc.

Although the individuals on the pro dealership side of the panel were clearly professionals in their own right, no FTC invitations were given to dealers or manufacturers or anyone that was allowed to clearly and precisely articulate how a dealership actually functions on a day to day basis and how a dealership actually makes or loses money given from the practitioner point of view. The ultimate authorities on this subject are the people with *skin in the game*, which are the dealers and those selling the cars. None were invited as panelists. In fact, the only reference or observation that crystallizes the starkness of this omission would be to compare hearings and testimony about Obamacare but not to invite any physicians to discuss or present their opinions about practicing medicine.

### ***Meeting Format***

The meeting format was for Commissioner Ramirez to give opening remarks about the workshop and then to discuss the various panels, the goals of the workshop (hear from industry participants) and to discuss and introduce various academics who would be giving their opinion on the industry. Several panels were selected and gave presentations on the following topics:

- The new vehicle franchise system.
- Manufacturer to consumer sales (direct distribution) and new entrants.
- New vehicle repairs conducted under factory warranty.
- Autonomous vehicles.

### ***Economist Assertions***

The economists that were invited to speak were all highly regarded, tenured professors from top Universities. My expectation was to hear these individuals give a fairly balanced observation regarding the current franchise system, insight

about the direct distribution model as well and to discuss their opinions on the effect of the warranty process on vehicle costs.

What we heard from several of the panelists advocating change was a truly hostile, grossly misinformed and aggressively presented position that dealers have paid off legislators and politicians to develop an archaic, protectionist, labyrinthine web of laws and regulations whose only purpose is to ensure that vehicles can only be purchased from a franchised dealer. The connotation delivered in the various lectures by academics is that the dealers provide these services to consumers in exchange for an obscene profit with little risk to the purveyor and at an intolerable, damaging cost to the consumer.

It was clearly articulated and presented by panelist advocating for the current system that these laws were put in place to lessen a manufacturer's ability to abuse the factory/dealer relationship, encourage significant investment and to develop markets on behalf of a manufacturer. This nuance was dismissed as histrionics, continuously relied upon to support laws that are no longer necessary and only supported by dealers to reap undeserved profits at the expense of customers who have no choice where they buy a car or what they pay for it. One of the presentations by a professor was an angry lecture punctuated with innuendo that was borderline offensive, but at the same time embarrassingly inaccurate. It was truly beneath the stage and audience where it was delivered.

### ***Warranty Reimbursement***

The FTC and the anti dealer, anti franchise panelists including attorneys that represent manufacturers laid out their assertion that dealers should provide warranty repair services at little or no cost to the manufacturer. That the mark-up "legislated and protected" by the dealership franchises laws unjustly increases the cost of a new vehicles to a consumer and amounts to a "wealth transfer" from the consumer and the factory to the dealer. That is correct, a wealth transfer from a factory making billions of dollars, to a dealer on the backs of a consumer to fulfill a warranty obligation promised by the maker of the car, built into the price. They further asserted that warranty fulfillment should be allowed by any repair facility that the manufacturer would allow. The reader needs to keep in mind that these

are tenured professors' at large institutions who have studied automotive retailing. It was difficult for me to believe that anti franchise panelists did not understand the costs to hire and retain a qualified technician that could fulfill a dealer's warranty commitments to a customer, the cost of mandatory special tools, mandatory training at the dealers expense, or the open account that basically is an open line of credit for a manufacturer to grab in the event the factory determines through audit that the dealer has abused their position of trust in fulfilling the warranty commitment. Also, none of the anti dealer panelists understood the terms of trade payments tied to customers' satisfaction with their warranty experience. The panelists also lacked the understanding that customers often take their vehicles in for warranty work at a different dealer from the dealer where the purchase occurred and that the purchase experience of one dealer can bleed over to the warranty experience of the repairing dealer causing the repairing dealer to suffer decreased satisfaction scoring and the funds tied to the scoring process.

### ***Tesla's Objection to Selling through Franchised Dealers***

A Tesla attorney was one of the panelists during the Direct Distribution session in the afternoon. The gentleman speaking was very polite and matter of fact but most certainly had followed the company line. During his presentation he stated that there were 16 or 17 reasons why Tesla did not want to sell through a franchised dealer network. He discussed 7 of the reasons and then was out of time. The reason's below are closely paraphrased and can be viewed on the broadcast.

- Dealerships are large, out of the way locations not suitable for selling Tesla products.
- There is no inventory to carry as Tesla does not build the car until it is ordered.
- Dealerships sell at too fast of a pace for what is required by a Tesla buyer. Tesla is an educational process that takes hours.
- No margin in the car. Dealers would not want to represent them because they cannot make any money selling the car.

- Dealerships rely on large advertising budgets, Tesla does not advertise.
- Dealers cannot make any money selling Tesla products.
- Tesla believes that all cars should be electric cars and that gas powered cars should all be eliminated. This is counter to what dealers believe and what they sell.

The other seven or eight items were not addressed because his time was up to present. It should be noted that Tesla has publicly stated and it is widely published that Tesla does not want to be represented by licensed, franchised dealers because they do not believe dealers are capable of *“maintaining the integrity of their brand”*. Some additional information including a reprinted email from Elon Musk also stated that Tesla did not want to be associated with dealers because their business practices are unethical. I assume that is what was meant by his comment asking to garner support from *“everyone who has been screwed by a car dealer”*. It should be noted that just because it is on the internet does not make it true, so Elon Musk may in fact love new vehicle dealers and someone was simply being unfair to him.

### ***Summary to Dealers***

The FTC has it in their collective psyche to change your pay plan. If they had a magic wand they would deregulate the franchise system and let the free market take over along with deleting every cent ever invested in your business. It is their mindset to have manufacturers sell to dealers and consumers and let manufacturers establish as many or as few dealerships as they would like and allow manufacturers to add and terminate dealers based on the free market.

It is also the FTC’s position and desire that warranty work be performed wherever and with whomever will perform it and let the quality of the repairs be in the hands of the factory that is responsible for it. It is clearly the Commission and their advisors’ opinion that the current system is outdated and the completely distilled net result of the current system creates a special interest legislated, forced profit upon all automotive consumers.

Dealers need to clearly understand that they need to apply their core philosophy to the legislation that has been hard earned for the past century. That core philosophy is -- the only thing that is constant is change. You currently deal with issues regarding privacy, fair trade practices, issues regarding indirect lending, licensing, city and county changes to zoning, and attorneys who sue dealers for a living whether a case exists or not. You now need to add to your collective plate attention to a frontal assault on the core of what protects the tens and hundreds of millions of dollars invested in representing your manufacturers.

States have significant horsepower to change the laws upon which you have relied to invest. It is my belief that that FTC will rely on your false sense of security to obtain traction in their work to dilute and erode the financial security we rely on when investing in purchasing dealerships and the assets necessary to fulfill our obligations to our factory partners. It is also my information that the factories for "the most part" don't have any desire to significantly change how the dealer network functions. They do desire a better way to delete gray from the color scale created by the legislation regarding adding and terminating dealers. Those states where it is almost impossible to terminate a really bad dealer or to add a dealership within a less restrictive range of a bad dealer can expect to feel the assault first.

Regarding direct sales to consumers, the dealers have taken a very aggressive stance which has created the "NRA Effect"; any change is bad. Most of us believe that at the core of the system, both the dealers and the factories agree that the system works. Little has to be feared from new entrants with niche cars that will likely not survive beyond the "early adopters" phase. Some current cases exist and others will follow. Anyone familiar with distribution understands the margin necessary in a car to be successful as a car manufacturer will also understand that long term success of new entrants is unlikely.

Again it is my belief that dealers need to focus on allowing manufacturers more options in curing serious network issues and not to force the factory to keep bad dealers in business. It is my opinion that the FTC's current interest in franchising has been set in motion by new entrants that feel they are not getting a fair shake

in selling their products the way they want to sell them. Dealers have taken the position that all cracks turn into breaks and all breaks turn into a tsunami. A deeper dive must be taken by dealers to allow some cracks that have chance of becoming breaks. Giants are best left asleep.

Dealer associations react to dealer sentiment and sometimes that sentiment is inaccurate and can have the effect of appearing unnecessarily protectionist. I think this is a good time to be thoughtful and not reactionary and to carefully respond to inquiry. Everyone is busy, that is what the FTC is counting on. Complacency and a false sense of automatic victory is not the best course in dealing with changes in our business and clearly should be avoided when dealing with the FTC. Dealers need to be vocal with their associations and if they are not members, they need to become one NOW. If dealers are not familiar with their association then can go to [www.automotivebuysellreport.com](http://www.automotivebuysellreport.com) and find the contact information of every dealer association in the United States. Dealers also need to be a member of NADA and financially support actions that protect franchise laws. Franchise laws are just like the cars you sell. Without proper, continuous maintenance, things get bad quickly.

### ***Summary to the Commission***

Although my comments are somewhat critical of the Commission's success in creating balance in their panel selection, any opportunity to discuss the dealer franchise system with regulators is welcome. History tells us public policy decisions, when executed fairly, often create the desired outcome. The court system has recognized that certain proceedings are heard by a judge and not a jury in what the Commissioners likely know is various forms of Complex Trial Court. Complex Trial Court is just that. It is complex law and concepts not suitable for a jury and only suitable for a judge or a practitioner in this case, professionals with a deep understanding of the law or process.

I believe that the Commission would have been better served had they constructed a workshop that addressed this topic in a known, accepted and recommended manner. Practitioners should be on the panels and allowed to openly address the speakers or panelists. Also, questions should be allowed in an

open format as well as on question cards. The question cards should not be screened just by FTC personnel but by all panelists, and surely by a practitioner. I would define a practitioner panelist as a dealer principal and a factory representative at the Regional Manager level or higher.

It is my opinion that the Commissioners deprived themselves of obtaining the knowledge they were looking for as stated in the documents prepared and distributed prior to the workshop. The proper panel would allow the Commission to understand the following;

- How *exactly* does a dealership make or lose money?
- How much competition and cross shopping is there in major metropolitan areas?
- Why are certain stores owned by the manufacturer in certain mega cities?
- What are the principals required to follow in the operation of a dealership to meet all factory obligations and to be profitable?
- What issues has the dealer faced in the past regarding his or her relationship with the factory?
- How do the current regulations help or hurt the dealer? In the past?
- The factory personnel need to also be able to comment directly on what they are looking for in their relationship with the dealer and how observation of the law helps and hurts the manufacturer in executing their goals.
- The Commission needs to hear directly from factory management how they feel about the distribution system and what they would like to do differently if the opportunity presented itself.
- The Commission needs to hear from many manufacturers how they feel about direct distribution, Pros and Cons and their desires to wade into direct distribution again.
- The Commission needs to hear from Factory and Dealership owners and management how the warranty process works, how the customer's satisfaction with the process fits into both interests' business plans.

This is a sampling of what was not discussed in your workshop that without hearing the answers to these questions in an open dialogue format, the Commission cannot fully appreciate the Automotive Distribution system as it functions today and therefore cannot achieve their stated goal of gathering information and increasing their knowledge. Also during the presentation Attorney Frost and Attorney Roach asked the audience for questions. No audience participants were asked to comment on questions and of the 50 plus questions submitted, less than a handful were read.

### ***Suggestions and a Request to the Commission***

I strongly suggest and respectfully request that the Commission host an additional practitioner led workshop at the same venue. In that workshop the panel would consist of dealers and factory management. I would volunteer my time and my staff's time along with other organizations such as NADA to develop this panel and present the agenda to the Commission. It may require that the meetings are held over two days, one for franchising issues and one for warranty and direct distribution. In this meeting or meetings the Commission and their advisors would learn from and interact with the actual industry participants; the people with the investment and the people building the cars. I can personally assure you that at the conclusion of this workshop, good, bad or indifferent, the Commission would be in a significantly better position to govern and not a single seat would be vacant in your auditorium.

Respectfully,

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Article Addressing the FTC on Dealer Franchise Exploratory Workshop

<http://www.mdjohnsoninc.com/graphics/FTC-Workshop-Auto-Dealerships-MD-Johnson-Inc-Paper.pdf>

