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## ROCHESTER AUTOMOBILE DEALERS ASSOCIATION

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Brad McAreavy
*President*

My name is Brad McAreavy. For over thirty years, I have worked in the automobile industry, for General Motor's previous captive finance company (GMAC), for an automobile dealer group, and for the past eight years, I've had the honor and privilege to serve as the President of the Rochester Automobile Dealers Association. Not many people have seen and experienced this industry from multiple sides. In my current role, I have represented the interests of over one hundred franchised new motor vehicle dealers before the state legislature, local governments, and the public at large. Because of my experience, I have gained a comprehensive knowledge about how the motor vehicle industry operates.

I am writing to express my frustration over much of what I heard presented at the workshop the FTC conducted on January 19, 2016. This workshop focused on automobile distribution and the franchise laws that my state and 49 other states have enacted to regulate certain aspects of the relationship between manufacturers and independent franchised motor vehicle dealers. Unfortunately, rather than being a thoughtful, fact based examination of an extremely important industry, the workshop showcased several speakers invited by the FTC who had clearly made up their minds about the continued need for laws that have helped serve the public interest for many years.

While persons representing the dealers' viewpoints were present on several panels, it was obvious that the other speakers chosen by the FTC were of a single mindset: opposed to the current system of vehicle distribution in the United States and the franchise laws that regulate it. Much of the rationale advanced during the workshop was premised on the belief that the economic relationship between manufacturers and dealers is more balanced today and that dealers have grown in size to such an extent that such laws are no longer necessary to address the disparity in bargaining power between manufacturers and dealers that led to the enactment of these laws. Unfortunately, these individuals seem to have little understanding of, or appreciation for, how the business actually operates, and their comments did a real disservice to the franchised dealers in my state, their employees and, most important, to the public at large.

The public policy grounds which supported the enactment of these laws originally (the need for consumer protection, the disparity in bargaining power between manufacturers and dealers, and the value of community-based businesses) are as valid today as when these laws were first enacted.

They benefit consumers because:

- The laws ensure local, independent competition, which allows a consumer to shop for price and service. To highlight the importance of competition, we only need to look back a few years to remember a manufacturer's effort to operate in the automotive retail market. In the early 2000's one major domestic manufacturer bought all of its franchises in three separate U.S. markets. They employed a strategy that a consumer would get the same price for a specific vehicle from any location, and there would be no need to shop other same-brand dealerships in the area. Much like a big box retailer operates. In reality, because consumers could not shop and negotiate price, many simply stopped buying that manufacturer's products. The experiment was a disaster, the manufacturer lost millions of dollars, and ultimately sold the dealerships back to local, independent dealers.
- Dealers are the consumer's advocate when it comes to warranty repairs and chronic mechanical problems (Lemon Law). These are an expense to the manufacturer, and left to their own devices, they would deny/avoid them if possible. It's the dealer that holds the manufacturer accountable to the consumer.
- Consumers benefit from having an independent dealer representative who often remains in the market, despite the fact the manufacturer may have gone out of business, and there have been many.
- The dealer provides consumers with a place to trade in their current vehicles for its fair market value.
- Just this past weekend the Rochester area dealers partnered with the local Rotary club to raise over $100,000 for local children's charities. Is it reasonable to assume that a distribution network owned entirely by manufacturers would support local communities in that way? The answer is "no". Locally-owned businesses invest and reinvest in the communities in which they operate. The Rochester area is filled with second, third and even some fourth generation dealers. They are stable, pillars of the community they serve.

What's more, these laws drive efficiency by ensuring that a stable and level playing field exists in auto retailing. The speakers at the January 19 workshop who said that there is now a fairly equal balance of power between dealers and manufacturers were simply wrong. To the contrary, manufacturers continue to have the clear upper hand in this relationship. Once a dealer has invested millions of dollars to support a particular franchise, the dealer becomes, in a very real sense, the economic captive of the manufacturer. And while dealer associations have had some success leveling the playing field, there is literally no defense against a manufacturer targeting an individual or segment of dealers who on their own, cannot afford the legal expense to defend themselves against the egregious practices of some manufacturers. The following examples should help educate the FTC about the continued need for these laws:

- Dealers can only sell what their franchised-manufacturer produces. That means the dealer's success, their very survival, is inextricably tied to the reputation of the manufacturer, and the products they produce. With that in mind, let's examine the impact of recalls on dealers. A flaw in manufacturing (unintentional or intentional) triggers a recall. The affected vehicles are "grounded" until a remedy is developed and

the vehicles are fixed. Through no fault of their own, the dealer cannot sell vehicles. Several states have franchise laws that entitle the dealer to reimbursement of their carrying costs while a vehicle is grounded due to recall. And yet sadly, a number of manufacturers are unwilling to reimburse the dealer without legal action being taken. So not only is there a direct cost of the manufacturer's error, but there's an indirect impact to the reputation of the brand which also affects the dealers.

- Like most businesses, manufacturers establish annual sales and market penetration objectives. These targets can be very aggressive. And their production schedules are set to achieve those sales objectives. The manufacturing and sale of vehicles to dealers is primarily a "push system". That means the manufacturer produces vehicles "they think" consumers will want, with colors schemes and interior content based on their research. The vehicles are then sold to the dealers who have the job of selling it to a consumer. Dealers are routinely forced to accept excess inventory and are sometimes saddled with vehicles that are undesirable to consumers. When that happens, dealers are left with no alternative but to discount the price (sometimes below what they paid the manufacturer for it) until a consumer is willing to purchase it. Again, the dealer's success is completely dependent on what the manufacturer gives them, or in some cases, forces them to take. And if the dealer tries to resist the "push" system, the allocation of more desirable vehicles can be affected. Having been on the manufacturing and dealer side of this situation, I've witnessed it.
- Maintaining a clean, comfortable, appealing facility is a reasonable expectation of a dealer. And it makes good business sense. However, there is absolutely no evidence to suggest having a "cookie cutter" look and feel results in increased sales. And yet dealers have been regularly coerced into spending millions of dollars to change their dealerships to meet the "brand image of the latest marketing executive for a manufacturer". These facility programs have included the following consequences:
  1. Being required to buy materials from only manufacturer approved vendors at prices well above what a dealer could get locally.
  2. Specifications so minute that they forced the dealer to install or replace facility improvements that might have been completed (and approved by a manufacturer) within the past few years.
  3. Facility reimbursement money that comes not based on building cost, but rather vehicle sales, resulting in larger dealers receiving a disproportionate share of money, creating an unfair advantage in the market.
- Many manufacturers use state-wide market share data as a basis to measure performance. In New York, the downstate New York City area is predominantly an import market. However, Western and Central New York are predominantly domestic markets. A Toyota dealer in New York City will be judged to be a better performer based on market share versus a Toyota dealer in Rochester. Conversely, a Chevrolet dealer in Rochester will be deemed a better performer than one in Manhattan. The dealer's performance will be affected more by the overall market of buyers rather than their own individual efforts. And yet, rather than use more local market statistics, manufacturers will use this measurement as a basis to attempt termination of a dealer's franchise. There is a pending case in New York at this very moment.

These are just a few of the circumstances that have been addressed through state franchise laws. In light of these market realities, it is not hard to understand why state legislators in all 50 states have voted over and over to ensure that the system of retailing automobiles remains consumer friendly and fair. The FTC needs to look beyond the theoretical and understand the actual before reaching any conclusions about this important market. Finally, and of the utmost importance, the FTC also needs to appreciate and respect the fundamental role the states play in determining what level and type of regulation these markets need.

Thank you for your consideration of my views on this important matter.

Very truly yours,

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