

GROUP 1 AUTOMOTIVE

March 3, 2016

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue NW, Suite CC-5610 (Annex B)
Washington, DC 20580

Re: Comments on state automobile distribution regulation

Dear Commission Members:

Please include the following comments in the record for the workshop on state automobile distribution regulation conducted by the Federal Trade Commission on January 19, 2016.

Group 1 Automotive, Inc. ("Group 1") is a leading operator in the automotive retail industry. As of December 31, 2015, Group 1 owned and operated 151 franchises at 116 dealership locations in the U.S. Through our dealerships, we sell new and used cars, arrange vehicle financing, sell service and insurance contracts, provide automotive maintenance and repair services, and sell vehicle parts. Our operations are primarily located in major metropolitan areas in 14 different states in the U.S. Through the years, Group 1 has been involved in disputes that address franchise terminations, the establishment of other same brand dealers, dealership relocations, additions of other franchises, changes in dealership ownership and management, unilateral dealership agreement changes by the manufacturer, and warranty reimbursement. Group 1 submits the following comments to the state automobile distribution regulations based on its significant experience and leadership in the industry.

Historically, automobile manufacturers distributed their products through franchised independent dealers for several reasons. The primary reason was the cost savings associated with making the investments in facilities, equipment, personnel, training, marketing and inventory needed to successfully sell and service the automobiles covered by the franchised dealer. The secondary reason was their ability to retain total control over the distribution of their automobiles to the dealers. The dealer were completely dependent on the manufacturer to build and supply them with the vehicles they needed to sell and service. This resulted in the manufacturer's ability to control how their vehicles were marketed, sold and serviced by the dealers. Manufacturers leveraged this control by drafting dealer agreements that contained unfair obligations of each dealer. These dealer agreements were offered on a take or leave it bases and allowed the manufacturer to terminate the relationship at will at any time. These agreements did not even obligate the manufacturer to provide the dealer with any vehicles. On the other hand, if manufacturers overestimated demand and produced an excess number of vehicles, dealers were

forced to accept and pay for vehicles that would remain in their inventories, often resulting in floor plan interest charges for extensive periods of time. If a dealer refused to accept vehicles in excess of the demand for their market, the dealer faced being terminated and the loss of its entire investment.

Dealers eventually formed trade associations to address this unequal bargaining power and petitioned the legislative branch of government for protection. State legislatures responded by enacting laws that prevented manufacturers from terminating dealers without cause and from coercing dealers to accept unwanted vehicles and parts. Every state eventually had a law that prohibited automobile franchise cancellations without good cause. In addition, several states enacted other statutes aimed at protecting dealers from various "unfair practices" by manufacturers. These practices include: (1) coercing dealers to accept unwanted vehicles, parts and other commodities; (2) establishing or relocating another same brand dealer into an existing dealer's relevant market area without notice and a hearing; (3) unreasonably refusing to approve a change in a dealership's ownership or management; (4) unreasonably refusing to allow a dealer to relocate, or add a franchise for another brand to, the dealership facility; (5) failing to reasonably compensate dealers for repairs covered by the manufacturer's vehicle warranty; (6) unilaterally changing the terms of the dealer agreement without notice or a hearing; (7) refusing to defend and indemnify dealers against third party claims caused by the manufacturer's design and manufacture of the vehicles; (8) imposing unreasonable performance standards; (9) competing against their dealers in the selling of vehicles to the public; (10) failing to allocate vehicles among their dealers in a fair and equitable manner; and (11) failing to buy back new vehicles, current parts and special tools from terminated dealers.

Critics of these state laws ignore the public benefits that state regulation of automobile distribution provides, including the preservation of strong intrabrand competition, maintaining the stability of automobile retailing and service, avoiding the shifting of manufacturer warranty repair costs to consumers, and promoting localized control of retail automobile sales and service outlets. One of the most important roles that franchised dealers play is to advocate the concerns of customers who experience repair and service issues that are covered by the manufacturers' warranty. Because manufacturers are financially motivated to reject warranty claims, dealers often step in to assist customers who usually lack the technical knowledge and experience to adequately support their claims. Without dealer advocacy, manufacturers would be allowed to more readily reject such claims.

Moreover, none of the state automobile franchise laws prohibit a manufacturer from terminating an underperforming dealer or prohibit a manufacturer from establishing or relocating a dealership where the interests of the manufacturer, the dealers involved and the public justify the establishment or relocation. Rather, where the proposed action is disputed, these laws allow an independent agency or court to review the facts of the case and decide whether it is in the overall

interests of those concerned. Absent any regulation, it is the manufacturer who would make the sole decision. The manufacturer's decisions are often made by individuals who are often only in the decision making positions for a short time before they move on to other positions within the same or a different manufacturer or in another industry entirely. Dealers, in contrast, are required to think long-term due to their personal investment.

A presumption that manufacturers are more likely than an independent state agency to make decisions that are in the public interest ignores the manufacturer decision-making that has led to the consumer disruptions caused by the several manufacturer bankruptcies, product withdrawals, recalls and deceptive practices that have plagued the automobile industry in the United States in recent years. Given these disruptions, the states have an even larger reason to regulate automobile distribution in their states than ever before.

The warranty reimbursement system likewise provide a reason to retain state regulation of automobile distribution. Automobile dealers perform two types of motor vehicle service and repair functions. One is for owners of vehicles that are out of warranty and for which the owners must pay out of pocket. Dealers compete for customer pay work in a highly competitive market that includes franchised dealers of both the same and other brands and independent repair facilities. As a result, the prices that dealers can charge for customer pay work are truly competitive. The other type of service and repair is warranty work for which the franchised dealers are paid by the manufacturer. If requested by the owner, dealers are required by their dealer agreements to perform warranty work on any vehicle of the brand they are franchised to represent, regardless of where the vehicle was purchased. Unlike for customer pay work, the prices that dealers are paid for warranty work are set by the manufacturer. Since the manufacturer is the sole buyer of warranty work from each of its dealers, each dealer has no choice but to perform the work for the prices set by the manufacturer.

Despite the fact that franchised dealers make a large investment in the service facilities, equipment, tools and personnel needed to perform both customer pay and warranty work, new vehicle retail prices do not provide dealers with sufficient margin to cover this investment. Instead, the profits generated by the dealers' service and parts departments are needed to keep dealers financially viable. The state warranty reimbursement laws ensures that these costs are equitably covered by the revenues generated by both the warranty and the customer pay work that dealers perform. Because customer pay prices are set in a highly competitive market, the state warranty reimbursement laws generally use these prices as the standard for what the manufacturer should pay for warranty work. Without these laws, manufacturers would be free to utilize their leverage to force dealers to accept artificially low compensation for warranty work. In essence, the state laws prevent manufacturers from having the legitimate costs of their warranties subsidized by the dealership's nonwarranty service customers.

There is no dispute that vertical integration of the distribution of a vehicle brand will eliminate intrabrand competition for that brand. This indisputable fact justifies the direct sale bans enacted by some states, particularly given the absence of any credible evidence that vertical integration has other pro-competitive benefits that could possibly outweigh the anti-competitive effects from the elimination of intrabrand competition that vertical integration would have. Even the argument that cost savings can be achieved only through vertical integration of an automobile brand's distribution are completely unsupported. Whatever distribution costs are needed to effectively market, sale and service a vehicle brand, such costs must be borne by someone regardless of whether the distribution is achieved through independent franchised dealers or the manufacturer. Whoever makes the investment needed to cover these distribution costs, including the manufacturer, is also going to require a reasonable return on that investment; otherwise, there would be no inducement to make the investment in the first place. If a manufacturer makes an additional investment in the assets needed to sale and service its vehicles at the retail level, it and its shareholders will require a return on this additional investment that equals or exceeds the return on investment received by franchised dealers.

Given the absence of any credible economic evidence that vertical integration of automobile distribution would result in cost savings or other pro-competitive benefits that would offset the clear anti-competitive impact of eliminating intrabrand competition, we urge the FTC to stay its opposition to these laws until it has at least conducted a true economic analysis to determine if there are, in fact, any offsetting benefits from vertical integration that merit the condemnation of these laws.

Some argue that state automobile franchise laws are no longer needed due to growth in the number of manufacturer participants in the market and in the size of some of the independent franchised dealers. In reality, the manufacturer which controls the supply of that brand gains economic power over the dealer which has made the sizeable investment. The argument ignores the fact that the independent franchised automobile dealer network is still dominated by individual investors whose assets are primarily invested in the automobile brands and who will be economically devastated if those assets are lost due to arbitrary or unfair actions by manufacturers. The argument also ignores the beneficial impact these laws have on consumers by regulating the distribution and service of motor vehicles.

As a federal agency, the FTC should support, rather than oppose, state regulation of automobile distribution. There is no credible evidence that such regulation has harmed the public in any way. The public currently benefits from a retail automotive market characterized by low prices and a high level of customer service and satisfaction. The primary cause of these benefits is the competition created by the historic distribution of automobiles through independent franchised dealers. The state automobile franchise laws help to ensure that the public will continue to enjoy the benefits of a strong, competitive retail automotive market in the future.

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Sincerely,

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Group 1 Automotive, Inc.

cc: Darryl M. Burman
General Counsel
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