Auto Distribution: Current Issues and Future Trends
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KEYNOTE PRESENTATION

- **Dennis Carlton, Professor of Economics, University of Chicago**

PAOLO RAMEZZANA: Hello, my name is Paolo Ramezzana. I'm an economist in the Bureau of Economics at the Federal Trade Commission. I'm here to thank you for coming back from lunch on time and to introduce our keynote speaker, Professor Dennis Carlton. Dennis is a professor of economics at the Booth School of Business of the University of Chicago, and is one of the main experts in the world on the economics of antitrust and competition. Besides having authored a large number of academic articles—and, I should add, one of the most widely-read textbooks in industrial organization—Professor Carlton has also held a number of policy positions, including Deputy Assistant Attorney General at the Department of Justice, and has consulted extensively on a number of antitrust matters. So, without further ado, Professor Carlton.

[APPLAUSE]

DENNIS CARLTON: OK, thank you very much. It's a pleasure to be here. I'm enjoying this conference and learning about the pros and cons—or people's views on the pros and cons—of these regulations we are discussing.

My topic this afternoon is not specifically about whether car manufacturers should have the right to sell cars themselves. But it's rather on a slightly broader topic, though closely related to the narrow one of this conference. My topic is the state-action doctrine.

The state-action doctrine is a doctrine that allows states to do what, if individuals did, would violate the antitrust laws. So if a state does something that an individual would be thrown in jail for, for example, under our antitrust laws, that's OK under the state action doctrine—or, can be OK. And I want to talk about that from an economic point of view.

I'll give you two examples of state intervention and then I will talk about what the FTC might be doing in order to promote economic efficiency in the interpretation of this doctrine. You'll find that, by and large, I agree with the FTC in what they're doing and encourage them to keep doing it. That's not always the case when I'm evaluating government actions, even though I was once in the government. But here I think they're on the right track.

I wasn't planning on talking about the topic of this conference in my speech, but I've been somewhat stunned by some of the comments this morning. So at the very end I will give you some brief reactions to what I've heard.

Every introductory economics course teaches that if you have a competitive market, it produces desirable results, efficient results. The right incentives get created, consumers are benefited, producers are rewarded and are given incentives to innovate. Intervention in that market—as, for example, would occur if everybody in that the market got together and decided to behave like a cartel—is decidedly bad. The reason is, prices go up, consumers wind up paying more, consumption goes down, and there's a transfer of wealth from consumers to producers.

Now it's not a zero sum game. It's not like consumers lose $1 and produces gain $1. It's worse than that. And that's what really bothers economists, in addition to the transfer of wealth. It produces an inefficient result. What do I mean by that? What I mean by that is someone might value something—let's say $10—and it only costs $9 to produce. In a competitive market, that transaction occurs, creating $1 of value to society. But in a market where there are distortions, that transaction may not occur—as for example, if there were a cartel and it charged a price of $12. That's an inefficiency. We're throwing money out the door. We're throwing output out the door.

Well, economists don't like such results, don't like such inefficiencies. And that's why, when economists study the antitrust laws and they learn that under Section 1 of the Sherman Act it's illegal to have a cartel, and they understand that that's been interpreted in the courts to mean there's a per se violation against naked price fixing under our antitrust laws, they applaud it. They say, that sounds exactly right.

And when they read decisions that say: “Listen we're not going to pay any attention—courts won't pay any attention—if a cartel says: “wait a minute, what we're doing is reasonable. The price we're charging is reasonable. It's fair. It's justified”.” Our Supreme Court says: “I don't want to hear it. Naked price fixing—illegal.”

You can imagine then, when economists who really have very little familiarity with the law, come upon the case Parker v Brown. To slightly over-simplify, in the case of Parker v Brown, the state of California allows, or enables, raisin producers in California to basically get together, cut output, and raise the price of raisins throughout the country. The Supreme Court says: “That's OK. A state is allowed to do it under the state-action doctrine.” So economists say: “What's going on? How could that be?”

So one answer is: “Listen, you're only mere economists. You don't understand how complicated our government is. There's a process we create. And the process is that states have certain rights, and states can do things. And we're not going to interfere with that political process.”

An economist thinks a little bit about that and tries to put it into economic terms and says: “Well, maybe what they mean is: if everybody involved in the decision gets together in the legislature, then somehow the right decision gets made. That's what they must think.” That's one view.

Another view is: “Well, there are 50 states. If one state does something bad, people can leave and go to the other states.” There are some flaws in that reasoning.

What are the flaws? The first one is that there's what economists call an externality. In the case of California, the victims aren't just in California. The victims are all over the country—the consumers of raisins. That means everybody isn't involved in the political process.

The second is, even if all the victims were in the same state, is it reasonable to say that the political process represents everybody equally? I understand we might have that as an ideal, but if you actually look at legislation, that doesn't appear to be necessarily the case. Economists who studied legislation have shown that special interest groups have enormous influence through their political and lobbying power and the amount of money they can give to people.

Finally, the argument I gave about mobility may not be so convincing if people aren't mobile. Even if all the victims in the state are within the same state, it's not true that if you victimize a group they can leave the state. They may not be mobile. Sometimes they may be mobile, and that's a protection. But many times they won't.

So the justification for the state-action doctrine, at least in economic terms, seems a bit flimsy, at least to this economist. The real danger is that special-interest legislation will permeate the states. And special-interest legislation is simply one group taking advantage of other groups, distorting the competitive process and sending distorted signals throughout our economic system. And that'll lead to inefficiency. And if there are enough distortions in the system, an economy can grind to a halt.

And one way to introduce distortions is by special-interest legislation and regulation. That doesn't mean that all legislation is bad, or all regulation is bad. But it means you have to be on guard.

One of the key concerns about special interest legislation is corruption. Now, no one has mentioned corruption, and you might say: “What's Carlton talking about corruption here?” Well, let me tell you. Economists have recently been making a lot of progress in understanding the linkages between incentives and corruption.

Now, it may come as no surprise I'm from the University of Chicago. So I'm in the city of Chicago—that’s where I work, at the University—and I live in Illinois. Four of our last seven governors have gone to jail. And if you look at many rankings of corrupt states, we appear often in the top five.

This turns out to be an economic problem. Economists can study incentives that create corruption. And indeed, special interest legislation is exactly one of them. And what happens when there's corruption in the system is, at least according to some articles I've read, political voting goes down, because people basically give up. Well, that further undermines the state-action doctrine's justification based on everybody participating in the political process.

So what I want to do now is give you two examples of state actions having nothing to do with the topic of this conference, but somewhat related in that they are state actions. The first one I want to talk about is what's called divorcement.

Divorcement legislation means that an oil company cannot own and operate its own gas station. A lot of gas stations—say a BP gas station—could be a franchise dealer, a lessee dealer, OK? The lessee dealer is an independent businessman. Or, it could be owned by BP, in which case it's company-owned.

There are some states that have laws that prevent divorcement. This is an old issue, and in fact one that I was involved in. I wrote a report many years ago for the American Petroleum Institute that examined the effect of such laws. The standard argument justifying these laws has been that if the oil companies owned and operated their own gas stations, they would charge such a low price for gasoline that they would drive out of business the lessee dealers, and then they'd raise the price. Or, at least that was one justification.

There have been a lot of studies of what happens when divorcement comes into a state. And the numbers I have on the board here are from a study by Barron and Umbeck that looked at what happened to the price of gasoline and the hours of operation of gasoline stations when divorcement occurred in Maryland.

What it shows is that—and I just worked this out for a particular case, but what's important is understanding the change in prices—before the divorcement, if you looked at a station that was company-operated, it was charging $1.27 per gallon. After divorcement, when it had to spin that station off to a lessee dealer, the price went up to about $1.33. About $0.06. Stations that were lessee dealers were charging about $1.36 before, about $1.37 after. So their price went up a tiny bit.

If you look at hours of operation, the hours of operation of the company-operated stations were 136, much higher than the 124 of the lessee dealers. But after divorcement was passed and the company-operated stations had to become lessee dealers, the hours of operation fell to 128. The hours of operation of the already lessee dealers went up a little bit, but it wasn't statistically significant. So basically what this study says is, prices go up, hours go down. Consumers obviously are harmed.

In order to investigate the argument that the oil companies were choosing not to invest in lessee dealers and instead were only investing in company-operated stations, I did a study. And this purpose of this study was to see whether what the stations were saying was correct. And what the stations were saying is, because of certain economies of scale, when there was a large gas station, they wanted it to be a company-op. When it was a small gas station, they could understand, in certain circumstances, why it should be a lessee dealer.

I did a study—and I just summarize that study in this chart—that shows that when you're a low-volume gas station, the likelihood that a new lessee dealer in a state would be opened was higher than if it was a very large-volume station. So there was a decided pattern, and predictable pattern, in where investment is occurring. Now, it turned out that there was a, I believe, Supreme Court case—Exxon v the Governor of Maryland—on this issue of divorcement. And if you read the opinions, it's pretty clear they're skeptical about any anti-competitive motive of company operations. But they have very clear language that says, under the state-action doctrine, we're going to allow this.

Now I would say—people in the FTC are here, so they can correct me if I'm wrong—I'm fairly certain the FTC has a policy position in which they oppose divorcement. And also I believe the state of Maryland did studies that also showed the danger of divorcement. Let me turn to one other example of state intervention—again, always wrapped with what sound like self-serving statements about preserving benefits to consumers. This has to do with occupational licensing.

So states can require that, if you want to practice a particular occupation, you have to get licensed by the state. Licensing has grown over time. Right now, over 25% of the workforce is affected by licensing restrictions. In 1950, that number was 5%.

So we've had an enormous growth in the amount of occupational licensing that's going on. And this growth is coming not just because people are switching professions. This growth is coming primarily because the number of occupations that are licensed has been growing. There are over 1,100 occupations that, if you collectively put all the states together, are licensed.

Now, they're not all the same ones in each state. About 60% are the same in each state. If you choose a particular occupation that's licensed, it's licensed in about 22 states. There are some commonly licensed occupations—barbers, doctors, lawyers, plumbers, electricians. But there are others where it varies across state—interior designers, florists, teachers, massage therapists. That differs state to state.

Even when there's licensing of the same profession in two states, the licensing restrictions often differ a lot. So if you want to open a salon that does nails, in one state you might have to have 100 hours of training, in another state you might have to have 600 hours of training. Well, there's no question there can be a benefit to having licensing for the protection of the public. So one of the benefits can certainly be protect customers, improve safety. No one can deny that can be a rational justification for what's going on.

But what are the costs? The costs are higher wages, decreased mobility of people in the profession—because the licensing restrictions differ from state to state, people can't move between states. This, particularly, hits hard people in the military. Also, licensing restrictions particularly hit hard people who have low income and low education, and people who are immigrants—because they have difficulty doing all the paperwork. Moreover, if you are licensed, it might restrict how a profession can be done, and that can retard innovation.

So what are some of the sort of interesting features of licensing, before I go through some facts?

First, licensing is typically justified on the basis of providing consumer benefits. This is for the consumer. It's not to protect the profession. It's not to jack up the wages of the people in the profession. It's to protect the consumer. Yet, even though it's to protect the consumer, it's typically the case that the licensing is asked for and promoted by the industry, not by consumers. So that might make you a little skeptical that they really have the consumer interest at heart.

Second, licensing fees are collected by the state. That now gives the state an interest to have this licensing that, we'll soon see, makes people wealthier. That, then, can provide an incentive for them to contribute to political campaigns.

Now, if you're really worried about asymmetry of information and protecting consumers, licensing could be one way to do it. But there are other ways. You could have certificates issued. And it's not a requirement that you have a certificate in order to practice the profession, but if you have a certificate, you could advertise it. Therefore, if people really valued having that certificate, that could be a way to overcome whatever asymmetric information you think there is.

Well there have been lots of studies of licensing. And it's hard to completely generalize, and obviously there are exceptions. But here's what the findings tend to be.

Licensing raised wages somewhere between 5% and 15%, compared to not licensing. If you look at employment growth in states where a profession is licensed and where it's not licensed, the employment growth is higher in the state where it's unlicensed. The effect of licensing on wages grows over time.

As I look at that, that can be worrisome to me, because what it means is that, as interests become entrenched and licensing starts raising wage rates, that provides an incentive for contributions to promote politicians who support your view. And the licensing can become more and more effective to the extent that states are getting more licensing revenue. It creates a vicious circle of incentives.

What about the benefits? Like I said, there's no question there are certain professions where the benefits are undeniable, OK? And they're clear to see. But there are other instances where they're much less clear and, I would say, nonexistent, and are just covers to pass protectionist legislation.

So just to give a few examples, there's a continuing education requirement for real estate agents in—I think it's Massachusetts. People have studied that—no effect on improved quality. There's licensing of florists. And people have compared the beauty of the floral arrangements in those states where florists are licensed to those where they're not licensed—no difference.

Perhaps a profession where there's a bigger effect, if you look at the medical profession, people have studied—I told you, licensing often restricts the scope of actions you can take. So people have looked at what some states restrict—say, what a nurse practitioner can do—versus other states, and the studies have shown that in states where nurse practitioners, for example, are able to examine children, that the wages of physicians go down with no adverse consequence in terms of quality of care.

A similar result is found for dentists. So when dental assistants can do more tasks, dental wages go down, no adverse health effects. And as far as I can tell, these studies don't fully take into account the fact that if you lower the price of something—by making, say, child exams more available or more affordable—you'll get more of them. And that too can provide a benefit.

Again, you shouldn't misread me as saying that there can never be any benefits from such regulations. It's just that my reaction from reading the literature is, there are probably many fewer benefits than the statements that appear self-serving to justify the restrictions.

Almost running out of time. So let me turn to the very last topic. What do I think the FTC can do?

Basically I think the FTC is doing a good job in how to deal with these things. But let me just tell you my reaction, what I would do. If I could, I'd like to alter the state-action doctrine.

It seems pretty clear to me that if a victim of a state's action is someone not in the state, it's very hard for me to understand why the state-action doctrine should protect that action. So I'd like that to be rolled back. Of course, an economist liking something doesn't mean legally it will occur. And I'll leave it to the legal minds in this audience how to pull that off.

Second, even if the victims are just within the state, if the sole purpose of a state regulation, a special interest legislation, is to harm consumers—same as naked price fixing, having no cognizable benefits—I would like some way to restrict that. I don't think that should be protected.

I don't quite know legally how to do that. If I could, I'd say a rule of reason analysis, as currently done under our antitrust laws, would be appropriate. Show me the benefits. Show that the benefits outweigh the costs.

Barring a change in legal doctrine, I would try and restrict the application of the state-action doctrine. And that, as far as I can tell, is what the FTC does. It requires clear articulation by the state and close supervision, and they try and interpret those two clauses very narrowly. And that seems appropriate.

When legislation is being proposed and proponents come up and they say: “I have a study that shows benefits,” I think—if the study is false, consciously false, deceptive—people should be held liable. There should be no immunity. This might get into Noerr-Pennington issues—I'll leave that for the lawyers to worry about. But it seems to me that should not be used to protect fraudulent behavior.

Finally, last two things: the FTC should educate—that's what a conference like this is designed to do—should go to the states and try and tell them what they think. The FTC is limited, I understand, obviously, as part of the government, in what it can do and what it can't do. But I think if there were more creative ways to get its point across—you know, teaching legislators basic economics—might actually have a pretty desirable long-run payoff.

Finally, I'm an academic, and I know there are a lot of economists at the FTC. Academic studies—studying the consequence of special-interest legislation is something that could perhaps be a tool to make people realize the real costs of allowing special-interest legislation at the state level.

So for example, studying the incidence of how special-interest legislation is affected by issues like corruption, its relation to corruption, campaign contributions, the political prevalence in the state of the various parties—the beneficiaries and the victims—all strike me as appropriate things for the FTC to be encouraging—and to explicitly evaluate the effect of special interest legislation on consumers' prices and the quality of their goods.

I only have, I think, about a minute left. So just let me try and react very briefly to what I've heard.

Frankly some of what I've heard this morning was disconcerting to me—disconcerting for the reason, I think, probably best articulated by David Sappington. And that is, economists know a lot from our past experience with regulation and deregulation about what works, what doesn't work. That doesn't mean we know everything. But we know a lot.

And we know the following. These are not reasons to regulate an industry: “It's important.” That's not enough. You have to tell me why competition doesn’t work in the industry.

It's not enough to say, I'll replace competition with a reasoned process in which a neutral fact-finder, after a year or two of deliberation, will tell you what to do. And he'll tell you how to micromanage your industry. That just strikes me as a recipe for disaster.

I understand why it's appealing, especially to non-economists. But economists' experience has been that it's very hard for any regulator to duplicate what a private market can do. And if you try and do that when there's no justification for intervention, you're likely to make things worse. And even when there is some justification for intervention, you better make sure that you won't do worse by regulating than by not regulating.

Finally, a reason for regulating is not to make things fair. Every time an economist hears the word fair, he understands no one wants to be unfair, but in a proceeding, each side always says they're fair. It's kind of like two kids fighting. It's not fair this one gets the toy. It's not fair this one gets the toy. On what principle do we decide this? So our experience with deregulation has been that we often get big benefits by not trying to micromanage.

So let me just end with a few hard questions. Why regulate this industry? Why can't we rely on competition? We're at the Federal Trade Commission. Our premise is that competition works in the marketplace unless there's something unusual going on.

What do you think is so special about this industry? Why can't you rely on contracts like other firms do? The mere assertion that there's a difference in bargaining power—that occurs in lots of places in our economy. We don't intervene in every single place. And we don't micromanage individual industries. So what is so special about this industry?

Second, if this regulation that we're talking about today really is in the interest of consumers, is it the case that it's consumer groups that are asking for it? Or instead is it that the franchised dealers are asking? And if it's the franchised dealers, does that tell us something?

Finally, why isn't this just the sort of garden variety special interest legislation that harms consumers, helps dealers, and maybe harms manufacturers? What is the evidence that consumers are harmed? The only evidence—and I'll keep an open mind on this, I'll sit through the afternoon session—the only evidence that has been presented so far has shown that these restrictions have impaired the deployment of the location of dealers. Old companies are treated differently than new companies. That's an economic inefficiency.

I've seen no evidence that there are any economic benefits. The only evidence that's been presented so far in this conference has been that consumers are harmed. So I'm waiting to hear what makes this industry special, that we should see regulation of it. And I'd be especially grateful and interested in seeing evidence showing that consumers would otherwise be harmed. Thanks.

[APPLAUSE]

PANEL 3: DIRECT DISTRIBUTION

Panelists:

- **Dan Crane, Professor of Law, University of Michigan**
- **Maryann Keller, Managing Partner, Maryann Keller & Associates, LLC**
- **Todd Maron, General Counsel, Tesla Motors, Inc.**
- **Steven McKelvey, Partner, Nelson Mullins Riley & Scarborough LLP**
- **Paul Norman, Partner, Boardman & Clark**
- **Joel Sheltrown, Vice President of Governmental Affairs, Elio Motors**

Moderators:

- **Patrick Roach, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**
- **Paolo Ramezzana, Economist, Bureau of Economics, Federal Trade Commission**

PATRICK ROACH: Well good afternoon. My name's Patrick Roach. I'm with the Office of Policy Planning at the FTC, as I said earlier. Joining with me as moderator of this panel is Paolo Ramezzana of the Bureau of Economics. I'll repeat the disclaimer that James Frost made this morning—that nothing I say today, neither Paulo nor I, anything we say should be thought of as the views of the commission or any of the commissioners.

Our third panel today has to do with the issue of direct distribution of motor vehicles. What do I mean by that? Well as was discussed this morning, the auto franchise laws in virtually every state regulate quite thoroughly the business relationship that's created between motor vehicle manufacturers who enter into a franchise agreement with their franchised dealers.

But the direct distribution issue goes beyond that. In some states the statutes require that manufacturers must use a franchise dealer network. Some states make it illegal for manufacturers to operate themselves, to operate dealerships, or to sell their products directly to consumers. And some states make it illegal for motor vehicle manufacturers to operate service facilities or to contract with non-dealers to operate service facilities in the state.

Unlike the other topics that we're discussing today, this is a topic on which the FTC staff has expressed our views in advocacy letters responding to state legislators in three states over the past couple years. We have opposed these sorts of regulatory restrictions. But our task today is not to advocate for this view. It's here to learn. It's here to listen, to ask questions, and to learn from the discussion on the panel that we have today.

So without further ado, let me do the panel introductions. This is the order in which we'll ask them to make their presentations. Todd Maron, the first, is the General Counsel at as Tesla Motors. Immediately beyond him is Joel Sheltrown, who is the Vice President of Government Affairs at Elio Motors. Tesla and Elio are motor vehicle manufacturers that seek to distribute their products without using franchised dealers.

Immediately past Joel is Maryann Keller. She's a principal at the consulting firm Maryann Keller and Associates and has extensive background in the automotive industry. She's the author of a paper that is available on the website of the National Automobile Dealers Association.

Past her is Paul Norman. Paul is a partner at the Boardman & Clark law firm in Madison, Wisconsin. Paul litigates disputes on behalf of dealer clients and has, from time to time, represented the NADA. These two speakers will give us the dealer perspective on these topics today.

Past Paul is Steve McKelvey, who is a partner at the law firm of Nelson Mullins in Columbia, South Carolina, who litigates franchise disputes on behalf of various auto manufacturer clients. Steve will address the issue from the perspective of manufacturers who have existing dealer networks. And at the end of the row is Dan Crane. Dan is a professor in the Law School at the University of Michigan who has, in various settings, expressed his views opposing state direct distribution prohibitions.

Each of the panelists will have 10 minutes to give their presentations on the topic of the panel. After that we'll have a discussion. As with the panels this morning, if any of you in the audience have questions, please write them down, pass them up, hand them to one of the attendants, and Paulo will take a look at them. And then we'll proceed on a question and answer discussion following that.

So that's where we are. And without further ado, I leave it to you, Paolo—sorry, Todd. Thanks.

TODD MARON: Good afternoon. Thank you for having me. I appreciate the FTC inviting me here today to speak about this important issue and Tesla's position on it. Any discussion about why Tesla sells directly comes back to our mission. Our mission is quite specific. It's to accelerate the world's transition to sustainable transportation.

You could say we're true believers, and it wouldn't be an unfair characterization. That's our mission because we fervently believe that transitioning to electric vehicles is critical to the health of our planet, and simply because we believe that electric vehicles are superior vehicles to their gas-powered counterparts. They're higher-performing, they're more efficient, and they're safer than gas-powered cars. All of our actions track back to this mission, and our decision to sell directly is certainly no exception.

But before getting into the reasons why we've chosen to sell directly, it's important to appreciate the challenges that we face. In what is probably an obvious statement to everyone in this room, starting a new car company is hard. Just look at the record of the US automakers. Putting Tesla aside, there have been zero successful new car companies in this country in generations. Even the big three have had their struggles, with Ford being the only one to never go bankrupt.

So this is not easy. And that is all the more true for Tesla, because we're selling a new product with a new technology under a new brand to a public that's unfamiliar with all of it. So it should come as no surprise that the traditional distribution system used by established manufacturers is not automatically the right one for us. We have unique factors at play here.

So why do we choose to sell directly? The answer is for a great number of reasons, and many have nothing to do with the traditional dealer model. They simply have to do with what we believe provides the best customer experience in our estimation, and our belief that in order to achieve our mission, we need to be the ones evangelizing for it, not outsourcing that responsibility to someone else, someone who's not a true believer. But I'm also going to focus on the very many reasons why the franchise dealer model simply would not be viable for us. Here are seven key reasons.

First, traditional dealerships are in large, out-of-the-way locations. This wouldn't work for Tesla, which is why our stores are small and often in high foot traffic areas such as shopping malls. We do this for a reason. It's not surprising that when new technology comes out, consumers don't go to it. You need to bring the new technology to the consumer. That's a standard, well-accepted thing. If you go to any business school and learn about new products and new technology, you have to make it convenient for people.

Second, going back to the size point, traditional dealerships are large in size because they carry a lot of inventory. Inventory is the lifeblood of a traditional dealership. But we don't have inventory in the same way. Our cars are custom-built for each individual customer, meaning they don't get built until they're ordered. This is unworkable for the traditional franchise dealer.

Third, the franchise dealer model is based on a high volume of fast-paced sales where customers come in already having done their shopping and knowing what they want. Salespeople are then paid by how quickly they can close the deal. The longer it takes, the worse it is for the salesperson, and the worse it is for the dealership.

We are different, and have to be, because we're selling a new product. There's an important education process for our customers who do not already come in knowing what they want. They have many questions, questions about how to charge at home, how to charge away from home. What is range anxiety? How am I going to solve it? What are the incentives that are unique to EVs? What is the difference between the price of gas and electricity? How does the car actually work? What is regenerative breaking? What is dual motor?

For all these reasons, our customers take a long time to study the car. It takes hours—hours of the patient education process that only we can afford them and a traditional dealership model cannot. We do this because it's our mission to educate people, and we're in the best position to do that.

Fourth, it is well known that franchise dealerships derive relatively little profit from new car sales. Instead, most all their profit comes from other parts of the house. Service and parts, trade and used car programs, financing products, insurance products, and other add-ons—we can't offer that to any franchised dealer, because we only profit in one way—from new car sales and new car sales alone.

We can't make profit from service because our cars have far less parts than gas-powered cars. There are no regular service visits for engine tune-ups and oil changes. We don't have oil. We don't have an engine.

We don't make money off financing programs. We don't have insurance products or add-ons. A franchised dealer would look at this and just scratch their heads. They would not know how to make money in this model.

Fifth, traditional dealerships rely on manufacturers to fund their advertising, which we see on TV, on the radio and on print media. We don't advertise. And we certainly wouldn't allow, let alone subsidize, someone else to advertise for us. What franchised dealer is going to accept not being able to advertise?

Sixth—and this is probably most important in terms of the economics—franchised dealers could not make money selling our cars, could not. And there's a simple reason why. If we hypothetically used a franchised dealer in a certain state, we would still be selling online, and in neighboring states we'd be selling from our customer-owned stores.

Franchised dealers make profits for marking up the price of the car sold by the manufacturer. If a franchised dealer marked up the price of our car, no customer would ever buy from them. They would simply go to us and buy it for less online or in a neighboring state. No franchised dealer would ever opt into this system for us.

Finally, number seven, there's a clear conflict of interest. Returning to our mission, we don't simply believe that EVs represent a nice complement to gas-powered cars. We believe it's imperative that they be replaced entirely by electric vehicles. Even if we wanted to outsource the responsibility of communicating this message, it would be impossible for traditional dealers to convey this adequately.

This isn't a knock on them, but dealers are not fundamentally committed to the mission of EVs. We are. And they make 99% of their revenue off gas-powered cars. If you're opening a Yankees team store, are you going to ask a lifelong Red Sox fan to manage it? And what if he's still selling Red Sox gear out of another store down the road? Or, even worse, in the same store?

You don't need to take my word for it when I say these factors make the franchise dealer system not viable. Many independent studies have been done, including from Consumer Reports and others, and they've all showed that franchise dealers uniformly either declined to sell electric vehicles or are simply ineffective at doing it.

So this is not a matter of principle. It is, but it goes further. It's the difference between succeeding and failing, between fulfilling our mission and not.

Now in the few states where we can't sell directly, there's harm to consumers, and I'm going to go through them quickly. But customers have to travel out of the state if they want to touch and feel a car and learn about it. This is harmful to them.

If they want to finance the car, they're unable to take advantage of the lower finance rates that we've negotiated for them- with no profit to us. We have relationships with banks where we've negotiated good deals for customers. They can't do financing in states where we can't sell directly. And overall basic economic principles dictate that when competition like us is excluded from the marketplace, prices rise, innovation declines, and the consumer is harmed. This is the very essence of why competition is so important, and why monopolies are harmful.

Now there's one thing that there's just no dispute about—consumers have weighed in on this. Surveys have been taken, and it is overwhelmingly in favor of our ability to sell directly. I've put three surveys on, I believe the 86% is the lowest support we've ever received in any of these surveys. Usually they're in the high 90s. Consumers absolutely want the choice of how they buy their cars.

Now quickly I'm going to discuss the statutes. One might think that we're actually really disadvantaged here. That's not true. It's a very, very small minority of states that restrict our ability to sell directly. Most are sensible, in my perspective. They regulate the relationship between two parties, a manufacturer and their affiliated franchise dealers, because as we've heard throughout the day, franchise dealers believe that their affiliated manufacturers are prone to doing unfair things to them. And so states have regulated that relationship.

But of course, that has nothing to do with us. States with laws that have a blanket prohibition on manufacturer direct sales are in the clear minority. This should come as no surprise, because dealer protection laws were never aimed at giving dealers a monopoly over everyone else. They were aimed at protecting dealers from specific actions by their own affiliated manufacturers.

Briefly, I just want to show that in the rest of the world, this is not an issue. The only place where this debate ever takes place is in the US. We're totally unrestrained in our ability to sell anywhere else.

Now our opposition comes from two groups—primarily from dealer groups, and secondarily from General Motors. In my view and the view of many others, the dealers' opposition is driven by protectionist interests and a desire to cement a monopoly on the distribution of cars. Other reasons have been provided, but they're all makeweight. None of them are correct.

With respect to GM, their position boils down to this—because they voluntarily chose generations ago to use a certain business model, everyone else that comes after should be required as a matter of law to use the same model. That's code. That's code for, Tesla's able to sell the product to consumers for a lower price than we're able to through the franchise system, and we don't think they should have that advantage and be able to serve customers in that way. That is bad policy.

Real quickly, I want to show a quote that the CEO of General Motors just made. She said, "Unlike some EV customers, Bolt EV customers never have to worry about driving to another state to buy service or support their vehicles." This shows that their interest here is purely competitive. They're actually touting their ability to try to block us from selling directly, and then compare the fact that our customers can't buy our car as easily as theirs.

Just in conclusion, on the flip side of GM and dealers, there's an extremely large tent of consumers, economists, legal experts, academics, policy think tanks, the FTC has weighed on this—it's universally in favor of our position. So in conclusion, whether you're interested in consumer protection and ensuring the consumers a choice in how they buy products, whether you're interested in promoting competition free market principles, whether you're interested in promoting innovation and just think that the best car should be capable of being sold, whether you're interested in protecting the environment regardless of which of those angles you come from, you recognize that direct distribution, particularly for a company like Tesla, is critically important. Thank you.

PATRICK ROACH: Joel.

JOEL SHELTROWN: Thank you. Good afternoon. My name is Joel Sheltrown, and I'm representing Elio Motors here today. We'd like to thank the FTC, Patrick Roach, and all those who put on this workshop, had a part in that—also to thank the participants on this panel.

First, I'd like to start out by introducing you to Elio Motors, a new startup that will be manufacturing and distributing autocycles, since some here probably aren't too familiar with autocycles or our company. Elio Motors is a product of a mobile society naturally evolving into a more efficient, practical, and affordable form of transportation.

Looking at our product, Elio Motors is a product of innovation. Why that's so is, we have a vehicle that the target price will be about $6,800. That includes front and side airbag protection, ABS stability control, and air conditioning, powered windows and powered door locks. We have ultra-high mileage, estimating at 84 miles per gallon. We're engineered to the highest safety standards in all directions. And the top reliability of using advanced powertrain technology and off-the-shelf parts, and manufactured in the USA—parts that we know that work. So we believe our vehicle would be extremely reliable.

This is the heart of the Elio. This is the IAV engine design. IAV is a company owned by Volkswagen. IAV spent a great deal of time designing this engine and coming up with ultra-highly—it was necessary to come up with a ultra-high mileage estimate of 84 miles per gallon. And IAV has done a great job for that.

IAV has designed high-end vehicles, powertrains for vehicles like the Bugatti Veyron. I'm not sure if I pronounced that right, but I can't afford one anyway. I know how to pronounce Tesla, but I can't afford one of those either.

[LAUGHTER]

But anyway, our engine, as far as we know, is the first startup automotive company to design and manufacture its own engine since the 1950s. The IAV engineered power plan is designed to specifically achieve the 84 miles per gallon, 0 to 60 in mid 9's and top end of over 100 miles an hour. This is a CAD drawing of our P5. And this is the Elio autocycle. It's one of my favorite shots, which is in Salt Lake City, Utah.

We have over 49,000 pre-sold spot-in-line reservations for this vehicle, because you can see the demand. The people want this vehicle. When you look at the situation that we have—about 95 million old, used vehicles on the road today. They're on the road because their owners cannot afford anything else. That's our market.

Now as far as I know, for the first time in history these owners will be able to buy a brand new vehicle to drive back and forth to work that's highly efficient, and safe, and fun to drive. The reservation distribution—you can see it's all across the United States. So we are certainly in demand all over.

But we're here to talk about business models. The current system uses the package system to minimize build configurations. They have to. We've calculated that one particular automotive company, if we had all the options, considered all the different combinations, they'd have to have 10,000 vehicles on their lot. So the package system is what rules the day.

In the Elio system, we don't use that. We'll have retail centers that will offer point-of-sale options. Customers choose those options they desire. The customers choose the color and the transmission. The customer's specific vehicle is built out, options installed at marshalling centers and delivered the next day. The value proposition under the current system—we found that this current system, 25% of the retail price goes towards advertising and dealer network.

In Elio's system, customization happens at the point of sale, decreasing costs and improving satisfaction. Our retail strategy—how does that work? Customer visits the retail center—which are located in the 60 top markets—probably does a test drive, selects the color, transmission, and options. The order goes to one of seven marshalling centers, where all the inventory is located. The stores are open until 9PM. The marshalling centers build out vehicles until midnight.

The ordered vehicle is put on a truck and delivered to the retail center by 10AM the next day, just the way the customer ordered it. Key partners in this effort would be CarsArrive, which will transport the vehicles. ADESA—we'll use their existing infrastructure at their auction sites to install options. Pep Boys will provide factory-authorized service. That gives us 800 servicing locations around the United States from day one.

This was the former GM plant in Shreveport, Louisiana. That's where we'll be manufacturing our vehicle. It's about 4 million square feet on 530 acres with a paint shop, body shop, and rail service. We'll be producing about 1,500 direct jobs in Shreveport, Louisiana.

We like to consider ourselves as the sub-four-minute mile of manufacturing. What I mean by that is, Roger Bannister tried, and tried, and tried to break the four-minute mile barrier. He finally accomplished that. Wasn't long after that, it's not really even a special event anymore. There are a lot of people that run miles in less than four minutes.

We like to consider ourselves the same way. Most everyone thought it was impossible. He did it. Paul Elio and the Elio Motors team is obsessed with carrying out this business plan.

This is an actual business board in Johannesburg, South Africa. Advertising the Smart it reads, "German engineering. Swiss innovation. American nothing."

That's what the world thinks of us. And frankly, often that is what we think of ourselves. Paul Elio knows we can change this. He knows we have to change this to create jobs for the segment of our society that needs them most.

Between 1998 and 2013, the US lost 5.7 million manufacturing jobs. That has to change. Elio Motors blazed through innovation and design, manufacturing and distribution. It can prove to the world that American companies can once again provide world-class, low-cost vehicles. Thank you very much.

PATRICK ROACH: Thank you Joel. Maryann Keller, you're next. Thanks.

MARYANN KELLER: Thank you very much for inviting me today. I have spent the last four decades involved in many aspects of the automotive industry as an investment analyst for 30 years, president of Priceline's online auto buying service when it was launched in 1999, and as a consultant and director of public and private automotive-related companies.

I am not an attorney. And I am not an economist. I am someone who knows this industry and how it works at every level. So I understand why automotive executives experimented with build-to-order and direct sales initiatives to transform their assembly and distribution models, and why those initiatives only prove the value of the franchise system for consumers and for the automakers as well.

Much of the academic research that I've read on the franchise system is either out-of-date, misinterprets data, or lacks real knowledge of how the industry works. For example, this morning we heard about low volumes of Cadillac sales per dealer. Now is that the fault of there being too many Cadillac dealers, or 30 years of mismanagement by General Motors of the brand? I suggest it's the latter.

Indeed in the debate about the franchise system, there are two erroneous assumptions that have become dogma. First, that direct distribution lowers cost and those savings will be passed on to consumers. And second, that there are no benefits to consumers from competition among same-brand dealers. These beliefs persist despite the body of evidence that consumers benefit tremendously from competition among same-brand dealers in new cars, used cars, service and parts, as well as finance and insurance.

I was very happy this morning that Jim Anderson confirmed those exact facts, as did other panelists on this topic. First, direct-to-consumer auto sales do not result in lower cost or savings passed on to consumers. In the 1990s, auto manufacturing managements turned their attention to distribution and sales as a way to improve their financial performance. At that time, reports by McKinsey and other consulting firms convinced these executives that they could capture substantial savings from build-to-order assembly and changes to distribution and sales channels.

The domestic auto companies aimed to lower their dealer count and replace independent dealerships with fewer stores that were economically controlled by the auto maker. General Motors announced, but never acted upon, the acquisition of more than 10% of its US dealers. But Ford did launch its ambitious retail network in 1997.

Having fewer same-brand locations in a city was supposed to reduce competition. That was the goal of the Ford retail network—support fixed prices, and lower distribution costs. So indeed, Ford fixed retail prices. It established employee compensation, standardized inventory management, advertising, and many other aspects of store operation.

Ford held a controlling equity interest in these stores, an interest which it intended to eventually take public. Like other automotive analysts, I believed at the time that the changes Ford proposed would result in exactly what they hoped for—higher revenues, lower expenses, higher margins, all to the benefit of Ford shareholders. But in 2002, after suffering from lower market share in five test cities, falling store-level profits, and the added administrative cost burden, Ford terminated the retail network and sold the stores back to its dealers.

There were in fact no realized savings across this new distribution channel. This is because there are simply costs associated with the distribution of objects that weigh 4,000 pounds, occupy 50 square feet of space, and are sold to consumers with varying needs including trade-ins, credit issues, et cetera. These costs don't go away because there are fewer stores, or because the OEM is the owner of the store.

And because of its size and structure, Ford's approach actually ended up increasing its overall distribution costs. Meanwhile, Ford stores in the surrounding areas to those five cities either maintained or increased their market share, again proving the superiority of a system based upon the independence of individual dealers. Making and selling cars are two different areas of expertise.

Later, taking a page out of former Ford CEO Jack Nasser's playbook, to transform Ford from the supplier through distribution by harnessing the internet, a Goldman Sachs analyst published a report titled, "E Automotive" in January 2000. That analyst was swept up in Wall Street's dot com mania when he accepted without question that technology would enable build-to-order assembly, eliminate dealers, facilitate online parts exchange, and generate incremental profits to the auto companies. But not a single prediction in that report was proven right for the analyst or for Ford, which had completely embraced all of this data.

None of us is ever right all the time, but few of us were so ill-timed and wrong as this report. Nevertheless, portions of the report, despite clear evidence to the contrary, find their way as support for more recent studies that are critical to the current auto distribution model that suggests there is a cheaper way of doing it and savings to be garnered for the consumer. In fact, in the 2010 analysis by Lafontaine and Scott Morton, as well as the 2009 Department of Justice report on auto retailing by Gerald Bodisch, this report is cited as evidence that there are cost savings to be had. Both Goldman Sachs and Lafontaine and Scott Morton laud a build-to-order system, with the latter praising Scott Painter's build-to-order.com, despite the fact that it was regarded as ridiculous within the auto industry at the time of its seeking of venture capital.

Reading that report, one would think that years of engineering effort that go into the development of a car and the hundreds of millions of dollars spent on each car to validate compliance with federal regulation can be circumvented with off-the-shelf-parts that somehow snap together like LEGO blocks. To suggest that this is a plausible model for vehicle assembly from which to draw conclusions reflects a profound lack of understanding of the time, investment, and complexity of engineering and mass producing the vehicle. So it is no wonder that Mr. Bodisch, among others, failed to investigate the status of GM Brazil's initiative to retail its Celta model online at company-set prices before relying on the Celta experiment to conclude that a direct sales build-to-order approach was a distribution panacea for the US.

Mr. Bodisch's 2009 report was based largely on press releases issued at the time of the Celta launch in 2000. But General Motors actually ended the direct sale of Celta in 2006, three years before the publication of this report. And in response to an inquiry by my business partner regarding the status of the Celta, GM emailed that the program had ended, quote, "because of the high cost of selling online and operating distribution centers." Unfortunately, notwithstanding the reality of the Celta experience, the Bodisch study continues to be used today in defense of the direct sale model. As the Ford retail network and the Celta experiences demonstrate, there are no savings to be passed on to the consumer from direct sales.

Second, there are clear benefits to consumers from intra-brand competition in auto retailing. What promoters of the direct sale model fail to recognize is that same-brand dealers vigorously compete with each other for the benefit of consumers. I personally saw this when I ran Priceline's auto buying service. We forwarded customer orders to purchase cars to the same-brand dealers in the designated trading area and watched them compete with one another on price.

By reducing competition and standardizing prices, company stores like Ford retail network remove the most critical function of the dealer. And that is to allow market forces to determine the price. Inter-brand competition occurs at the manufacturer level where OEMs establish the value of their brands through advertising with consumers. But once the OEM has gotten the consumer's attention and has its car put on the consideration list, at that point the customer knows what he's going to buy. And it is intra-brand competition among dealers that sets the transaction price.

But even OEMs want customers to enjoy the benefits of intra-brand competition. In October of last year, in explaining why his company didn't want one retailer to own too many outlets, then-Mercedes Chief Steve Cannon explained that, quote, "if suddenly one entity comes and buys up all the dealerships, we don't have competition." To further see intra-brand competition in operation, one only has to look at the massive numbers of online listings by dealers on autotrader, cars.com, Edmund's True Market, Autobytel, Kelly Blue Book, and many others. The TrueCar model is in fact based upon the fact that dealers will compete on price.

Indeed, the salutary effects to consumers of intra-brand competition was confirmed in the report by Scott Morton in her 2000 analysis on internet car retailing. What's more, there's now substantial empirical evidence to confirm this. A study of hundreds of thousands of transactions published in 2015 by the Phoenix Center in Washington shows that intra-brand competition in auto retailing lowers prices for consumers significantly. For example, a popular Honda Accord in this report shows that by increasing the distance between Honda dealerships by 30 miles, the price is raised to consumers by $500.

The Phoenix Center's comprehensive analysis of the impact on price in markets with multiple same-brand dealers provides evidence that should be obvious. Competition lowers prices. Critics of intra-brand competition are in the unenviable position of arguing the absurd.

Finally, there's one additional point to be made about the consumer benefit of an independent dealer network. Every year dealers perform millions of warranty repairs, but dealers and manufacturers stand at a very different place relative to this work. I leave it to you to decide—who would you trust to do the right thing for the owner? The dealer who desperately wants to retain the customer, or the automaker who wants to minimize the cost of the repair?

A factory-controlled sales service system aims at keeping costs down, and that includes that of warranty repairs. In fact one manufacturer has publicly said in its 10k that it wants to sell through factory stores to, quote, "avoid the conflict of interest in the traditional dealership structure inherent in most incumbent automobile manufacturers, where the sale of warranty parts and repairs by a dealer are a source of revenue and profit for the dealer and expense to the manufacturer."

PATRICK ROACH: Maryann, are we getting close to the end here?

MARYANN KELLER: Yes. Very much so. Thank you. So If I were a state legislator, that anti-consumer position would certainly prompt me to vote that there could be no vertical integration in this market. When considering direct auto selling policy, we do better to look at real data, including that of the Phoenix Center and the market realities that don't rely on mistaken and unproven assertions that are based on wishful thinking and generic economic theory. Thank you.

PATRICK ROACH: Thank you Maryann. Paul?

PAUL NORMAN: I believe any discussion of the state automobile franchise laws really should begin with acknowledging our system of federalism, under which the states are primarily responsible for regulation of commerce within their respective borders, and the federal government for regulating commerce between the states. As a Supreme Court recently reaffirmed in the *North Carolina Dental Board* decision, the states possess a significant major sovereignty under our constitution which empowers them to regulate commerce within their borders even in a way that may be inconsistent with the goals of the federal antitrust laws.

The state action doctrine is alive and well. But by this, I do not suggest that the direct sales laws that we're talking about here are in any way anticompetitive. To the contrary, as Maryann has just indicated, they fully promote competition by ensuring intra-brand competition. And that intra-brand competition, which has existed in our distribution system in the auto industry for years, has resulted in very unusual low profit margins, which of course result in lower retail prices for consumers and other benefits.

I begin my remarks with federalism, which we're all aware of, mainly because I just think it's good to remind us, as we sit here, that the state franchise laws are entitled to a great deal of deference by the federal government, the courts, and by extension, federal agencies. The concept of federalism, of course, has resulted in the Supreme Court upholding RMA laws, such as discussed this morning in the *Orrin W. Fox* case against charges both that they violated due process and that they were preempted by the federal antitrust law because they restrained intra-brand competition.

The same concept of federalism caused the court in the *Exxon v. Maryland* case, which we heard about earlier, to uphold Maryland's ban on vertical integration in the gasoline market of that state, which tended to preserve intra-brand brand competition among independent gasoline dealers. Now the law upheld in *Exxon* was the same as the direct sales laws that we are addressing today, in that it prohibited any producer of petroleum products from operating a retail service station that state. However, we're talking about a different market, as I will discuss in a little bit.

And unlike *Orrin W. Fox*, there was no contention in the *Exxon* case that the restriction on vertical integration in that case was preempted by the federal antitrust laws, because it impeded competition. Instead, it was based simply on the commerce and due process clauses. And the courts had no problem concluding that it bore a reasonable relation to the state's legitimate purpose in controlling the gasoline retail market.

So when I look at the direct sales laws that we're talking here today that do prevent, in some states, vertical integration of the retail market in the automotive industry, when you look at it from a constitutional perspective, we look at whether there is a reasonable relationship between that law and the state's purpose in regulating the market. And then we can move on to the political question, which is really what we're addressing, whether this is sound economic and other public interest thinking.

I submit that these laws submit both. First, as Maryann has very well established, intra-brand competition does affect retail pricing in a very positive way. Notwithstanding the federal antitrust focus on inter-brand competition, intra-brand competition benefits car buyers. And manufacturers who choose to vertically integrate their distribution systems to control all the retail outlets for their products, they eliminate intra-brand competition entirely from the retailing of those products.

Again, intra-brand competition reduces prices. If this is not true, then I ask, why do we have a *per se* antitrust rule against horizontal price fixing even by same-brand sellers? Or, I'll put the question this way—to those on this panel who may not agree, or dispute, that the importance of preserving intra-brand competition in the retail market, are you prepared to do away with the *per se* rule against horizontal price fixing as among same-brand dealers? If not, or even if you are, it is certainly rational for state legislators to themselves decide that preserving intra-brand competition, by prohibiting vertical integration of the retail auto market in their state, is in the best interest of that state and its residents.

I find it ironic that some of the strongest critics against the direct sales laws are also strong critics of the RMA laws, for the obvious reason that RMA laws are attacked because they have the potential of reducing intra-brand competition, while the direct sales laws are aimed at preserving it by prohibiting vertical integration of a distribution of a particular brand. On the other hand, I see no credible evidence that vertical integration increases intra-brand competition. Whatever efficiencies are claimed to be achieved through vertical integration, such as expediting the supply chain to reduce inventory cost, could just as readily be achieved through the current market structure as they could through vertical integration. The costs of the distribution network, at worst, are going to be the same whether borne by independent franchised dealers or by the manufacturer.

Now beyond the competitive benefits, the other justifications for prohibiting vertical integration of automobile retailing include, one, independent dealers provide a healthy consumer dynamic. For example, when a vehicle has warranty or recall problems, the independent dealers see that as an opportunity and will do everything they can to help the customer get the problem resolved. Manufactures view warranty and recall issues as adding cost to be minimized wherever possible.

Independent dealers also act as advocates for consumers and provide a local presence, which is a convenient place for customers to go to resolve their problems. Independent dealers add an extra layer of accountability in the retail motor vehicle industry. The direct sales laws contribute to the stability of the industry by dispersing investment among manufacturers and several independent dealers. Imagine how more difficult the GM and Chrysler bankruptcies would have been to resolve, had those manufacturers also borne the high cost of the distribution network, which were fortunately dispersed among their dealers instead.

And when a manufacturer leaves the market, as several manufacturers have—including Suzuki, for one example, Fisker, and others—the franchise dealers remain available to service the vehicles that were already sold.

There are also important values that go beyond competition and market efficiency that economists have to appreciate even though it's not part of what they study. Automobile dealerships in the states are important local businesses and employers that state legislatures obviously care about, because the dealers themselves care about and support their local communities. Independent franchised dealers also have better knowledge of the local market, which helps them find better locations for their dealerships, better familiarity with the regulations, and a better understanding of how to market and advertise to the local market.

Now there's a final justification for direct sales laws, which is the one which is normally attributed to them—that is to protect incumbent dealers from unfair competition from manufacturers, who obviously can manipulate the allocation, the pricing, and other aspects of the distribution system to favor their own retail outlets if they're allowed to own them. Now while this justification does not apply to new entrants that do not have or intend to have an independent dealer network, such as those whose representatives are here on this panel, their desire to sell directly does confront state legislatures with a choice of treating some manufacturers differently, or applying the direct sales laws to all.

Faced with this choice, many state legislatures may reasonably choose to treat all manufacturers equally, while preserving the benefits, both dealer protection and otherwise, of their direct sales laws, while others may choose to permit exceptions to the law. In any case, the decision is for the state to make.

What I would like to also add in response to the two representatives of the new entrants here, there's nothing in these laws that says you have to retain an existing franchise dealer. What these laws require is that you retain an independent entity to interface with the customer, to promote intra-brand competition among various sellers of your products, and to interface and help as an ombudsman to solve warranty problems. You can retain another entity who is not in the market, who will adopt your system of distribution. So to say the traditional franchise dealer doesn't work is not a defense to not complying with these laws if you choose to go into a state that requires it. Thank you.

PATRICK ROACH: Thank you. Steve?

STEVEN MCKELVEY: Thank you very much to the FTC for inviting me to be a part of the panel. I appreciate it. And like many of the speakers before me, I will give my disclaimer—the views expressed are my own, not any particular manufacturer or group of manufacturers. So in case you fell asleep during the before-lunch sessions, I'll remind you that discussion over these issues is a sensitive subject sometimes. The reason for that is that manufacturers and dealers share important business relationships. There's no question about that.

But the relationship is, as we know and we've heard today, very highly regulated. You can see the number of bills that have been introduced. This includes those have been reintroduced are carried over from the year. But you can see there's quite a bit of legislative activity in the states.

And it has reached the point, certainly, where virtually every aspect of the relationship is regulated now. And that includes, of course, how manufacturers sell vehicles and provide warranty service to consumers. So it's easy, in the midst of all of the regulation, to overlook the fact that the relationships between manufacturers and dealers generally are very good. It's a point I've not heard made all day long. They generally are very good.

There are important exceptions to that, and it's the exceptions to that—and when the action needs to be taken—that calls the problem, because that's what the laws really are designed to prevent, in my view. It is not the 95 plus % of the good relationships and the good working together. So newer entrants to the auto manufacturing arena have made the decision to seek a direct distribution model. And others may as well.

But for franchisors now—I'll use the term, even though I don't really like it, for purposes of consistency today—for manufacturers who have a franchise dealer network, the focus really is not on how can those manufacturers operate without dealers? That's not their intent. Traditional manufacturers generally do want and intend to continue their long history of providing sales and service to consumers through that model.

But the critical point is this: Manufacturers who have that network have to be able to adapt over time when, and to the extent, consumer and market demands require. And there should not be undue restrictions on the ability to meet those demands, now or in the future. So the questions, really, are these:

First, if a manufacturer should determine it needs or wants to offer alternative sales and service options in order to meet consumer market demands, should the power of the state be brought down on those manufacturers to say, we will substitute our judgement for yours? We will tell you how this will happen. And we will do it to the extent of virtually every aspect of the relationship.

And second, if the manufacturer who makes that decision is one with an existing dealer network, should that manufacturer be denied the right to operate under the same legal rules and restrictions as other manufacturers, including newer entrants? The question, again, really is not whether dealers can and do serve an important purpose. They do. At the same time, being free to respond to consumer demand for additional sales and service options would serve not only the interests of the consumers, it's also going to serve the interests of the brand and dealers.

Why would it serve the interests of dealers and the brand? Very simple—"he who rejects change is the architect of decay. The only human institution which rejects progress is in the cemetery." Those are the words of Harold Wilson, a former UK Prime Minister. They are as true today as they were in his time.

Yet for traditional manufacturers with existing dealers, the state motor vehicle laws allow no room to adapt as may be needed. And the wording of the statutes vary from state to state, but they essentially fall into three buckets. One, you can't engage in sales to consumers directly or through any person other than a franchise dealer—37 states. No manufacture can compete with an existing dealer—21 states. And no manufacturer may own or operate or act the capacity of a dealer—18 states.

Obviously this means some states have multiple buckets, so you're going to get caught in several ways. But regardless of which bucket or buckets apply, for traditional manufacturers, the effect is the same. The sole option is for consumers to seek to buy and service, for warranty purposes, the vehicle through existing dealer networks.

Now these same restraints do apply to the newer entrants, unless an exception has been granted. And in several states, such an exception has been granted. Typically, they've been granted based on the total volume for that newer entrant being below a certain threshold, the total number of stores being below a certain threshold, they manufacture only electric vehicles, and they've been grandfathered in because they have some existing stores already.

I'm going to skip a couple slides where the point's been covered fully. So as a practical matter, how do these restraints impact auto distribution and consumers? Remembering that most manufacturers value the relationships and recognize the important function they serve, but at the same time recognizing that there are, and there will be, times when consumer demands or market needs warrant at least having the option to engage in sales or service activity through channels other than the existing network.

But that's blanketly prohibited under virtually all states, through one of those buckets. The only time it's not prohibited is when there is either no franchise network or one of those exemptions that I just pointed out earlier applies. The problem's not the franchise dealer model. That's not the problem.

The problem is the overreaching motor vehicle laws that prohibit the traditional manufacturers from having even the option to respond to consumer demands, market needs, or competition in any way other than through the traditional channels, regardless of the circumstances. It's the one size fits all point that was made earlier. These laws do distinguish the auto industry from virtually every other industry.

The problem is exacerbated by the fact that traditional manufacturers are subject to restraints that the newer entrants are not. This means the newer manufacturers can offer vehicle buying and warranty service options that traditional manufacturers don't have available to them. Regardless of whether the traditional manufacturer would ever choose to exercise the option or not, they ought to at least have the option to look at certain circumstances, certain times, certain markets, and determine, would it be appropriate to have some sort of direct sales or service market opportunity here.

And this means that the newer manufacturers have flexibility—and this is important—it's not really the direct sale piece that's the issue here. It's that by being free of the laws that we've been talking about, they also have the ability to respond in other ways. In other words, relocating a dealership to where it needs to be, and taking other action where they're exempt under these laws and other manufacturers are not. I'm not going to run through the examples of the restrictions, because we covered those fully this morning.

But in my view that's what brought us here today, OK? It's not manufacturers knocking on any state door saying, let us sell directly. That has not occurred. They've not knocked on the door and said, let us service directly. That has not occurred. What's happened is, and what's brought this to attention, is the overreaching laws are well known to the newer entrants, OK?

There's no question about that. They know the restrictions on being able to respond in the market and add dealerships, or relocate dealerships, or engage in warranty service in the way they want and may need.

In light of that, those newer entrants have elected not to go in this route. Of course many decades ago there was the argument that there was abuse or an imbalance of power. Now whether or not that's true, the mom and pop store that existed when those laws were written is not what we have here today. Essentially, the scope of the regulations and the restraints are far greater today. And the auto retail world, as we know, has changed considerably, including those who own it and the power there.

So today—and I'm gonna skip that piece, I'm almost wrapped up—but I do want to comment quickly that the assertion that these laws are necessary to protect dealers from unfair competition of any kind by a manufacturer, whether through direct sales or otherwise, it is a fiction. And also, the notion that manufacturers would not protect the interest of consumers through whatever sales or service channel is out there is baseless.

The fact is, manufactures can succeed and thrive only if they're able to provide products consumers want to buy, make sure consumers can get fair value and pricing, make sure consumers are able to buy their products where and how they want, and stand behind those products with good and readily accessible warranty service. Any suggestion that the manufacturers would abandon consumers if it weren't for state laws forcing them to stand behind their product and forcing them to make those products available on good terms is absurd.

The bottom line is, the consumer is King or Queen, and every person in this room, every company represented in this room, is dependent upon the consumer. And if consumers, over time, demand additional or alternative opportunities to obtain sales or service—and we in this room and the people who can impact this—fail to make manufacturers able to respond to that, then we are ultimately the architects of our own decay.

PATRICK ROACH: Thank you, Steve. Pretty close to the time. Dan Crane.

DAN CRANE: Sooner or later.

STEVEN MCKELVEY: This clock up here, by the way, is like three feet tall. So you cannot miss it. You have to move on.

DAN CRANE: Great. Well, thanks so much to the FTC for inviting me today. I need to begin with my own disclaimer, which is that the views I will be expressing today are not my own. They are the views of Dennis Carlton. Actually, Dennis did preview a lot of what I intended to say, so I'll try to say it as well as I can.

So here's the roadmap in case I don't get to everything. First of all, the choice of a direct franchised or mixed distribution method is a question of transactions, cost, and other firm-specific circumstances. Secondly, the choice of distribution method is an important vector, or component, of competition. Third, emerging technologies often require to be distributed in innovative ways, hence laws that entrench status quo distribution methods can chill product market innovation.

The existing direct distribution protections were motivated by dealer protection, not by consumer protection. And finally, efforts to redefine these prohibitions on direct distribution in consumer protection terms are frivolous. All right.

If you look at the market today, you observe a variety of distribution strategies. We can talk about Apple and dual distribution through its own stores and through big box retailers. You also observe only direct-to-consumer distribution models, like Gateway or Dell computers used to have. You should ask the question ex ante, why would one choose one or the other? Ronald Coase, of course, taught us that transactions costs within and without the firm, whether firms organize in the markets or perform functions internally, is an important competitive question.

There are generic reasons why one could choose to distribute through dealers. There are advantages to that. I think Maryann pointed to some of the advantages to that. But there are also, generically, advantages to direct distribution. The point, from a regulatory perspective, is that there's no a priori reason, as a matter of public policy, to favor any particular mode of distribution. In any particular market circumstance, consumers are better off when manufacturers are free to choose the distribution method that works best for them in their particular market circumstance.

Here's the important point. The choice of distribution methods—and for the FTC as a competition agency, I want to underline this—the choice of distribution methods is itself an important dimension of competition. The effects of banning direct distribution are troubling, because as economic literature—in my recent article in the Iowa Law Review, I cite some of this literature—economic literature shows that new market entrants with new technologies often must use innovative distribution methods to get to market. That means that laws that entrench incumbent distribution methods can have an anticompetitive effect on product market innovation.

We heard this morning about the historical pedigree of these dealer franchise laws. I won't go through the whole history here. The point is that these are dealer protection laws. If you look at the legislative history in my home state of Michigan, the prohibition on direct distribution is explicitly stated in the legislative history, as it is in every other state I'm aware of, as being about the unequal bargaining power and the protection of the dealer from the manufacturer. There's not a whiff of consumer protection sentiment in these statutes.

The big three no longer dominate the market. We can talk about whether the dealer protection argument still makes sense today, but in terms of the consumer protection interest, observe that concerns about unequal bargaining power and protecting dealers have no relevance at all to Tesla and Elio or any other manufacturer that wants to bypass dealers altogether. You don't have to worry about dealer protection in a context when the manufacturer does not want to use the dealers.

The current efforts to redefine these laws in consumer protection terms are completely misguided. Dennis asked a question I want to answer now, which is, which of the consumer organizations in the United States today that think about the welfare of consumers are standing with the dealers saying, yes, we don't want direct distribution for all the reasons that the opponents of direct distribution have articulated today? As far as I'm concerned, the answer is zero. Because the Consumer Federation of America, and Consumer Action, and Consumers for Auto Reliability and Safety, and the American Antitrust Institute, and the Federal Trade Commission, and every other consumer-oriented group that I know about, has taken the position that these laws are protection for the dealers and are anti-consumer.

Where are the academic economists? Where are the experts on competition who are standing up with the dealers, saying we need to protect consumers against direct distribution? I don't know of a single economist, a single academic expert, who's taken that position. So the record, as far as I know, is that there is no justification on any public policy grounds in consumer protection for these laws. They are protection for the benefit of the dealers altogether.

Let's look now at the arguments that we need to have a prohibition on direct distribution to protect consumer interests. The claim we've heard already on this panel is that somehow, intra-brand price competition is good. That may very well be true, but it doesn't follow from that that some other manufacturer has a monopoly over retail distribution, and that forcing the manufacturer to distribute through dealers lowers prices to consumers. As a matter of economics, that makes absolutely no sense.

First of all, if the manufacturer has no market power in the brand, it can't charge a monopoly price at retail or at wholesale. It just doesn't have the power to do that. If the manufacturer does have market power in the brand, it will fully extract that market power premium at the wholesale level, regardless of whether it engages in the direct distribution function or outsources that to a dealer. The manufacturer cannot increase its profits by extracting the full monopoly profit at the wholesale level and extracting a second monopoly profit at the retail level. That doesn't work.

Further, if both the manufacturer and the dealer have market power, then double marginalization will occur through dealer distribution. Vertical integration will actually lead to cost savings to consumers because the manufacturer will internalize some of the cost. Now Maryann mentions some of the empirical work—the Goldman Sachs study, the 2009 Justice Department study—that suggested there could be cost savings from direct distribution. I don't know whether they're right or not.

The one thing I do know is that in a competitive market, we'll find out. I mean, Todd and Joel could be completely wrong in their companies' decisions to go through direct distribution. But let's let the market sort that out. Remember, the choice of distribution method is a competitive vector itself. And so we'll find out whether or not direct distribution leads to consumer savings. That's what markets are for.

Here's one important source of evidence that suggests that, in fact, direct distribution will lead to lower prices to consumers. That's what the dealers and GM have said themselves. When the dealers have gone into court challenging Tesla in states like Massachusetts and New York, to get legal standing, what do they say? They say that direct distribution leads to quote, unquote, "inequitable prices."

Well what does that mean? If inequitable prices were prices that were too high, they would not have legal injury. They only have legal injury if inequitable pricing means prices that are too low. So the dealers understand this. Why are the dealers fighting against direct distribution? It's because it's a competitive threat to them.

In 2014 when General Motors wrote to John Kasich in Ohio and said, you need to not allow Tesla a special loophole to compete directly in the state of Ohio, you know what GM said? GM said, that's an unfair competitive advantage Tesla will have over GM in Ohio. Well, what's the translation of that? Is it that Tesla will come in and charge prices that are too high? Well then GM shouldn't be worried at all.

No, the only logical implication of that letter is that Tesla, through direct distribution, will charge prices that are too low. So you don't have to believe the economic arguments. You don't have to believe the empirical evidence. Believe what the dealers and GM themselves are saying, and you find out that there's no credibility to the claim that somehow the dealers are the protectors of the consumer interest here.

We've heard that manufacturers won't provide adequate levels of aftermarket service. Well, as we've already heard, manufacturers like Tesla and Elio are making multibillion dollar investments in their brand. They will not be able to recoup those investments in the long run if they obtain a poor reputation for service. Paul says, well what about Fisker? Fisker—remember the last electric car company that tried to go through dealer networks and went out of business in, what, 18 months? Actually media reports said that there were many Fisker customers who were left stranded without service.

Why? Because there weren't dealers who were willing to continue providing service once the manufacturer was out of the market. So what happens? There were other media reports that an aftermarket for Fisker service springs up to take care of them. There's nothing inherent in dealer distribution that guarantees consumers will have access to service, any more than there is through any other model of distribution.

The argument that somehow dealer distribution is necessary for auto safety—what's ironic is that people who have made this argument have often pointed to examples like GM and Volkswagen as safety concerns. Well, of course, those examples arise in the context of dealer distribution. They're not very good examples of how you must have dealer distribution for auto safety.

In any case, dealers don't make recall decisions. NHTSA, the federal regulator, and manufacturers make recall decisions. We don't need to mandate dealer distribution to have regulation in place to ensure auto safety. And I'll end there. Thanks.

PATRICK ROACH: Thank you. This was an entertaining hour of presentations. Before we begin with questions, I'd like to again repeat that if we have questions from the audience concerning some or all of these presentations, we will be happy to entertain them.

There's been a lot covered in this hour here. And I think, perhaps the best way to begin is to see whether there are, among folks on the panel here, folks would like an opportunity to respond to any or all of the comments made in other directions? We'll do this without using another hour, but perhaps briefly. Paul Norman?

PAUL NORMAN: I'd respond to Dan because he was talking fast. But I was able to catch "intra-brand competition is good." And he could have stopped right there, because I think that's the whole argument.

If there's one justification for prohibiting vertical integration in the automobile retail market, it's because that is necessary to preserve vertical integration. Without it, manufacturers are free to take over the distribution and eliminate intra-brand competition. Everything we've heard here today, including coming from Professor Crane, is that intra-brand competition is good.

And why is it good? Because it lowers prices. It also increases the quality of service among dealers, because dealers compete not just on price, but on quality of service and other aspects of the buyer behavior. So intra-brand competition—good. Case closed.

STEVEN MCKELVEY: I have a question. If intra-brand competition is good, what's wrong with the manufacturer being able to be one of those competitors?

PAUL NORMAN: Because if a manufacturer is—you're talking about dual distribution now?

STEVEN MCKELVEY: Well no. I'm addressing the point I made earlier, which was, in some markets and sometimes, under some circumstances, it may be appropriate. For example, an exceptionally expensive market, Manhattan or somewhere like that, where it may not make economic sense, a manufacturer may choose, under certain circumstances, to say, we would like to own that dealership. And we're willing to take on that risk because it's good for the brand, it's good for everyone. Dealers would get a benefit.

PAUL NORMAN: So you're talking dual distribution, because that New York, Manhattan dealership would compete with the other dealerships in the New York City area.

STEVEN MCKELVEY: As long as long as the competition was fair—meaning that you didn't charge yourself a different price, you did just like every other dealer—why must that competitor be excluded?

PAUL NORMAN: I agree with Dan Crane that the original purpose of these laws was to protect dealers in dual distribution systems, because it's very difficult to police. Is the price fair? Since the price is internal to the manufacturer, to its own retail outlet, it's very hard to police. So the states, in their wisdom, as to how we protect the dealers' investment which is vitally important to the distribution system—is to say, manufacturers in this important industry, we're not going to allow you to compete with your own dealers. At least in some states.

STEVEN MCKELVEY: So you believe that a manufacturer—even if it was fair competition, would you say that's hard to police? Of course, if a dealer believes that they were being treated unfairly, they certainly, through discovery, could determine whether there was unfair advantage given and things like that.

PAUL NORMAN: There would be a lawsuit to get discovery.

STEVEN MCKELVEY: Well there's generally no shortage of those, right?

PAUL NORMAN: Well, I'm gonna caution you on using the word fair since the speaker at lunch said we don't talk about fairness of these laws, even though we're appearing on behalf of an agency whose mission is to control unfair practices and unfair methods of competition. But we can't talk about fairness.

PATRICK ROACH: Joel, think you had indicated you were interested.

JOEL SHELTROWN: Yes. I find it interesting that a potential competitor of mine, of our company, would want to protect us by making sure that we didn't charge too much for our brand, and help us develop the business model that they think that we would most likely succeed with. I think that's pretty ironic.

I'm a previous state representative in Michigan. I served six years there. In Michigan, there are laws just recently passed. A technicality where we could sell was stricken in the last hour, late at night. Struck some language out of the statute which required both Tesla and Elio Motors to use franchise dealers. It was also attached to a bill—the bill that was amended also prevented manufacturers from telling their dealers what they could not charge or could charge for a particular service—in this case, document fees, the fine print.

I just bought a used car just recently, and the doc fees were $150. It took them about five minutes to do it. Car dealers are now charging $200, $300, and I heard one that talked to me that charges $400 for document fees.

This is damaging to our brand. And we want to be able to control all that process. We don't have any issue with franchise dealers. But we do have an issue with the fact that franchise dealers have been able to pass laws saying that we have to use that business model.

What would the franchise dealers think if Tesla and Elio Motors went back to the legislature and passed laws that say that we have to use direct sales models? Everyone has to use that. Tesla and Elio Motors, I'm sure I don't want to speak for them, but I'm sure that we would be against that is all. And the bottom line is, the customer is the one who should be deciding these issues.

PATRICK ROACH: We've gotten a pile of questions from the audience. So let me select from among some of them here. Again, this the language of the questioner, not me. The question asks, "Is there something disingenuous about dealers relying on intra-brand competition to argue against direct sales but opposing more intra-brand competition when they argued against ad points?" Is there anybody stepping up to that one?

PAUL NORMAN: I'll take that one.

PATRICK ROACH: Paul, you want to take that one?

PAUL NORMAN: Well I think, as the dealer representatives on the first panel this morning tried to stress, first of all, dealers are both beneficiaries and victims, if you want to use that term, of the RMA laws, because it's usually a dealer who wants to relocate. Or, it's usually an incumbent dealer who will get a new point. Not always, but sometimes—or most of the time.

However the process is simply to make sure that the decision to locate another same-brand dealer into a market, whether it's by establishment of a new dealer or relocation of a dealer from outside, is in the best interest of not just the dealers and the manufacturer but of the public, because there's a balance in these laws between intra-brand competition and efficiencies. A balancing, I think we saw on the panel this morning, where some people talked about inability to reduce the dealer count in a certain area, because having a super-optimal number of dealers in a particular market can create inefficiencies, versus needing enough intra-brand competition.

Intra-brand competition undoubtedly is important. But in some markets, particularly metro markets where you already have five, six, ten dealers of the same brand, there comes a point where you don't need more intra-brand competition. And the balance will weigh more toward preserving efficiencies that do come with dealers who have a larger volume of sales to cover their overhead. So I don't think there's a—

PATRICK ROACH: Paul, sorry.

PAUL NORMAN: No, that's OK.

PATRICK ROACH: I don't need another 10 minutes. Todd Maron had flagged, I think. Todd, did you have a response?

TODD MARON: Well, I mean actually, I don't mean to denigrate this line of questioning, but I just don't think this is even subject to serious debate—that intra-brand competition, the existence of a middle man, someone else who needs to obtain a profit in the process of selling a car, results in lower prices. That is counter-intuitive to every economic principle that exists. It's why, as Dan cited, 72 economists spoke out on this issue against this notion that the existence of dealers lowers prices.

It's why the dealers have said in court, in our cases, that it's us who are lowering the prices. And that's what's harming them. It's why when we were in trial in the state of Georgia and we put on an economist to explain how we were the ones who were able to lower prices and how the franchise model increases prices, they didn't put on any testimony to dispute that. They didn't even put on an economist even though there was one sitting in the courtroom. These questions are not subject to serious dispute.

PATRICK ROACH: Dan, did you have—briefly, if you could.

DAN CRANE: So I do think Paul's confused on the value of intra-brand competition. Sure, intra-brand competition can reduce prices. That's because dealers in the same brand will compete against each other to lower the retail markup that they put at retail. That's a very different question, though, than intra-brand reducing prices vis-a-vis the incentives of the manufacturer.

PATRICK ROACH: Here's a question. I think it touches on something that I flagged for some of you in advance of this panel. This questioner asks, "Does Tesla support legislative changes that would permit all manufacturers to sell direct? Would that solve the opposition?"

TODD MARON: Want me to take that one?

PATRICK ROACH: Yes.

TODD MARON: Good question.

JOEL SHELTROWN: I think you're the only one.

TODD MARON: The answer to that question is yes—but. Yes as a matter of policy, as a matter of principle. That's what I believe. I think that's what the company would believe, as well, is best. The reason I say but is, it's not our issue.

And to understand this issue you do have to understand the difference between how Tesla gets involved in this issue and how every other manufacturer gets involved in this issue. I can't speak to them in any firsthand way, but there are some interests out there, between manufacturers and their affiliated franchise dealers, in how they should compete against one another. I don't know where to draw those lines. I know that we have nothing to do with that question.

So I would say as a personal matter, yes. I think there should be the ability to have direct distribution. Where those lines get drawn—vis-a-vis the manufacturer and their affiliated dealer, presumably—actually, I shouldn't presume. Maybe there are no lines that should be drawn. Maybe there are some lines that should be drawn that allow most but not all forms of direct distribution in that context. I know that none of the arguments have anything to do with our context, where we have no franchise dealers to compete against.

PATRICK ROACH: Joel, are you waving?

JOEL SHELTROWN: Yes. I would think a great compromise here, and one that I hope that state legislatures in areas where we're banned, is that we would allow any manufacturer that has a previous franchise agreement with dealers, or future franchise agreements planned, they would be able to sell directly. And if their business model fails, it doesn't work—as the auto dealers have suggested it won't, because of intra-brand competition—then we will switch to a franchise system or we will die. Once again, let the customer rule.

PATRICK ROACH: I'm looking at my watch. And I think we're coming up to the close of the discussion. Thank you all for this conversation. I think it's been very illuminating—certainly to me. And so we will do a 15-minute break before the final panel session. Thank you all very much.

[SHORT BREAK]