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4 March 2016

Federal Trade Commission  
Office of the Secretary  
400 7th Street SW  
5th Floor, Suite 5610 (Annex B)  
Washington, DC 20024

RE: Auto Distribution Workshop, Project No. P131202

On January 19, 2016, the Commission held a one-day workshop exploring state laws governing automobile distribution. As someone who has studied this issue in some depth, I respectfully submit the following thoughts for your consideration.<sup>1</sup>

My comments will focus largely on two issues. First, based on the panel discussions at the workshop and recent letters written by FTC staff regarding state franchise laws, it is perhaps fair to say that the staff's present view of such laws is that they serve primarily *private* rather than *public* interests. I believe the evidence does not support that position. Second, as observed at the workshop by FTC Chairwoman Edith Ramirez, this workshop and comment cycle is part of the FTC's long-standing and continued effort to "examine the complex system of automobile sales" with a focus on "whether consumers benefit from that system or if change is needed."<sup>2</sup> Following her guidance, I will address, within the context of a Nash bargaining model, the potential consumer benefits of state laws restricting direct sales.

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<sup>1</sup> I am grateful Randy Beard and Michael Stern, professors in the Economics Department at Auburn University and Senior Fellows of the Phoenix Center, for assistance in crafting my analysis. All views expressed in this letter are my own and any errors or omissions are my responsibility alone.

<sup>2</sup> *Opening Remarks of FTC Chairwoman Edith Ramirez*, Auto Distribution: Current Issues and Future Trends, Federal Trade Commission, Washington, DC (January 19, 2016) (available at: [https://www.ftc.gov/system/files/documents/public\\_statements/909813/ramirez\\_-\\_auto\\_distribution\\_workshop\\_opening\\_remarks\\_1-19-16.pdf](https://www.ftc.gov/system/files/documents/public_statements/909813/ramirez_-_auto_distribution_workshop_opening_remarks_1-19-16.pdf)).

*Public or Private Interest Legislation*

The Public Interest Theory of legislation or regulation holds that the government is a neutral arbiter that serves to correct some inefficiency or inequitable market practices, thereby benefiting consumers and potentially sellers as well.<sup>3</sup> Most, if not all, of the arguments supporting auto franchise laws are based on this public-interest view of government intervention. In contrast, Special Interest Theory holds that regulations serve the interests of particular groups, including possibly the regulated firms.<sup>4</sup> These groups compete for special interest legislation or regulation that shifts rents from other groups to their own. It was clear from the statements of some of the panelist and speeches given at the workshop, as well as the academic writings of a few of those panelists, that the auto franchising laws are being painted with the brush of private interest legislation like laws governing, for example, occupational licensing.<sup>5</sup> The economics profession's distaste for such laws is supported by time-honed arguments and a well-developed literature.

Bringing auto franchising laws under the umbrella of private interest legislation is admittedly a natural progression and the path of least resistance, especially in light of economists' (and their imitators) inherent yet perhaps understandable confirmation bias against government restrictions on markets activities. Still, my experience as a policy economist has taught me that such generalized, textbook-style arguments against *particular* laws governing *particular* industries is fraught with risk. In its assault on auto franchising laws, FTC staff labels such laws as an "an anomaly within the larger economy," but the fact is that the automobile industry *is* an anomaly within the larger economy.<sup>6</sup> In that light, the FTC's evaluation of auto franchising laws—laws governing the \$50 billion new-car market where the product has an average price of \$33,000—should not be a classroom exercise. The unique character of the auto industry, as well as

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<sup>3</sup> See, e.g., A.C. Pigou, *THE ECONOMICS OF WELFARE* (1932); R.A. Posner, *Theories of Economic Regulation*, 5 *BELL JOURNAL OF ECONOMICS AND MANAGEMENT SCIENCE* 335-358 (1974).

<sup>4</sup> G.J. Stigler and C. Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 *JOURNAL OF LAW & ECONOMICS* 1-16 (1962); S. Peltzman, *Toward a More General Theory of Regulation*, 19 *JOURNAL OF LAW & ECONOMICS* 211-240 (1976); G.S. Becker, *A Theory of Competition Among Interest Groups*, 98 *QUARTERLY JOURNAL OF ECONOMICS* 371-400 (1983); F.S. McChesney, *Rent Extraction and Interest-Group Organization in a Coasean Model of Regulation*, 20 *JOURNAL OF LEGAL STUDIES* 73-90 (1991).

<sup>5</sup> I refer primarily to the arguments made by Professors Dennis Carlton, Dan Crane, and Fiona Scott Morton, as well as the FTC Staff letters to Rep. Paul D. Moriarity dated May 16, 2014 (available at: [https://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-new-jersey-general-assembly-regarding-assembly-bills-2986-3096-3041-3216-which/140516nj-autoadvocacy.pdf](https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-new-jersey-general-assembly-regarding-assembly-bills-2986-3096-3041-3216-which/140516nj-autoadvocacy.pdf)) and to Rep. Michael Colona (New Jersey) dated May 15, 2014 (available at: [https://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-missouri-house-representatives-regarding-house-bill-1124-which-would-expand/140515mo-autoadvocacy.pdf](https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-missouri-house-representatives-regarding-house-bill-1124-which-would-expand/140515mo-autoadvocacy.pdf)). The content of these two letters is very similar, so subsequent references are to the "Moriarity Letter."

<sup>6</sup> Moriarity Letter, *id.*, at p. 4.

a respect for the federalist principles upon which this country is founded, deserves thoughtful economic and legal analyses specific to the industry.<sup>7</sup>

As I see it, the evidence supporting this private interest view of auto franchise laws is weak. From what limited documents are available summarizing the staff's "examination" of the industry, it appears that the protectionist slant on the laws is based primarily on a thirty-year old FTC staff report, which by the way has been criticized and countered by more recent evidence, and a dated empirical study on gasoline prices that has nothing to do with "the complex system of automobile sales."<sup>8</sup>

A number of anecdotes mentioned at the workshop seemed to me to work against a purely private-interest interpretation of franchise laws. For instance, as Chairwoman Ramirez observed, dealer franchise laws have been around since the 1930's and exist today in all fifty states.<sup>9</sup> As noted by Nobel Laureate Gary Becker, efficiency has an inherent advantage over inefficiency, and the persistence of significant inefficiency over an extended time scale is an anomaly to be explained.<sup>10</sup> It is likewise difficult to rationalize the claim that franchise laws raise prices for automobiles. Cars are a very expensive capital good purchased by virtually every constituent of a state.<sup>11</sup> In fact, an auto is the second largest purchase a consumer makes, second only to housing.<sup>12</sup> To the economist, special interest legislation acts an implicit tax, and the last way to gather votes is to tax heavily a very large purchase made by most of your voters.<sup>13</sup> In fact, in my home state of Alabama, the state charges a sales tax on car purchases (2%) half that of other goods (4%).<sup>14</sup> Moreover, new automobiles are sold at scant profit margins.<sup>15</sup> If the state franchise laws are viewed merely as crude rent-seeking, then their persistence

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<sup>7</sup> See, e.g., *New Motor Vehicle Board of California v. Orrin W. Fox Co.*, 439 U.S. 96, 107 (1978) ("California Legislature was empowered to subordinate the franchise rights of automobile manufacturers to the conflicting rights of their franchisees where necessary to prevent unfair or oppressive trade practices.")

<sup>8</sup> Moriarity Letter, *supra* n. 5, at ft. 9, 22. M.L. Walden, *Do Geographic Entry Restrictions Increase Car Prices?*, 35 REVIEW OF REGIONAL STUDIES 231-245 (2005) (available at: [http://www.uam.es/personal\\_pdi/economicas/rarce/pdf/modelo\\_precios\\_coches\\_usa.pdf](http://www.uam.es/personal_pdi/economicas/rarce/pdf/modelo_precios_coches_usa.pdf)).

<sup>9</sup> *Opening Remarks Ramirez*, *supra* n. 2, at p. 3.

<sup>10</sup> Becker, *supra* n. 4.

<sup>11</sup> FTC staff has made such an argument in Moriarity Letter, *supra* n. 6 ("The report found that these state laws harmed consumers because they caused motor vehicle prices to rise (at p. 3).") The study cited by staff has been criticized and other studies published since, using superior methodologies and larger samples, finding opposing results. Such claims are also belied by evidence indicating that new cars are sold at exceedingly small margins. See, e.g., *NADA Data 2014*, National Automobile Dealers Association (2014) (available at: <https://www.nada.org/nadadata>).

<sup>12</sup> *Consumer Expenditures 2013*, Economics News Release, Bureau of Labor Statistics (September 9, 2014) (available at: <http://www.bls.gov/news.release/pdf/cesan.pdf>).

<sup>13</sup> Peltzman, *supra* n. 4.

<sup>14</sup> <https://revenue.alabama.gov/salestax/cutax.cfm>.

<sup>15</sup> Statistics indicate that automobile dealers operate on pre-tax net margins of only 2.2%. *NADA Data 2014*, *supra* n. 11 at p. 3; P. Reed, *Where Does the Car Dealer Make Money?*, EDMUNDS.COM (December 3, 2013) (available at: <http://www.edmunds.com/car-buying/where-does-the-car-dealer-make-money.html>).

for decades is difficult to rationalize using the economic theory of special interest regulation and the empirical evidence on car prices.

Also, the automobile industry is not lightly-regulated by any means and perhaps for sound reasons; cars are essential to American living, but they are also expensive, complex, and dangerous. State and federal laws cover a wide range of issues relevant to the automobile industry including environmental concerns, financing practices, licensing, insurance, and so forth. Many, if not most, of such laws have a plausible public interest motivation. For instance, all fifty states and the federal government have a lemon law, protecting consumers from autos that fail to meet acceptable standards of quality and performance.<sup>16</sup> Such laws—both federal and state—suggest legislators believe private incentives alone, even in the relatively competitive auto industry, may not be perfectly aligned with the interest of consumers, a fact inconsistent with the staff's assertion that the manufacturer will act in a way "it believes will be the most responsive to consumers."<sup>17</sup> Manufacturers will act in ways to maximize profits, not consumer welfare.<sup>18</sup>

#### *Independent Dealerships and the Consumer*

While FTC staff "offer[s] no opinion on whether automobile distribution through independent dealerships is superior or inferior to direct distribution by manufacturers," economic theory may shed some light on this seemingly important question, especially in relation to "how [these laws] might affect consumers [and] what justifications might exist for any restrictions" on the direct sales of autos to consumers.<sup>19</sup> It may be, as the staff inquires, that the "reliance on independent dealers [achieves] the best outcome for [] the consuming public."<sup>20</sup> My analysis below focuses on the consumer effects of certain aspects of franchise laws and in particular direct sales.<sup>21</sup>

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<sup>16</sup> <https://www.carlemon.com/lemons.html>; <http://www.dmv.org/automotive-law/lemon-law.php>.

<sup>17</sup> Moriarity Letter, *supra* n. 5 at p. 4.

<sup>18</sup> See, e.g., D. Harwell, *America's Best-Selling Cars and Trucks are Built on Lies: The Rise of Fake Engine Noise*, WASHINGTON POST (January 21, 2015) (available at: [https://www.washingtonpost.com/business/economy/americas-best-selling-cars-and-trucks-are-built-on-lies-the-rise-of-fake-engine-noise/2015/01/21/6db09a10-a0ba-11e4-b146-577832eafcb4\\_story.html](https://www.washingtonpost.com/business/economy/americas-best-selling-cars-and-trucks-are-built-on-lies-the-rise-of-fake-engine-noise/2015/01/21/6db09a10-a0ba-11e4-b146-577832eafcb4_story.html)); *Former Law Enforcement Officials Ask Ford Motor Company To Apologize And Withdraw Lies About Them From False Affidavits Prepared By Ford*, PR NEWswire (October 9, 2015) (available at: <http://www.prnewswire.com/news-releases/former-law-enforcement-officials-ask-ford-motor-company-to-apologize-and-withdraw-lies-about-them-from-false-affidavits-prepared-by-ford-300156904.html>); D. Carrington, *Four More Carmakers Join Diesel Emissions Row*, THE GUARDIAN (October 9, 2015) (available at: <http://www.theguardian.com/environment/2015/oct/09/mercedes-honda-mazda-mitsubishi-diesel-emissions-row>); R. Sherefkin, *Lee Iacocca's Pinto: A Fiery Failure*, AUTOMOTIVE NEWS (June 16, 2003) (available at: <http://www.autonews.com/article/20030616/SUB/306160770/lee-iacoccas-pinto-a-fiery-failure>).

<sup>19</sup> Moriarity Letter, *supra* n. 5 at p. 2.

<sup>20</sup> *Id.* at p. 5

<sup>21</sup> For two reasons, I do not focus on the competitive effects. First, both the manufacturer and distribution of automobiles are workably competitive. In fact, it could be argued that auto distribution is

Automobiles are complicated, expensive durable goods that are able to provide the expected stream of transportation services only when they are combined with a maintenance/recall program sufficient and appropriate to the task. Thus, from the buyer's point-of-view, purchasing and using an automobile necessarily involves two related, but logically separate dimensions. Although somewhat of an oversimplification, the net benefits obtained by the consumer in using the automobile depend on both the price paid for the vehicle (i.e., the initial price) and the degree of support (i.e., maintenance and repair), this latter factor being obtained over time after the initial acquisition. Here I propose to demonstrate that this fact may offer an explanation for the persistence of auto franchise laws that does not rely on the simple and ultimately unsatisfactory claim that such laws are merely inefficient pandering to special interests as staff (and some of the workshop's panelists) appears to believe.

Ultimately, the existence of independent dealerships introduces a persistent intermediary between buyers (whose demands for new cars and car services are lumpy and disconnected in time) and manufacturers. These dealerships sell both new cars and provide maintenance and recall services for consumers continuously. In the absence of such independent franchise dealers, buyers would be, in effect, bargaining directly with the manufacturer, of which the direct sales retailer would be merely a creature. Viewed in this light, the function of independent dealerships can be seen as affecting an aggregation, or "bundling" of the separate relevant elements—the new car price and service support—over which the individual buyer bargains. Unlike the retail purchaser, the dealer engages in continuous and ongoing transactions with the manufacturer, and this continuity is interpreted as changing the nature of the implied bargain between the retail customer and the manufacturer. I explore this basic idea in what follows.

It must be admitted at the outset that any granular description of transactions between car buyers, independent retailers, and manufacturers of automobiles, is likely to be very complicated and, in consequence, not terribly useful. However, we are fortunate in the present circumstance to have several widely-accepted "stylized facts" which help focus the analysis. Specifically, these facts are: (1) the margins earned by auto retailers on new car sales are extremely low, and much of the profit in car retailing comes from warranty work, repairs, and the like;<sup>22</sup> and (2) consumers are relatively more satisfied with the prices they pay for new cars than they are with the levels of services they receive from dealers after the sale.<sup>23</sup> These stylized facts, if accepted, are evidently a

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excessively competitive. See, e.g., T.R. Beard, G.S. Ford, and L.J. Spiwak, *The Price Effects of Intra-Brand Competition in the Automobile Industry: An Econometric Analysis*, PHOENIX CENTER POLICY PAPER No. 48 (March 2015) (available at: <http://phoenix-center.org/pcpp/PCPP48Final.pdf>) (a copy of which is attached); J. Flint, *Too Many Dealers, Again?* WARD'S AUTO WORLD (September 2007). Second, states are not precluded from regulating the details of the competitive landscape generally and specially in auto retailing. See, e.g., *New Motor Vehicle Board of California*, *supra* n. 8 ("if an adverse effect on competition were, in and of itself, enough to render a state statute invalid, the States' power to engage in economic regulation would be effectively destroyed (at p. 439).")

<sup>22</sup> NADA Data 2014, *supra* n. 11; *Where Does the Car Dealer Make Money?*, *supra* n. 15. Trade in used vehicles is outside the scope of my analysis.

consequence of the structure of automobile retailing, which is characterized by independent dealerships. These facts, though, can be shown to be a direct consequence of the role of the independent retailer as a “bundler” of the relevant issues in the negotiations between car buyers and (ultimately) the manufacturer.

In the simplest terms, the analysis proceeds as follows. Manufacturers produce cars, and also service components for their cars, and consumers want to buy both cars and service support (e.g., warranty service and safety recalls). The typical consumer derives benefits from both dimensions: consumers want low car prices and also lavish service support. In contrast, the manufacturer, with profit as its objective, wants to charge high prices and provide minimal costly service, so the usual tension between buyer and seller is evident. In the usual fashion, we may imagine the buyer and seller negotiating (“bargaining”) over these dimensions, resulting in an intermediate outcome. Given this conceptualization, what is the potential role of the car dealer?

First, if the dealer is merely an instrument of the manufacturer (thus having identical preferences), then the dealer’s function is purely technical: dealerships provide retail delivery and service as part of the manufacturer. When the potential buyer bargains with the dealer, she is merely bargaining with the manufacturer. This is important: if there are no independent dealers, then car purchases can be thought of as bargains over price and service between a consumer and the manufacturer. The consumer rarely buys cars, and her acquisition of cars and car repair/warranty services are discrete and random in time.

This story is clearly inadequate, though, when the dealer is itself an independent intermediary. The independent dealer, by definition, does not have preferences that are identical to the manufacturer. The dealer, instead, sells cars acquired from the manufacturer to a succession of local buyers, simultaneously providing warranty services and so on. From the dealer’s perspective, the issues of car prices and service support are not sequentially presented, as they are to the retail buyer, but instead occur simultaneously among perhaps thousands of separate buyers. The dealer’s profits will be determined, *inter alia*, by wholesale prices for cars and reimbursement for warranty repairs and the like.

What, though, could be the practical implications of this difference? When dealers are independent of the manufacturer, then they do not act as pure instruments of the manufacturer. At the same time, however, they are not servants of consumers: dealers act to maximize their profits, just like everybody else. How, then, could the existence of independent dealers benefit consumers, and what form would such benefits take?

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<sup>23</sup> While various Internet sites list consumer complaints about dealer services (e.g., complaintslist.com), satisfaction with car dealer services is actually quite high. See, e.g., G. Hoffman, *How Dealers Are Making Consumers Happier These Days: Are You One of Them*, AUTOBLOG (March 23, 2011); *Despite Three-Year Increase in Recalls, Satisfaction among Recall Customers Continues to Climb*, J.D. Power (March 18, 2015) (available at: <http://www.jdpower.com/press-releases/2015-us-customer-service-index-csi-study#sthash.AuTuiOny.dpuf>).



Although one could imagine many ways in which independent dealers could alter the nature of car purchase bargaining, one obvious affect is suggested by the discussion above: independent dealers are persistent actors in the car market who are not manufacturers. The relations between the franchisees and the manufacturers are inclusive, persistent, and ongoing. Thus, the presence of such independent retailers implies that the terms (express or implied) of transactions are resolved “simultaneously” as implicit parts of the franchise agreements. This conceptualization has an interesting consequence that leads to conclusions consistent with the stylized facts above. To see this, I consider a simple model of bargaining, between two parties (a car buyer and a manufacturer), in which the presence of an independent intermediary is seen as allowing the customer to indirectly bargain with the manufacturer (through the dealer) over both aspects of the car purchase simultaneously. This simple modification of the strategic scenario has interesting implications.

To see this, let there be a buyer (B) and a manufacturer (M) that must bargain over two aspects of a potential car purchase, the price  $p$  and the level of service support  $s$  (e.g., warranty, recall, etc.) The payoffs to both parties are given by:

$$B_p = (1 - p), \quad M_p = p, \quad (1)$$

$$B_s = s^\alpha, \quad M_s = (1 - s). \quad (2)$$

I assume the parameter  $\alpha$  is less than one, an assumption that makes the buyer’s payoff function concave with respect to future service support on the vehicle. This curvature in the buyer’s payoff represents the notion that the consumers derive a lot of utility from basic service that keeps the vehicle performing its fundamental functions (e.g., the transmission), but the marginal utility declines as less essential service is performed (e.g., eliminating every single noise or rattle). Further, this curvature also captures a notion of risk aversion relative to the manufacturer who views a dollar spent on service equivalent to a dollar collected on the sale.

Let us consider first the case in which the two dimensions are resolved separately. Presuming the two parties engage in Nash bargaining over the two issues separately, we obtain:

$$p^* = 1/2, \quad (3)$$

$$s^* = \frac{\alpha}{1 + \alpha}. \quad (4)$$

In contrast, suppose we envision a joint bargain, where the issues are resolved simultaneously and the joint payoffs are the sum of the two issues:

$$B_j = (1 - p) + s^\alpha, \quad (5)$$

$$M_j = p + (1 - s). \quad (6)$$

Here, the Nash outcomes would be:

$$p_j^* = \frac{1}{2} \left( 1 + \frac{1}{\alpha} \right) \alpha^{1/(1-\alpha)}, \quad (7)$$

$$s_j^* = \alpha^{1/(1-\alpha)}. \quad (8)$$

When we compare the outcomes and welfare of the parties under these two scenarios, we see that:

$$p_j^* < p^*; \quad (9)$$

$$s_j^* < s^*; \quad (10)$$

$$(B_p^* + B_s^*) < B_j^* = M_j^* < (M_p^* + M_s^*). \quad (11)$$

From Expression (11) we see that from the manufacturer’s point-of-view, the nature of consumer demand for services and the essentially “zero-sum” character of price negotiation implies that separate bargaining over these two aspects is more profitable (i.e.,  $M_j^* < M_p^* + M_s^*$ ). In contrast, the retail buyer benefits when these two aspects of the transaction are resolved “simultaneously” (i.e.,  $B_p^* + B_s^* < B_j^*$ ). The ability of an independent franchise dealer effectively to “bundle” these aspects of the transaction is valuable to consumers, and retail purchasers could not enforce this bundling on their own versus a manufacturer.

Although somewhat abstract, this interpretation gains considerable support from our “stylized facts” listed above. First, the bundling leads to lower retail car prices for buyers (by Ex. 9). What we observe, of course, is retail prices for new cars that exhibit miniscule margins, a result that is consistent with the model’s predictions. Simultaneously, though, service, for which the consumer’s marginal benefit declines (i.e., dash rattles and not serious mechanical issues), is reduced compared to that obtained in independent bargaining; there’s no lack of consumer complaints regarding repair work (or the lack thereof). Thus, the bundling of the bargains by the independent dealership makes consumers better off by potentially trading off some service for a lower initial price. Notably, survey evidence indicates the service quality provided by the dealerships remains quite good.<sup>24</sup>

Most importantly, though, and returning to our earlier discussion of the paradox implicit in viewing franchise laws as a pure rent extraction mechanism, consumers (i.e., citizens/voters of the states that promulgate these laws) benefit, on net, from the bundling of the issues of price and service coverage/support.<sup>25</sup> Although they may

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<sup>24</sup> *Id.*

<sup>25</sup> This result conflicts with staff’s view expressed in the Moriarity Letter, *supra* n. 5 (“Advocates for existing dealers also argue that manufacturers that sell directly to consumers will not provide them with adequate service. This argument presupposes that auto manufacturers in a competitive environment will act contrary to their economic self-interest. If consumers greatly value post-sale service and would be unlikely to purchase or recommend any automobile without a reasonable assurance of quality future service, then any manufacturer will have an incentive to supply such service or would see its sales decline to



sacrifice some service, the very low price for the car up-front more than compensates for the reduction in support for less important service issues. States, then, would have an interest in franchise laws if, as seems probable, the existence of the franchisees favorably affects the bargaining between buyers and the manufacturer and keeps the initial price of the car very low.

This analysis suggests an alternative take on the staff's "principal observation [] that consumers are the ones best situated to choose for themselves both the cars they want to buy and how they want to buy them."<sup>26</sup> The way the market is designed affects how consumers are able to buy cars and service. As shown here, the manufacturer prefers separate negotiations for the car and the subsequent service whereas the consumer wants the two elements of the transaction bundled. Independent dealerships perform such bundling and are in continual negotiations with manufacturers. Thus, it is not true, as the staff asserts, that "the law should permit automobile manufacturers to choose their distribution method to be responsive to the desires of car buyers," because manufacturers do not respond solely to the desires of car buyers.<sup>27</sup> Manufacturers maximize their profits, and profits are higher when the bargains are separate. Consumers, operating collectively through their legislatures, can alter the design of the market for auto distribution in a way that leads to a more consumer-friendly outcome. State franchise laws, therefore, are seen to address "supportable public policy considerations,"<sup>28</sup> and not merely special interest legislation as the staff seems to believe.

### *Conclusions*

Without dispute, the automobile market is one that all levels of government have a keen interest. Federal and state laws address a wide range of issues covering the manufacturing, distribution, and use of the automobile. Many of these laws and regulations serve plausible public interest concerns. As discussed here, staff's view that auto franchise laws are nakedly protectionist for independent dealerships not only conflicts with the evidence and the theory of special interest legislation, but economic theory shows that such laws serve valid public policy considerations and can be pro-consumer. It is not the case, as staff suggests, that a manufacturer will best satisfy consumer desires if it able to freely choose between independent dealerships and direct sales.<sup>29</sup> The manufacturer will make the choice that best suits the manufacturer, not the

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the benefit of its rivals. This competitive pressure is a strong motivation for manufacturers to either provide good service themselves or continue to contract with an independent service provider, such as a dealer, to do so (at p. 6).").

<sup>26</sup> *Id.* at p. 2

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at p. 4 ("If a manufacturer concludes that using independent distributors to sell its products will best serve consumers and its own needs, it is free to contract for those services. On the other hand, if it decides that direct sales work better for its products, it can pursue sales directly. Many manufacturers choose some combination of direct sales and sales through independent retailers. The competitive process gives the manufacturer the incentive to pick the distribution option that it believes will be the most responsive to consumers.").

consumer. While the oligopolistic competition among manufacturers does push the manufacturer to consider consumer interest, consumer welfare is not the maximizing objective of the manufacturer. In selling an automobile-service bundle, the independent dealership may have better incentives with respect to consumers than does the manufacturer.<sup>30</sup> It is not unreasonable for state legislatures to choose a market design that best serves their constituents. I have yet to see a compelling argument for federal intervention.

It is also worth noting that none of the *established* manufacturers has expressed an interest in replacing franchise dealers with manufacturer-owned outlets.<sup>31</sup> In fact, manufacturers are not prohibited from operating their own dealerships in some states, yet they do not. As for adding new dealerships or terminating existing ones, evidence presented at the workshop revealed that dealership termination and addition disputes almost always are decided in favor of the manufacturer. It would seem, therefore, that this renewed interest in auto franchise laws has an ulterior motive. In light of the workshop panels, warranty reimbursement, which is costly to the manufacturer but beneficial to the consumer, seems a likely candidate.

FTC Chairwoman Edith Ramirez inquired in her opening remarks at the FTC's workshop "whether consumers benefit from [the franchise system]." Based on the analysis presented here, the answer may well be *Yes*.

Respectfully submitted,



George S. Ford, PhD

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<sup>30</sup> J. Cobb and M. Mayersohn, *Why Do We Keep Buying Vehicles at Dealerships?*, CAR & DRIVER (October 2015) (available at: <http://www.msn.com/en-us/autos/news/why-do-we-keep-buying-vehicles-at-dealerships/ar-AAeZXDJ>) ("There has been a focus on outdated laws that protect dealers, but there is that consumer issue, and it is a real one," says Aaron Jacoby, chair of the automotive industry practice group at Arent Fox, a Washington, D.C.-based law firm. "Laws are still geared toward protecting consumers, and there is interest in how they will get service for these major expensive things they are buying. How will recalls be handled? How will warranty work be handled?").

<sup>31</sup> While Tesla has indicated its preference for direct sales, the manufacturer sells very few, very expensive cars. In 2015, Tesla sold about 50,000 cars with base price of about \$75,000. See, e.g., R. Waters, *Telsa Sales Pace Falls Short at End of 2015*, FINANCIAL TIMES (January 3, 2016) (available at: <http://www.ft.com/cms/s/0/9b0bfa4c-b25a-11e5-b147-e5e5bba42e51.html#axzz41ryVUYfP>); M. Sheetz, *So How Much Would Buying a Tesla Really Cost You?*, CNBC (October 15, 2015) (available at: <http://www.cnbc.com/2015/10/10/-would-buying-a-tesla-really-cost-you.html>).