

**Comments of the National Automobile Dealers Association (NADA),
McLean, Virginia, United States
On the
European Commission
Report of the Director General Competition
On the Block Exemption Regulation (BER 1400/2002)
Governing Motor Vehicle Distribution and Repair Agreements
Dated 28.5.08**

The National Automobile Dealers Association, founded in 1917, represents more than 18,700 new car and truck dealers, selling both domestic and international vehicles in the United States, with nearly 40,000 separate franchises. NADA membership is open to any new automobile or new truck dealership holding a new automobile or new truck sales and service franchise contract from a vehicle manufacturer. NADA is located in McLean, Virginia.

NADA wants to thank EC Competition Commissioner Neelie Kroes for this opportunity to comment on the Commission's Report on this important subject.

Summary of NADA Comments

Franchised new car dealers in the US – able to act independently at the local level, and protected from arbitrary and unfair actions by manufacturers – have increased both inter-brand and intra-brand competition by providing innovations in marketing and consumer service.

The US Motor Vehicle Sector

New car and new truck dealers in the United States sold 16.1 million new vehicles and 18.5 million used vehicles in 2007. Total revenue reached more than \$693 billion. Dealership employment remained consistent at about 1,100,000 employees. The typical dealership in 2007 employed 54 people with an annual payroll of \$2,594,000.¹

Service and parts (aftermarket) sales by U.S. dealers reached about \$84 billion in 2007. Dealership expenditures, excluding cost of goods sold, exceeded \$80 billion, and

¹ This information is summarized from *NADA Data 2008, Economic Impact of America's New Car and New Truck Dealers*, appearing in NADA's *AutoExec Magazine* for May 2008. It can also be accessed online at www.nada.org/nadadata.

franchised dealers were major generators of federal, state, and local tax revenues.² Forecasts for sales for 2008 are substantially lower, possibly at 15 million new vehicles or less, due to a variety of factors, including commodity prices, consumer attitudes, and uncertainties in the housing and financial sectors.

While there are many differences between the motor vehicle sector in the EU and in the US, there are also significant similarities in developments in recent years. The two sectors are part of an increasingly integrated global market and subject to the same trends and influences. Many of the public policy issues discussed in the Commission Evaluation Report of 28.5.08 (“the Report”) are also the subject of continuing discussion in the US. By submitting these comments, NADA hopes that the experience of US dealers will assist the EC Competition authorities in creating a regime to follow the expiration of the Block Exemption Regulation 1400/2002 (the “BER 2002”) on 31 May 2010.

BER 2002 – Objectives of the Regulation

The Report analyzes seven Goals³ for the BER 2002. The US has no situation analogous to Goal C, cross-border trade,⁴ and several other Goals (D, E, F) involve portions of the automobile sector where US dealers are not involved directly. The remaining goals (A, B, and G) are relevant to, and shared by, US dealers.

Goals A, B, and G address inter-brand competition among manufacturers, intra-brand competition among dealers, and protecting dealer independence from manufacturers, respectively. In the US, dealers are able to act independently at the local level and are protected from arbitrary and unfair actions by manufacturers, and, as a result, have increased both inter-brand and intra-brand competition, all to the benefit of consumers. This increase is the result of both innovation in market structure and innovation in consumer service.

The BER 2002 was designed to promote innovative distribution models and facilitate the entry of new manufacturers into the sector, both essential elements of Goals A and B. Rather than being an impediment to these goals, US dealers have been the source of many market innovations and have provided a source of experience and knowledge for new manufacturers entering the US market. For example, US dealers offer a full range of services to customers via the Internet. Many US dealers are also multi-brand operations, often at more than one location.

² Ibid.

³ **A:** Preventing foreclosure of competing vehicle manufacturers and safeguarding their access to the market; **B:** Reinforcing competition between dealers of the same brand by encouraging diversity in distribution formats; **C:** Facilitating cross-border trade in motor vehicles; **D:** Enabling independent repairers to compete with the manufacturers’ networks of authorized repairers; **E:** Protecting competition within the authorized networks; **F:** Facilitating spare part producers’ access to the aftermarket; **G:** Protecting dealer independence vis-à-vis vehicle manufacturers.

⁴ With the exception of dealers’ ability to open additional sales outlets, which is discussed below.

The Role of Dealers in the Motor Vehicle Sector

Automobile dealers are much more than a “black box” through which a manufacturer’s product is passed to customers at the retail level.⁵ It is important to recognize that competition in the automobile industry occurs along a number of dimensions, which can be generalized as *price* and *non-price* promotion. Dealers play a significant role in shaping both forms of competition. They shape price competition by, among other things, bargaining over price and assessing the trade-in value of used automobiles. Dealers also shape non-price competition by providing promotional activities, offering pre-sale services and knowledgeable salespeople, providing warranty coverage, maintaining product and parts inventory, performing aftermarket services, and certifying quality through reputation. The decentralization of such decisions is desirable from a manufacturer’s perspective – dealers are often better informed about local market conditions than are manufacturers, which makes contracting with dealers to carry out such activities more effective than attempting to provide them internally.

Providing many of the activities associated with non-price promotion requires a *significant investment on the dealer’s part*. Unlike more traditional investments, however, it is often not possible for dealers to recoup their costs by charging separately for the provision of these highly valued activities. This is particularly true for promotional activities and pre-sale services dealers provide in an effort to stimulate demand for their manufacturer’s product.⁶ Thus, the provision of these critical activities and survival of dealers depends on their ability to sell the product in question after making such investments.

Individual dealers are part of a larger dealer network that is responsible for marketing, distributing, and servicing a manufacturer’s product. When the value of a manufacturer’s product is positively influenced by the existence of this dealer network, the manufacturer’s *brand capital* – the value of the manufacturer’s brand in the consumer’s mind – is increased. The consumer will place a higher value on the manufacturer’s product when consistent support is available anywhere or any time that it is needed, not just at the point or time of sale.

In order to ensure that dealers perform these essential activities noted above, however, dealers must be able to secure an adequate return on their investment. They must be comfortable that their significant investment in facilities, training, inventory, and other areas will not be lost on a manufacturer’s whim or for unfair or irrational reasons.

⁵ Much of the analysis in this section is taken from *Incentives Matter: An Economic Perspective on the Use of Volume-Based Stairstep Programs in the Automobile Industry*, prepared by Jaison R. Abel, Ph.D., and Samuel Weglein, Ph.D., Analysis Group, Boston, Mass., for NADA, dated October 2005.

⁶ Consider the impossibility of a dealer charging a fee to “just looking” consumers for a test drive!

Goal A: Preventing foreclosure of competing vehicle manufacturers and safeguarding their access to the market; and Goal B: Reinforcing competition between dealers of the same brand by encouraging diversity in distribution formats

It may be that the Report looked at the competition (both inter- and intra-brand) created by the BER 2002 with an overly-narrow definition of competition and with a timeframe too short to allow significant changes in the EU dealer body.

For example, diversity in distribution is an important concept. The Report assumes that sufficient competition will occur only with the advent of “big box”⁷ stores selling new cars or direct factory sales via the Internet or through the factory-owned stores.

In the US, there are no “big box” stores, no direct Internet sales, and very few factory-owned dealers.⁸ Increased competition, both inter- and intra-brand, among dealers has occurred, however, for a variety of reasons, including: (1) multi-franchised dealers and an adaptable dealer ownership structure, (2) extensive use by dealers of the Internet, (3) eagerness by dealers to sell vehicles manufactured by factories new to the US market, and (4) dealer willingness to invest in dealerships subject to the protections of the US franchise laws.⁹

In addition, a major reorganization of the EU dealer body from many single-location, single franchise dealers subject to location clauses¹⁰ into a more diverse system including multi-franchise dealers with several locations will probably take longer than the period 2002-2008. The definition of a “dealer” is complicated,¹¹ but generally speaking, at the time the BER 2002 went into effect, for similar populations, the US had fewer dealers than the EU, but US dealers were generally larger, with many more multi-franchise operations. This situation was the result of decades of consolidation among US dealers, not a five year period similar to the timeframe (2002-2007) analyzed in the Report. As the report of London Economics to the Commission stated:

The changes taking place in the sector are substantial but it [is] *too soon* to conclude whether the final outcomes will meet to a satisfactory degree the objectives of the Commission.¹² (italics added)

⁷ For example, Wal-Mart or Carrefour.

⁸ Factory-owned stores are generally prohibited by US franchise laws, except in limited circumstances, such as dealer development programs.

⁹ For a discussion of this last item, US franchise laws, see the section on Goal G below.

¹⁰ As described in the Report, “parallel networks of single-brand vertical agreements,” page 4.

¹¹ A single ownership structure – corporation/partnership/sole proprietor – or a single physical location, a “rooftop” to US dealers, or a single franchise?

¹² *Developments in car retailing and after-sales markets under Regulation No 1400/2002, Vol. I, Final report to EC DG by London Economics, June 2006, (hereinafter, London Economics), page xvii.*

In the US, there is no “typical” dealership structure or operation. There are many types of ownership entities: sole proprietors, partnerships, and various forms of corporations, both privately-held and publicly-traded.¹³ This variety of ownership entities has fostered a corresponding variety of dealer operations, including many multi-franchise dealers. The US dealer entity may sell a single franchise at a single location, may sell several franchises at a single location, or may sell several franchises at many locations, sometimes located thousands of miles apart. Four of the larger groups¹⁴ operate more than 100 dealerships, and an additional seven groups operate more than 30 dealerships.

Of the 17,643 car dealers who were NADA members in July 2008,¹⁵ 45% held a single franchise. The remaining 55% held multiple franchises: 25% had 2 franchises, 18% had 3 franchises, 7% had 4 franchises, and 5% held 4 or more franchises.¹⁶

In the US in the 1990s, the advent of the Internet caused many people to question the need for state franchise laws to protect dealers’ commercial interests. (See discussion of Goal G below). The prospect of disintermediation, or the whole or partial displacement of the traditional physical distribution network with Internet-based systems, was felt by some to offer the prospect of innovative delivery mechanisms and increased inter- and intra-brand competition, similar to the benefits sought by the implementation of BER 2002.

The potential for savings through disintermediation, however, depends on conditions not found in the new car market.¹⁷ Two critical considerations are: (1) the physical properties of a product that affect shipping, and (2) the obligations of ownership and useful life. Consider a variety of common products: automobiles, wine and beer, compact discs, books, travel services, and contact lenses.

These products, other than automobiles, can generally be shipped easily and at a low cost. In addition, they generally have short useful lives or do not need routine maintenance. These products thus resemble commodities for distribution purposes. Disintermediation did occur in the distribution of these commodity-like products. Consumer, suppliers, and distributors realized savings and greater convenience.

In contrast to these commodity-like products, the automobile has physical properties that are infinitely more complex in design and construction. Even a single model auto is available in a bewildering array of colors and options.¹⁸ In addition, over its useful life of more than 100,000 miles and 10 years, the auto will need service and parts.

¹³ C-corporations, S-corporations, LLCs (limited liability corporations), and others.

¹⁴ Autonation, Penske Automotive Group, Sonic Automotive, and Group 1 Automotive.

¹⁵ NADA membership includes more than 93% of US new car dealers.

¹⁶ Data from the NADA Membership Dept., July 8, 2008

¹⁷ This analysis is based on *An Assessment of Franchise Laws and Internet Auto Sales*, prepared by Brian Shaffer, Ph.D., Univ. of Maryland, for NADA, dated August 2001.

¹⁸ Consider engine/transmission combinations, body color/interior color and upholstery materials, and electronics (sound, navigation, and entertainment systems) for each model.

Consumers of autos, like consumers of other complex and durable goods, will continue to need a community-based retail presence because of these inherent characteristics of the automobile. The Internet cannot be used to test-drive, deliver, inspect, service, perform safety recalls, or repair vehicles over their multi-year useful life. Automobiles and their traditional distribution system, unlike commodity-like products and services, are thus not subject to the benefits of disintermediation.

This lack of disintermediation in the auto industry did not mean, however, that the US motor vehicle sector missed an opportunity to increase competition, both inter- and intra-brand, and offer improved service to the consumer.

The Internet became the source of an enormous amount of information for automobile consumers.¹⁹ This information is provided by dealers²⁰ and non-dealers also. For example, there is extensive price information available on the Internet from both dealers and other sources. Both the Manufacturer's Suggested Retail Price (MSRP) and the dealership invoice cost²¹ for each vehicle, plus the MSRP and dealer invoice for options and option packages, are available. This situation has created virtual price transparency in the motor vehicle section for new vehicles.

In addition, US dealers have embraced the Internet as a way to provide better service and value to consumers – just the kind of dealer-driven innovations sought with BER 2002. Together with increased advertising on the Internet,²² many dealers have posted their inventory and hours of operation. Consumers in the market for a vehicle can make an appointment with a salesperson or submit an application for financing on-line. After the purchase, the consumer can schedule an appointment in the dealer's service department via the Internet.²³

Dealers competing for aftermarket customers offer loaner vehicles or taxi service to their service customers. Consumers can also find waiting rooms with internet access, child play areas, and coffee bars at dealerships.

BER 2002 sought to encourage successful market entries by additional manufacturers. US dealers have been and continue to be eager to assist new manufacturers seeking retail outlets. For example, there have been seminars and

¹⁹ See *London Economics*, page xix-xx: "Internet car retailing . . . has certainly increased the amount and depth of information available to prospective buyers and facilitated inter-brand comparisons at a much lower cost to consumers."

²⁰ More than 97% of US dealers have websites.

²¹ The dealership invoice cost is the "wholesale price," or the amount paid by the dealer to the factory to obtain the vehicle, without consideration of any holdback arrangements used by a factory.

²² The average US dealer spent 16.5% of advertising dollars on the Internet in 2007, up from 11.5% in 2006 and 9.9% in 2005. See *NADA Data 2008*, supra, n. 1.

²³ More than 70% of NADA members have evening, hours weekend hours, or both in their service departments. See *NADA data 2008*, supra, n. 1.

workshops at the last several NADA Conventions²⁴ on the Chinese automobile industry. NADA staff has issued guidance to dealers on evaluating new manufacturers. When new manufacturers face cultural and language issues as well as the complexity of the 21st century motor vehicle industry, existing dealers offer an effective, experienced, and lower-cost method for entering a new market.

Goal G: Protecting dealer independence vis-à-vis vehicle manufacturers

The type of franchise arrangement common in the US motor vehicle sector gives dealers great freedom at the local level in return for requiring them to make the investments necessary to provide the services described above. In the absence of the franchised dealer network, the manufacturers would need to invest billions of dollars (or Euros) in retail facilities and other assets. In addition, in the current economic climate, the manufacturers would be at risk for those investments rather than their dealers.

Despite the increase in the size of many multi-franchise dealers and the number of consolidated dealer groups, the dealer-manufacturer relationship at the basic level is not equal. The typical franchise contract is not negotiated. It is a “take it or leave it” offer presented by the manufacturers to their dealers. The basic terms are set by the factories, and any change in those terms is generally initiated by the factory.

The imbalance in bargaining power is obvious. Absent some type of statutory or regulatory protection, the only remedy available to most dealers is legal action against the factory. Dealers, however, are generally reluctant to sue their manufacturer. The prospects for an individual dealer’s success are poor due to the factory’s large budget for litigation and the factory’s ability to retaliate outside the courtroom in many ways, both obvious and subtle.

It is true that larger dealer chains may have more resources available for dealing with manufacturers, but the discrepancy in resources is still substantial. Even a large multi-state dealer chain will have reservations about litigation against some of the world’s largest multinational corporations.²⁵

Moreover, there are features of US antitrust (competition) law²⁶ that limit dealer actions toward their manufacturers. Dealers acting *as a group* may not, for example, refuse to sell an unpopular model. Dealers groups may not require better financial arrangements as a condition of using a factory’s financial subsidiary, nor may an

²⁴ The NADA Convention and Exposition is held annually in January or February, and typically attracts more than 25,000 dealers (including many non-US dealers), dealership staff, vendors, and manufacturer representatives.

²⁵ For example, the market value of Toyota Motor Corporation in early July 2008 exceeded \$160 billion.

²⁶ These laws are primarily at the federal (national) level, although most states have similar statutes. Two federal agencies, the Department of Justice and the Federal Trade Commission, have primary enforcement responsibility at the federal level. Each state has an attorney general and regulatory agencies with similar enforcement powers based on state law.

organized group of dealers refuse to accept a factory's changes to its dealer franchise contract. A group of dealers may not agree on retail prices for goods and services, nor may a dealer group organize to do business using limited (specific) terms and conditions.²⁷

In light of the imbalance of power between the manufacturers and dealers in the US, automotive vertical agreements, or franchise contracts, between manufacturers and dealers are heavily regulated. This regulation is done predominantly at the state level.²⁸ All US states have similar statutes. The specific provisions of these statutes may vary, but the statutory provisions generally override or modify any conflicting provisions in franchise contracts.

The specific provisions vary among the states, but certain provisions are common. The statutes generally prevent arbitrary termination or refusal to renew except for objective reasons or specific cause. Compensation to terminated dealers must be based on the dealer's investment, lost earnings, and the value of the business. A period to cure the alleged deficiencies must be offered.

Manufacturers are also limited in their ability to interfere with the transfer of ownership, either by sale or upon the death of the owner, if the buyer/successor satisfies certain objective criteria. Dealers often may protest if the manufacturer wants to add another dealership in the current dealer's "relevant market area." There are also frequently limits on the ability of the manufacturer to force the dealer to purchase unwanted inventory, or force the dealer to build exclusive or upgraded facilities.

A recent and relevant example of the beneficial effect of these restrictions on factory actions vis-à-vis dealers involves "exclusive" facilities. Prior to the current economic difficulties, many factories with popular models urged their multi-franchise US dealers to build expensive new "exclusive" facilities. Based on their knowledge of local markets and other individual criteria, some dealers built these facilities, but many did not. Without the franchise law protections in this area, *all* dealers would now be burdened with the financing and operating costs of these facilities, regardless of the conditions in their local market. A reversion to prior industry practice of rigid, top-down factory management, would also be at odds with the goals of the BER 2002.

A variety of enforcement mechanisms is an important adjunct to these restrictions. As noted above, dealers are often reluctant to sue their manufacturers. Many US franchise laws provide for disputes and licensing issues to be heard by state boards, commissions, or other administrative agencies. An appeal to the courts is a last resort.

²⁷ For example, dealers *as a group* may not agree to close on weekends, make no advertising that includes pricing information, or accept no contracts from computer vendors with a term in excess of six months.

²⁸ The one specific federal statute, the Automobile Dealers Day in Court Act, 15 USC 1221-1225, is generally viewed as having had little influence on the factory-dealer relationship.

There is a similar and important provision in the BER 2002. Article 3(6) provides for dispute resolution by a contractual arbitration mechanism for defined categories of dispute. As the Report states, “[t]his right to go to an expert or to arbitration is made without prejudice to each party’s right to make an application to a national court.”

Conclusion

NADA agrees with the Commission’s desire to reduce the complexity of regulation in the motor vehicle sector. Car owners (and also dealers and manufacturers) will benefit from a less complicated regulatory scheme.

It is NADA’s position, however, that provisions protective of dealers’ commercial interests, such as Article 3 of BER 2002, are not inconsistent with the Commission’s policy objectives. To the contrary, these protections are essential to securing the innovation and competition sought by the Commission. When viewed with a less-restricted focus on the types of distribution necessary, and given sufficient time to work, these protections will create an environment that supports the Commission’s policy goals.

The benefits of this approach are evident in the US motor vehicle sector, which is extremely competitive, both inter-brand and intra-brand. With their local market knowledge and ability to react quickly, US dealers have been able to provide the types of competition and innovation sought by the Commission. Innovation has occurred in new dealer structures – 55% of US dealers are multi-franchise operations – and competition has forced dealers to provide new and improved services to consumers at lower prices.

The key to this environment is the protection and freedom afforded to US dealers by the regulation of franchise contracts described above. Based on US experience, an EU regulatory scheme that allows dealer network reorganization (including the termination of dealers) at the *sole judgment of manufacturers* is not an effective way to increase competition and provide innovative consumer services. As in the past, such an approach will stymie pro-competitive behavior by dealers, and adversely affect consumers.

A more effective approach would be to encourage dealer innovation based on local market conditions rather than relying solely on factory oversight and direction. Those local conditions are best understood by dealers, not distant corporations. This approach will benefit all stakeholders in the motor vehicle sector – consumers, manufacturers, and dealers.

NADA urges the Commission to establish a regulatory structure to follow BER 2002 that continues to encourage innovation and competition by providing for dealers the types of protections described above.

/s/

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