S.47, An Act Relating to Motor Vehicle Manufacturers, Dealers, and Warranty or Service Facilities
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House Commerce & Economic Development Committee
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Thank you for the opportunity to testify. S.47 amends the motor vehicle franchise law so we thought it would be helpful to provide background on why Vermont has a motor vehicle franchise law. I will also describe ways in which the dealer franchise model benefits Vermonters and the state as compared to the vertically integrated manufacturer direct-to-consumer model. Then I'll describe the two amendments to the franchise law in S.47 – one related to dealer competition and the other to direct-to-consumer motor vehicle manufacturers, along with the process for DMV to collect proposed franchise amendments for consideration in 2022 in Sec. 5, and why VADA supports these provisions taken as a whole.

How does the motor vehicle franchise law benefit Vermont?

Every state has a motor vehicle franchise law. Vermont's Motor Vehicle Manufacturers, Distributors, and Dealer Franchising Practice Act, can be found in Title 9, Chapter 108. The legislative findings in the dealer franchise law recognize that *"the distribution and sale of vehicles within the State vitally affects the general economy of the State and the public interest and public welfare*," and as a result *"it is necessary to regulate vehicle manufacturers, distributors, or wholesalers and factory or distributor representatives . . . who are doing business in this State in order to prevent frauds, impositions, and other abuses upon its citizens and to protect and preserve the investments and properties of the citizens of this State."* 9 V.S.A § 4084(a).

Vermont's franchise law findings also recognize the "inequality of bargaining power" between a motor vehicle manufacturer and one of its dealers. 9 V.S.A. § 4084(b). Dealers make substantial investments in infrastructure on behalf of a manufacturer. The local investments by dealers ordinarily entails hundreds of thousands, and often millions of dollars, in the construction of dealership facilities, service facilities and tools, inventory, training and advertising, on behalf of the manufacturer. The dealer is dependent on the manufacturer to supply the vehicles to sell to support that investment. The franchise laws set the basic ground rules that govern the relationship. For example, the law requires a manufacturer must have "good cause" for terminating a franchise agreement. 9 V.S.A. § 4089. This ensures dealers are protected from unwarranted termination.

Vermont's franchise law provides significant protections to dealers but also to consumers who purchase vehicles from franchised dealers that do not exist in a vertically integrated, "factory store" model where the same entity manufactures and sells the vehicle to the consumer. Here are three examples:

1. ***Consumers benefit from fierce intra-brand price competition under the franchised dealer model –*** Approximately 86 percent of car shoppers conduct online research before deciding to visit a local dealership, according to research from digital marketing agency Adtaxi. Car shoppers know the manufacturer suggested retail price (MSRP) and can get information about the cost of options they might be interested in. Armed with that information, they can go to different dealers of the same line-make and negotiate price. Dealers compete with each other on price and service to sell vehicles. This drives down prices. There is a saying that a Ford dealer's stiffest competition is another Ford dealer, and it's true. In a factory-direct model, the manufacturer sets the price without the

consumer having the ability to negotiate. Some may argue that dealers are "middlemen" and add costs to the system. This is a myth because all manufacturers have retailing costs regardless of how they distribute their products.

2. ***The proper alignment of economic interests for warranty work and safety recalls*** – Manufacturers are liable to perform covered warranty and safety recall work on their new vehicles. Warranty work and safety recall work for a manufacturer is an expense. The manufacturer has a disincentive to do it. Franchised dealers have a financial incentive to fix vehicles under warranty or a safety recall since they are reimbursed by the manufacturer. Whether repairs are covered under warranty is not always black or white and can be a grey area. The franchised dealer is the consumer's advocate when it comes to warranty work. Dealers hold the manufacturer accountable for their obligation. Imagine a consumer calling up a manufacturer in a dispute about whether a particular repair is covered by the manufacturer's warranty? The dealer is the consumer's voice and their economic interests align because both want the manufacturer to pay claims that should rightly be covered under a warranty. Compare this to a vertically integrated factory store manufacturer engaged in direct-consumer-sales who also owns their service center where there would be no independent advocate for the consumer.

   Dealers also provide early warnings for safety recalls as they often notice a pattern in defects with vehicles in performing service work. Because dealers are independent from the manufacturer they are more likely to bring these safety defects to the attention of the public.

3. ***The provision of greater long-term accountability for the consumer*** – In addition to providing warranty and recall work throughout the life of a vehicle, franchised dealers also service vehicles when vehicle manufacturers go out of business. There are plenty of manufacturers who have gone out of business over the years, Oldsmobile, Pontiac, Saturn and Saab to name a few. Many franchised dealerships sell multiple brands and generally remain in business and will have trained technicians to give the consumer a place to go for help. If a direct-to-consumer manufacturer goes out of business, the consumer has nowhere to go for parts, service or safety recall and warranty work.

I will leave you with two documents from the National Automobile Dealers Association. The first titled Consumer Benefits of Your Local Franchised Auto Dealer, provides additional details about the three items I just outlined. The second, titled Auto Retailing: Why the Franchise System Works Best, provides a history of state franchise laws and explains in more detail why the independent franchised dealer model is the best method for distributing new cars and trucks.

The Amendments to the Franchise Law in S.47

In terms of the two substantive amendments to the franchise law in S.47, one relates to competition with dealers and the other to direct-to-consumer manufacturer sales. VADA urges the committee to adopt both of these amendments.

Competition with dealers **– Secs. 1 & 4**

Over time, franchised motor vehicle manufacturers have used their economic advantage over their franchised motor vehicle dealers to insert themselves directly into the relationship with the retail purchaser of a vehicle. The definition of New Motor Vehicle Dealer in Sec. 1 is revised to clarify the activities that are reserved for licensed new motor vehicle dealers including the sale, lease, subscription programs and the sale of parts to the retail consumer.

Section 4 of the bill also clarifies that a franchised motor vehicle manufacturer shall not engage in the activities reserved to a licensed motor vehicle dealer and makes clear that this prohibition does not apply to non-franchised zero-emission motor vehicle manufacturers.

Both New Hampshire and Massachusetts address leases, "engaging in the business of selling," and subscription programs in their respective definition provisions. *N.H. Rev. Stat. Ann. § 357-C:1(VIII, XII, XXVII); M.G.L.A. Ch. 93B, § 1.*

***Direct-to-Consumer Manufacturer Sales* - Secs. 2 & 3**

A definition of "non-franchised zero emissions motor vehicle manufacturer" is added in 9 V.S.A. § 4085(18) to address the new category of motor vehicle manufacturers that do not utilize franchised dealers and that manufacture zero emission vehicles. The definition is then used to clarify the permissible operations of a non-franchised zero emissions motor vehicle manufacturer in the State in contrast with the permissible activities of a motor vehicle manufacturer who has contracted with franchised dealers to sell and service their products in the State.

VADA supports all five requirements in the definition. Requiring a non-franchised zero emissions motor vehicle manufacturer to register as a dealer in Vermont is important to ensure that all of Vermont's consumer protection laws will apply and Vermonters will have access to local courts in the case of a dispute. The definition makes it clear that a manufacturer who has ever sold or leased vehicles through a franchised dealer in the state cannot qualify as a non-franchised zero emissions motor vehicle manufacturer, thereby preventing a franchised manufacturer from competing against its dealers. Section 4085(18)(D) ensures that a non-franchised zero emissions motor vehicle manufacturer does not have a financial relationship with a franchised manufacturer. Several states, including New York, have created a definition of a zero emissions motor vehicle manufacturer for this purpose. *NY VTL Article 16, § 415(7).*

Sec. 3 of the bill allows a non-franchised zero emisssions motor vehicle manufacturer to directly own and operate a warranty or service center in Vermont.

DMV Process for additional franchise amendments – Sec. 5

VADA supports the process set up in Sec. 5 of the bill for those that want to propose additional amendments to the franchise law for consideration in 2022.

VADA urges you to support S.47 as it passed the Senate. Thank you for considering my testimony.

NADA

GET THE FACTS

CONSUMER BENEFITS OF YOUR LOCAL FRANCHISED AUTO DEALER

Local franchised auto dealers create fierce price competition and prevent manufacturer monopolies; protect consumer safety with recall, warranty and repair service; generate good-paying local jobs, tax revenues and economic benefits; and simplify the otherwise complex car purchasing and registration process.

1. PRICE COMPETITION

Dealers increase competition and drive consumer costs down.

Dealers compete fiercely with each other, to the consumer's benefit.

- Having multiple retailers of the same brand in the same market creates price competition and superior customer service as they compete for business.
- If an auto manufacturer operated all its retail stores in a region, they would have a monopoly on the brand and would be able to set non-negotiable pricing.

Today's new-car prices are transparent, allowing customers to benchmark pricing and negotiate.

- The manufacturer's suggested retail price (MSRP) is readily available, and consumers can easily obtain invoice and independent pricing information for a vehicle.
- Armed with this information, consumers can go to different dealers to negotiate price.
- In a factory-direct model, the factory fixes the price of its vehicles without any opportunity for consumers to either benchmark or negotiate prices.

"Middleman costs" are a myth.

- Retailing expenses exist regardless of the distribution model used.
- In a factory-direct model, the costs of showrooms, car lots, sales staff and holding inventory would simply shift from the dealer to the factory.

2. CONSUMER SAFETY

Dealers ensure safety recalls and warranty work are addressed.

Dealers are more economically aligned with consumers than manufacturers when it comes to safety recalls or warranty work.

- Dealers are incentivized to respond quickly to safety concerns, since they are paid by the automaker to perform warranty and recall work.
- In contrast, automakers have an economic disincentive to issue recalls or incur warranty expenses, which may imply a mistake, significant expense and/or a lawsuit.
- Automakers also have an economic disincentive to follow through even after a recall or warranty action is announced.

Franchised dealers create an extra layer of accountability for public safety.

- Many states require both the manufacturer and retailers to be responsible for warranty and safety claims, in case a manufacturer goes out of business.
- For example: Former Suzuki dealers still service Suzuki cars and trucks even though that manufacturer no longer sells in the United States.
- State franchise laws usually require that franchised dealers have service facilities to perform warranty and recall work.

Having a dealer advocate on their side makes safety, warranty and service solutions easier for consumers.

3. LOCAL ECONOMIC BENEFITS

Dealers generate good local jobs and significant tax revenues, delivering a huge impact on their local economies.

Dealers fuel local economic activity, creating jobs and economic opportunity for local residents.

- Dealers employ more than 1 million people across the country in locally owned and operated small businesses.
- Dealerships provide good-paying jobs with benefits, and opportunities for personal advancement and professional development.

Franchised new-car dealers pay billions in state and local taxes.

- New-car sales account for 15% of all retail sales in the United States.
- New-car sales generate 15% of all U.S. sales tax revenue.

Dealer revenues stay in local communities, whereas profits generated by factory-owned dealerships flow up a vertical ladder to out-of-state shareholders.

Local dealers hire local people.

- When the going gets tough, a multinational giant can close a local retail outlet and move on. Local dealers will be there for consumers in good times and bad.
- Dealership jobs cannot be outsourced overseas.

KEEP { COMPETITION SAFETY JOBS TAX REVENUE & SERVICE } WITH LOCAL FRANCHISED AUTO DEALERS

4. ADDED VALUE

Dealers simplify a complex process and personalize the car buying experience.

A new-car dealer serves a consumer for the entire ownership experience.

- Dealers provide test-drives of multiple vehicle models and competing brands, sales, financing, trade-ins, registration and tags — as well as repair, warranty and recall service work.

Consumers want a convenient purchasing process.

- Dealers offer a wide variety of financing options, which are frequently more affordable than bank loans.
- In addition to conducting online research, most consumers want to see and test-drive a car before they buy it.
- More than 60% of all new-car purchases include a trade-in to cover a portion of the down payment, and dealers provide a hassle-free market for trade-ins.
- Dealers take on the complex system of titling, registration and reams of regulatory paperwork, so consumers can simply sign and drive away.

Consumers value personal service and local relationships.

- While making a purchase that's second largest to a house, consumers want to interact in person, not with a website, a faceless 1-800 number, or a manufacturer or distributor located hundreds or thousands of miles away.

CURRENT AUTO DEALER FRANCHISE LAWS PRESENT THE BEST OPPORTUNITY TO ENSURE LOCAL OWNERSHIP AND OPERATION OF DEALERSHIPS, WHICH BENEFITS CONSUMERS AND LOCAL COMMUNITIES.

Visit nada.org/GetTheFacts

AUTO RETAILING:
WHY THE FRANCHISE SYSTEM WORKS BEST

Executive Summary

For manufacturers and consumers alike, the automotive franchise system is the best method for distributing and selling new cars and trucks. For consumers, new-car franchises create intra-brand competition that lowers prices; generate extra accountability for consumers in warranty and safety recall situations; and provide enormous local economic benefits, from well-paying jobs to billions in local taxes.

For manufacturers, the franchise system is simply the most efficient and effective way to distribute and sell automobiles nationwide. Franchised dealers invest millions of dollars of private capital in their retail outlets to provide top sales and service experiences, allowing auto manufacturers to concentrate their capital in their core areas: designing, building and marketing vehicles.

Throughout the history of the auto industry, manufacturers have experimented with selling directly to consumers. In fact, in the early years of the industry, manufacturers used three methods to sell vehicles, sometimes concurrently: (1) factory-owned stores, (2) independent distributors under contract and (3) independent franchised dealers. Manufacturers quickly learned that the franchise system worked best. Franchise agreements ensured adherence to brand standards and consistency. Manufacturers also realized that independent, entrepreneurial franchise owners—all of whom had made significant financial investments into their businesses and communities—were much more highly motivated and successful retailers than factory employees or contractors.

That's still true today, as evidenced by some key findings of this study:

- Today, the average dealership requires an investment of \$11.3 million, including physical facilities, land, inventory and working capital.
- Nationwide, dealers have invested nearly \$200 billion in dealership facilities.
- Annual operating costs totaled \$81.5 billion in 2013, an average of \$4.6 million per dealership. These costs include personnel, utilities, advertising and regulatory compliance.
- The vast majority—95.6 percent—of the 17,663 individual franchised retail automotive outlets are locally and privately owned. They generate billions in state and local taxes annually and provide significant employment opportunities that help build goodwill in the community.
- Manufacturers benefit from the high return on capital invested in manufacturing vehicles, as opposed to the low margin of retailing them.
- Dealers bear the cost and risks of these investments—at virtually no cost to the manufacturers—and provide a vast distribution channel that benefits the consumer.

> *"We need people in the individual communities to serve those customers. We couldn't do that from a central location. And so our dealers are the embodiment of Ford Motor Company in their local communities—both in how they sell and service our vehicles to the consumers … The system works well because there are entrepreneurs—dealer principals—investing in the facilities and the people locally, to serve customers. And it's served us well for over 110 years and will continue to serve us well in the future."*
>
> JOE HINRICHS, FORD MOTOR CO. VICE PRESIDENT AND PRESIDENT OF THE AMERICAS

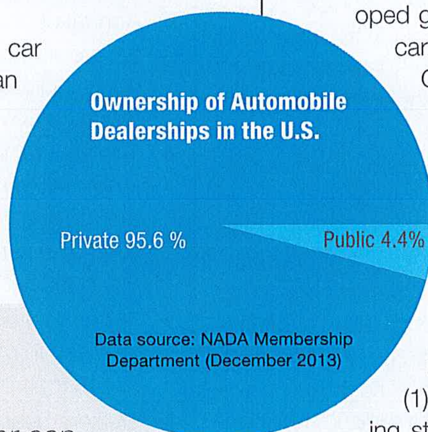
Overview

"The prejudices of some political writers against shopkeepers and tradesman are altogether without foundation. So far from it being necessary to tax them or to reduce their number, they can never be multiplied so as to hurt the public though they may be so as to hurt one another." (Adam Smith, The Wealth of Nations)

These words remain as true today as when Adam Smith wrote them 200 years ago: retailers compete fiercely for customers, and that competition is good for everyone, not just consumers. There are few industries with as aggressive or economical a retail model as the automotive franchise system. Far from being mere "middlemen," franchised dealers provide a wide range of services that are essential to the effective and efficient distribution of motor vehicles and, in support of those services, invest millions of dollars of private capital into retail outlets. Most of these retail outlets are privately owned, representing not large corporations but individual, family-run businesses that are locally based.

In the U.S., virtually every new car or light truck is purchased through an independently owned and operated franchised automobile dealership. The automotive original equipment manufacturer (OEM) makes no investment in these retail outlets. Dealerships are financed completely independently by owners and operators who combined have invested tens of billions of dollars into thousands of independent retail locations. In addition, dealers employ more than 1 million workers in some of the highest-paying retail jobs available.

Moreover, the lion's share of the 17,663 individual franchised retail automotive outlets are locally owned, atypical given the rapid consolidation in the retail sector. Indeed, private ownership accounts for 95.6 percent of the dealerships in the U.S.



Evolution of the dealer model

This fragmented ownership structure is not the result of market inefficiency or regulation, as some would claim. Far from being a burden on the public, the sales and service process that dealers provide is a natural evolution of the marketplace that has continued to serve customers for over 100 years.

While the earliest automobile dealerships existed before 1900, the modern system of franchised dealerships developed gradually. In the earliest days of the horseless carriage, there simply was no need for a dealer. Customer demand for vehicles was so high that there were often waiting lists for companies that had yet to produce a single vehicle. This was a customer-pull model, where demand exceeded supply and companies were virtually assured of selling out their production runs.

This system changed rapidly with Ford's introduction of the mass-produced Model T. By the 1920s, three separate systems existed: (1) a branch system with automotive OEMs owning stores (2) independent distributors under contract with an OEM and (3) independent franchised dealers. All three methods were used to sell directly to consumers, but the factory-owned outlet was quickly being eliminated, out-competed by independent dealers.

OEMs learned early on that ". . .even a man who makes a 'fair to middling dealer' lies down and quits completely when put in charge of a factory branch—where the urge of actual personal incentive is less strong." (Epstein, 1928). This was particularly important as the market for motor vehicles fundamentally changed. Most significantly, by the 1920s an OEM could no longer count on its cars selling out a production run. The intensity of competition had increased dramatically, particularly between Ford and General Motors. Motor cars had changed from being a toy of the wealthy to a mass-produced household utility. The change meant that consumers now required financing and service.

Just as the market for selling vehicles became more difficult for OEMs, the methods of manufacturing cars also became more capital-intensive. In 1910, a plant would employ 500 to 600 workers and manufacture a few thou-

> *"Our dealers know their markets better than we ever can. They compete against one another to provide Toyota customers with the best buying and service experience possible. Toyota, Lexus and Scion dealers are among our most valuable business partners. They are the experts at every aspect of selling and servicing our products. Our dealers have invested so much of their hard-earned money — and sweat equity — into their businesses. When they succeed, we succeed."*
>
> JIM LENTZ, CEO, TOYOTA NORTH AMERICA

> *[GM dealers] are an asset … Think about it. They understand the communities, they have relationships with customers … We are seeing a great partnership, we're seeing great service, working together.*
>
> MARY BARRA, CEO, GENERAL MOTORS

sand cars a year. But by 1930, Ford's Rouge River complex in Michigan employed tens of thousands of people and produced hundreds of thousands of cars a year. (Rubenstein, 2001) This new level of investment and production meant that by the 1920s consumers had significant choice in the automotive market and OEMs needed retail sales outlets that could push these vehicles out to consumers.

These market changes—combined with the simple realities of increasing competition—meant that selling directly to the public was increasingly a distraction and a hindrance to OEMs. Manufacturers were fixated on design and production, on increasing labor strife and on product cycles that had become ever more complex to manage. The additional burden of finding suitable retail locations, funding thousands of them, and then recruiting and incenting sales staff was simply too cumbersome. This was especially the case when independent dealers were ready, willing and able to handle all these functions in addition to funding inventory and constructing retail outlets, most often out of their own pockets. The use of independent dealers also afforded OEMs another advantage: speed. It was not only simpler but far faster to set up franchised dealers in exclusive sales territories.

Current status

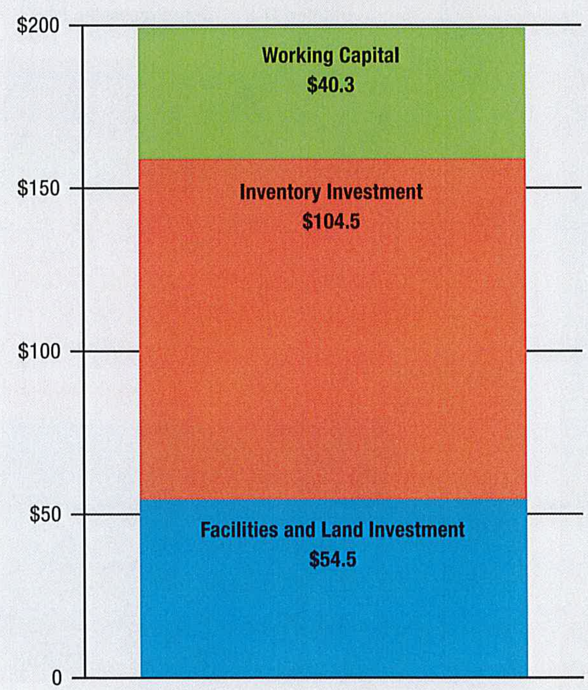
Competition was and remains intense among independent retailers and is best illustrated by both the lagging profits of automobile dealers and the steady decline in automobile retail outlets. Automotive industry profits rose steadily, from $38 million in 1914 to $1.3 billion in 1956. Meanwhile dealership profits declined, from about 33 percent in 1914 to 5 percent in 1956. (Rubenstein, 2001). By 2007, profits at dealerships had declined to 1.5 percent, before declining further to 1.0 percent during the recession and then rising slightly to only 2.2 percent in 2013. (NADA, 2014).

Dealer investments to facilitate these sales are considerable (see chart at right). Dealers invest an average of $11.3 million in each individual dealership. These investments can be broken down into three categories: (1) the actual physical facilities and the land on which dealers operate, (2) inventory and (3) working capital.

- Most dealerships require several acres of land in addition to a retail store, service bays and storage areas. These OEM requirements are fully funded by the individual dealers at an average per-franchise cost of just under $3.1 million.
- Dealers also carry all of the inventory costs of the vehicles on their lots. Dealers pay immediately for their inventory at the railhead. The costs to carry this inventory are not born by manufacturer and amount to an additional $5.9 million.
- OEMs have specific requirements for dealer working capital. Typically, an OEM will require that dealers carry net working capital investment equal to two months' parts inventory plus the value of two months' new- and used-vehicle inventory. In addition, more working capital is required to fund receivables due from the OEMs, customers and finance companies. The average dealership has just over $2.2 million in working capital.

These investments by dealers represent only the capital required. In addition to these costs, dealers also incur large operating expenses (see chart at bottom of page 4). Personnel costs for dealers in 2013 averaged over $1.9 million per dealership, over $33 billion collectively. In addition, training for these employees, whether sales staff, or back-office operations, was over $800 million nationally.

Total U.S. Dealership Investment (in billions)



Data source: NADA Industry Analysis Division (Tuff)

Dealers also advertise heavily. In addition to the spending by OEMs, dealers spent $7.6 billion on advertising in 2013—more than $21 million per day.

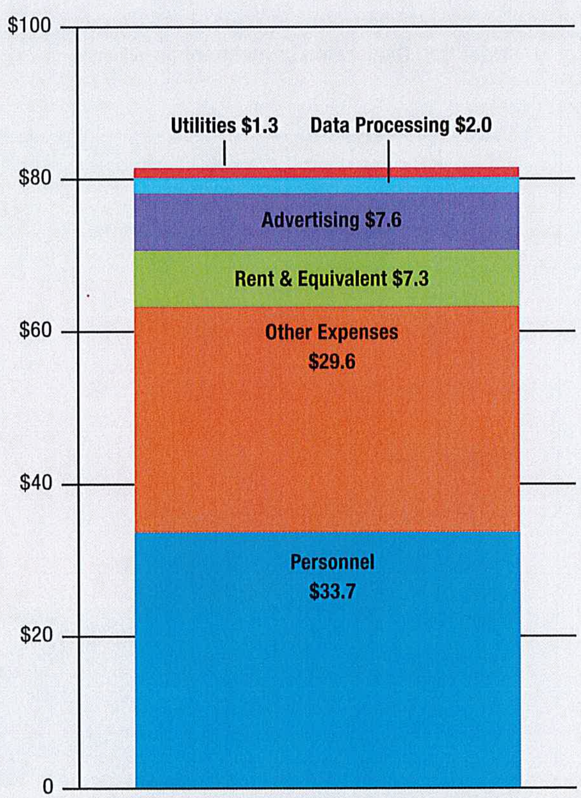
Finally, there is a regulatory cost burden faced by dealers. This includes complying with local and state ordinances, federal trade regulations and occupational health, safety and environmental requirements. These costs are estimated to be nearly $3.2 billion for all new-car dealerships.

The costs of owning and operating a dealership are separate from the costs of operating an automobile OEM. Indeed, the total investment by dealers in property, facilities and working capital exceeds the total investment by each of the OEMs themselves. This is not a matter of happenstance. As the vehicle-distribution channel developed over time, the OEMs learned the advantages of being inherently occupied with achieving high returns on invested capital by making cars over investing in low-margin retailing.

On occasion, a glamorous idea grips the mind of automotive executives and lofty ideas of dealer inefficiency and rent capture captivate their expectations. Yet dealer margins are slim, and the operations themselves require large-scale investment and careful planning. OEMs that have attempted to launch branch systems or pooled vehicle-distribution centers have failed miserably.

The most cited case—the Chevrolet Celta program in Brazil—was a dismal failure for GM. Selling directly to the public proved a burden on corporate offices, and it suffered from constant resource allocation issues, something with which no independent dealer ever struggles. There were also questions about the management of financing, delivery and inventory carrying costs. Indeed, the program proved so costly it was abandoned within only a few years. In contrast, dealers voluntarily take on these burdens from automotive OEMs. Dealers are in the business of selling, so resource allocation is never an issue. Inventory of new vehicles is merely a cost of doing business, and dealers represent the largest single point chain of financing anywhere.

Total U.S. Dealership Expenses (in billions)



Data source: NADA Industry Analysis Division (Tuff)

Conclusion

Efficiency and efficacy are constant questions for consumers and retailers: is the current system of independent dealers efficient and effective? Clearly, dealers take on a large financial burden to run stores, create pleasant retail environments and train staff. Is it more efficient for an automotive OEM, burdened by the capital-intensive needs of large-scale manufacturing operations, to recreate such a system? Historical evidence suggests the answer is clearly "no."

Few, if any, OEMs make good retailers; the businesses require vastly different skills, investments and incentive structures. Manufacturing lends itself well to the system of scientifically measured quality, quantity, and safety. Retailing lends itself to the inducement of consumer behavior melded with the irrational and unscientific emotional buying experience.

The success of some OEMs in operating retail outlets should not be confused with a renaissance of efficiency in the marketplace for cars. Anyone can sell an item where demand exceeds supply. The true test of a retailer comes when competition leads to supply exceeding demand. The U.S. has a free automotive market where competitive forces inherently come to bear in all segments with time. The question should not be about what inefficiency a committed dealer brings to her or his brand but rather what inefficiencies and overhead does an OEM bring to its retail operations.

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Data for this report was derived from dealer financial statements that are provided to NADA on a monthly basis from several OEMs as well as directly from dealers themselves. The numerical figures in this report are derived from direct line items contained in the financial statements as well as from composite calculations from several individual metrics.