BUREAU OF COMPETITION

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

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COMMISSION AUTHORIZED

May 2, 1989

The Honorable C.T. "Cub" Houck
Oregon State Senate
State Capitol
Salem, Oregon 97310-1347

Dear Mr. Houck:

The staff of the Federal Trade Commission is pleased to provide these comments on Senate Bill 34, "A Bill for An Act Relating to Equipment Dealers." 1/ The bill, if enacted, would prohibit suppliers of "heavy equipment" from discontinuing supply relationships with any Oregon dealer unless the supplier is withdrawing from the state or the dealer breaches a "reasonable and material" provision of its contract with the supplier. We believe that the proposed legislation is likely to harm Oregon consumers by increasing the costs of distributing heavy equipment.

I. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive practices in or affecting commerce. 15 U.S.C. § 45. Under this statutory mandate, the Commission seeks to identify and comment upon restrictions that impede competition or increase costs without offering countervailing benefits to consumers. The Commission and its staff, upon request, have provided comments to federal, state, and local legislatures and administrative agencies on matters that raise issues of competition or consumer protection policy. The Commission's staff has commented on several bills limiting suppliers' ability to terminate dealers. Earlier this year, for example, the Commission's staff commented on an Alabama bill to curtail the ability of construction equipment distributors to terminate dealers in that state. In 1988, the staff submitted comments to the Wisconsin legislature regarding a bill restricting the ability of suppliers to terminate dealers within that state. In 1986, Commission staff commented on a District of Columbia bill that restricted the ability of suppliers of alcoholic beverages to terminate wholesalers. In

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1/ These comments are the views of the staff of the Bureau of Competition of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or of any individual Commissioner.

1984, the Commission presented testimony concerning proposed federal legislation that would have restricted the ability of suppliers of office machines and equipment to terminate dealers.

II. Restrictions on Terminations of Supply Relationships

S.B. 34, if enacted, would restrict the ability of suppliers of heavy equipment to discontinue supply relationships with Oregon dealers. Under section 2 of the bill, heavy equipment suppliers would be prohibited from terminating or, upon expiration of a supply contract, failing to renew the supply relationship with any Oregon dealer without "good cause," as that term is defined in the legislation. The bill defines good cause as the supplier's withdrawal from the sale of products in Oregon, the dealer's bankruptcy or the assignment of its assets for the benefit of creditors, or the dealer's failure substantially to comply with any "reasonable and material" requirement imposed upon it in writing by the supplier. 2/ The bill would also require suppliers to give a dealer notice of the intention to discontinue the supply relationship, whether through termination or contract nonrenewal, at least 120 days prior to such discontinuation and state the reasons for the proposed discontinuation. 3/ Where the reasons for the proposed discontinuation "relate to a condition which may be rectified by action of the dealer," the dealer may take corrective action within 75 days of receipt of the notice. 4/ During the pendency of the notice, the dealer also has the right to transfer the dealership to new owners. 5/

S.B. 34 would override the private agreements of suppliers and dealers in two principal ways. First, the bill would require suppliers to continue supply relationships with dealers beyond the duration specified in private contracts. Second, the bill would override private contractual provisions governing good

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2/ S.B. 34, § 2(1).

3/ Id., § 3(2). A dealer may be terminated without notice if it is bankrupt or has had its assets assigned for the benefit of creditors, attempted to defraud the supplier, or has failed to operate during its normal business hours for seven business days for reasons other than acts of God, strikes, or other similar circumstances. Id., § 3(4).

4/ Id., § 3(2).

5/ Id., § 3(3). Although the bill does not explicitly state so, it appears that the transfer extinguishes the supplier's right to terminate the dealership.

cause for termination, including the duration for which a breach of contract must continue to support a termination and the circumstances under which a breach may be cured. We believe that both of these effects of the bill are likely to harm Oregon consumers.

By requiring suppliers to continue to supply dealers even after the expiration of a contract, the bill would freeze supply relationships without regard to changes in market or other economic conditions. As a general matter, private negotiations between suppliers and dealers can be expected to result in contracts that provide for efficient terms governing duration and termination rights. Dealers who value the stability offered by long-term supply relationships seek long-term contracts that protect their businesses from termination except upon specified terms. Suppliers who expect their distribution methods to remain unchanged for long periods similarly may choose to enter into such long-term contracts and offer dealers protection from termination. Of course, any dealer who is terminated in contravention of contractual terms can seek relief for breach of contract. Consequently, regulations that override private contract terms should be unnecessary to protect dealers from wrongful termination or to secure long-term supply where such arrangements would be efficient. Such regulations, however, may prevent parties for whom long-term supply relationships are inefficient from negotiating distribution contracts for shorter terms and retaining the flexibility to modify their distribution systems.

By requiring that a supplier affirmatively show some misconduct on the part of the dealer before it may refuse to renew an expired distribution agreement, S.B. 34 would prevent suppliers from modifying their distribution networks in response to business or technological changes. For example, a supplier may wish to withdraw from a particular geographic market within the state of Oregon because it cannot operate in that market profitably. In other cases, a firm may seek to reorganize its national distribution system to operate more efficiently and in the process realign its dealership network. 6/ Similarly, suppliers may need to alter their distribution methods to take advantage of new cost-saving technologies. In all of these cases, the realignment of distribution systems to operate more efficiently is likely to produce cost savings that will ultimately be passed on to consumers. By prohibiting such realignments from taking place, S.B.

6/ For example, in American Mart Corp. v. Joseph E. Seagram & Sons, Inc., 824 F.2d 733, 734 (9th Cir. 1987), the defendant "change[d] from a system under which it authorized several distributors to do business within a particular geographic area to a system of exclusive distributorships."

34 could be expected to increase the cost of doing business and, hence, the price paid by consumers for the products affected.

The proposed legislation also assumes that "good cause" for a termination or nonrenewal may readily be established in legal proceedings. Yet many performance deficiencies are not susceptible to proof in a legal proceeding or may not meet the narrow "good cause" standard set forth in the proposed legislation. For example, a supplier who believes that a dealer is making insufficient efforts to promote its products may be unable to satisfy the "good cause" requirement. The market solution for such proof problems is a privately negotiated agreement setting forth the duration of supply relationships. A supplier or dealer who is unhappy with the performance of its contract partner may simply decline to renew the contract upon its expiration. 7/ Under the proposed legislation, however, a supplier would not be able to protect itself from inefficient supply relationships by contractually limiting the duration of such relationships.

S.B. 34 would also displace privately negotiated procedures for discontinuing a supply relationship even when the stringent good cause requirement is satisfied, and is therefore likely to increase the costs associated with the termination or nonrenewal of a dealer "for cause." Under the bill, a supplier who is dissatisfied with a dealer's performance and wishes to terminate or refuse to renew the supply relationship must invest resources in compiling a record of that performance for use in legal proceedings and secure legal representation in any challenge to the discontinuation. Moreover, it must retain a poorly-performing dealer for at least four months after discovering the dealer's shortcomings. The supplier thus must incur the costs associated with delay in implementing an efficiency enhancing change in its distribution system while the legislatively-mandated process runs its course. These additional costs may deter suppliers in some cases from terminating dealers who do not perform in accordance with their contract obligations. As a result of these restrictions, suppliers must incur greater cost in maintaining their distribution networks and pass these costs on to Oregon consumers.

III. Conclusion

By denying firms the flexibility to tailor their supply contracts to market imperatives, S.B. 34 would tend to create excessively rigid distribution systems that are unresponsive to changes in market conditions. Such systems are likely to be

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7/ Klein & Murphy, Vertical Restraints as Contract Enforcement Mechanisms, 31 J. Law & Econ. 265 (1988).

costlier for suppliers to operate and therefore to lead to increased prices to Oregon consumers.

We appreciate the opportunity to comment on this bill. We would be happy to provide additional information if we can be of further assistance.

Sincerely,

Jeffrey I. Zuckerman
Director