January 19, 2016 Workshop Transcript

Auto Distribution:
Current Issues and Future Trends

Hosted by the Federal Trade Commission

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FTC Conference Center
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Washington, DC 20024

[START OF WORKSHOP]

WELCOME REMARKS AND ANNOUNCEMENTS

- **Patrick Roach, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**

PATRICK ROACH: Hello, everyone. My name's Patrick Roach. I am with the Office of Policy Planning at the FTC, and I welcome everyone here today. Before we get going, I have housekeeping matters to take care of, so let me inflict this on you, and then we'll begin.

First of all, I'd like to make sure everybody silences their phones or other devices while we're here. If you need to talk on the phone, out in the hallway would be great.

We have Wi-Fi available for those who want it in the auditorium. There is a pamphlet with the instructions about how to use it available at the desk.

If there's an emergency, listen for instructions over the building PA system. If there's an alarm, and you need to leave the building, the exit to use is out this door through the 7th Street entrance. Make a left for a half a block, and gather across the street on E Street. Everyone will be shivering today if that happened.

The workshop today will be webcast and recorded. I wanted to let everybody who is here know that by attending we are agreeing that your image and anything you say or submit may be posted on one of the commission's websites or social media.

There are restrooms. The restrooms are out the entrances, back around the doorway, and in the hallway behind the stage.

If we keep to the schedule on the agenda, there will be morning and afternoon breaks at 11:00 and at 3:45. Lunch is on your own from 12:30 to 1:45. There's a cafeteria on the ground floor of the building that will be open for lunch. It is kind of back off in that direction.

If you leave the Constitution Center building during the workshop, you'll have to come back in through security screening, so plan ahead for that.

One important note: the Constitution Center does not allow food or drink in the auditorium other than water, so while you're out, don't invest in a big venti latte thinking that you'll be able to sip it all afternoon. That's not going to work.

And finally, most of you received a lanyard with a plastic FTC event security badge. We'll be reusing those, so when you leave for the day, please return your badge to the staff. And that is my housekeeping list.

Our opening speaker today is the chairwoman of the Federal Trade Commission, Ms. Edith Ramirez. And without further ado, I will ask her to make her remarks.

OPENING REMARKS

- **Edith Ramirez, Chairwoman, Federal Trade Commission**

EDITH RAMIREZ: Thank you, Pat, and good morning, everyone. Thank you so much for being here, and welcome to the FTC's auto distribution workshop. As I think most of you who are here today know, the FTC is no stranger to the world of auto distribution. In fact, 100 years ago, when the agency was brand new, our country was in the midst of a major transformation. The newly formed domestic auto industry was at that point rapidly replacing horse-drawn carriages with new horseless carriages, thanks largely to the popularity of the first mass market car—Ford's Model T.

A major report on the auto industry that the FTC produced for Congress in 1939 details that interesting history. More than 1,000 pages long—thankfully we make our reports a little bit shorter these days—the report lays out the story of the early years of the industry, from the expansive growth in the teens and the '20s through the setbacks of the Great Depression. It also highlights the origins of our current system of auto distribution, which has remained remarkably unchanged in the subsequent 80 years, despite dramatic changes that have swept across other retail sectors.

The FTC continues to examine the complex system of automobile sales, and we're still asking whether consumers benefit from that system, or if change is needed. Just as the United States was experiencing significant changes a century ago, the automobile marketplace may be on the precipice of dramatic change today. Manufacturing upstarts—like Tesla with its electric vehicles, and Elio with its three-wheeled vehicles—both seek to sell their vehicles directly to consumers, rather than through dealer networks, and these are forcing us to reexamine the way that cars are sold. Moreover, evolving trends related to the sharing economy and autonomous vehicles could change the demand for and the sale of cars. So with today's workshop our aim is to explore these issues in greater depth, and examine their impact on consumers.

Aside from a home, a car is frequently the single most expensive purchase consumers make. In 2014, American consumers bought more than 16 million new cars and light trucks at an average price of nearly $33,000 each. And, of course, having access to a vehicle is essential for many Americans to carry on with their daily lives. Yet very few consumers understand the role that state government plays in determining how vehicles are priced, valued, and sold. That's why, on our agenda today, we're focused on how state-based laws and regulations affect consumers, competition, and innovation.

Now throughout the workshop, we'll also be exploring the future of the auto marketplace. Changes gripping the marketplace may raise additional questions about the regulatory structures that we currently have in place, and whether they will best serve consumers. So to set the stage for discussion this morning, what I'd like to do is to briefly discuss the origins of the current system of auto distribution, and then touch on some of the recent work in this important sector, before concluding with some thoughts on today's program.

The early 20th century witnessed a dramatic increase in the use and purchase of automobiles. In 1913, there were approximately 1.25 million motor vehicles registered in the United States. Twenty years later, motor vehicle registrations passed the 25 million mark. Notably though, as car sales grew rapidly, the number of auto manufacturers declined dramatically. By 1937, the so-called big three firms—GM, Ford, and Chrysler—manufactured approximately 84% of the motor vehicles sold in the United States.

With these events as a backdrop, car sales changed as well. As detailed in the FTC's 1939 report, during the first two decades of the 20th century, the same men who owned and operated garages and service stations often sold cars and trucks, typically from the same locations. With rising car sales, those former garage owners began to focus more on selling those cars, often making significant investments in buildings to serve as display areas and sales rooms. Gradually, manufacturers came to deal with retail sellers not as agents, but as independent merchants who took title and resold the vehicles, operating at a franchise agreement with the manufacturer. The basic system of independent franchised auto dealers that operates today was already established industry practice by the early 1930s.

As this system evolved, though, those dealers who had made large investments became concerned that they would be at the mercy of their affiliated manufacturers—especially with few automobile manufactures to turn to as alternatives. Dealers turned to policymakers about what they believed were abusive and coercive practices by manufacturers, and the regulation of auto distribution ensued. Over time, all 50 states passed laws regulating the relationship between auto manufacturers and dealers.

Now while many of these developments were detailed in our 1939 report, our interest in the auto industry did not end there. Nor has it been confined to competition. We've also addressed consumer protection issues as well.

Today, the FTC is the primary federal enforcement agency for most auto dealers, and last year we partnered with 32 law enforcement agencies, and brought a number of enforcement actions, including one against a car dealer for failing to disclose substantial fees for add-ons, like extended warranties, payment programs, and road service. We also pursued a case against a major car manufacturer for telling consumers that their warranty would be voided unless they used original equipment parts and franchised dealers to perform maintenance and repair work—a practice that violates that Magnuson-Moss Warranty Act.

In addition to enforcement efforts like these, the FTC also advocates for consumers in a number of ways. We engage in competition advocacy and outreach to policymakers across all levels of government. We also conduct important research and educate consumers on their rights. For example, the FTC is currently seeking public comment on a proposed qualitative survey to learn about consumer experiences in buying and financing cars at dealerships. And in 2014 and 2015, the commission submitted comments supporting proposed legislation that would affect the ability of motor vehicle manufacturers to sell their products directly to consumers without using franchised dealers. It was the work on those comments that led to today's workshop.

Today our panelists—representing manufacturers, dealers, and consumers—will explore this complex system of regulation governing auto distribution. Our two morning panels will focus on how state laws currently regulate the relationship between manufacturers and their franchised dealers. One afternoon panel will address laws prohibiting direct manufacturer sales to consumers. And in our final panel, we'll hear from experts on how technological changes affecting the industry may impact state auto distribution rules.

With new changes on the horizon for the automobile marketplace, questions about the impact of regulation on competition and innovation will continue. While some regulation may be beneficial and necessary, regulation can have detrimental consequences for consumers if it harms competition or stifles innovation. We must continue to consider whether the state laws under discussion here today are necessary to protect dealers against abuses by manufacturers, or if they serve some other purpose.

There are also many other questions that need answers. How do the laws affect competitive decisions of manufacturers and dealers? Are other interests helped or harmed by particular aspects of state laws? Are the changes affecting the industry today—like the connected and autonomous and semi-autonomous cars on display at last week's Detroit Auto Show—going to have an impact on methods of distribution? These are complex questions with no easy answers, but today's workshop is designed to prompt meaningful dialogue on these and related issues.

So before I wrap up, I do want to take this opportunity to thank the FTC staff who worked really hard to organize this program, including Pat Roach and Ellen Connelly of our Office of Policy Planning, James Frost of the Bureau of Competition, and Nathan Wilson and Paolo Ramezzana from the Bureau of Economics. I also want to express my gratitude to the speakers and panelists who are joining us this morning and the rest of the day to share their expertise with us.

So now I'm really delighted to turn the floor over to Professor Francine Lafontaine, our former director of our Bureau of Economics, who joins us from the University of Michigan Ross School of Business. Welcome back, Francine. Thank you.

FRAMING REMARKS

- **Francine Lafontaine, Professor, Stephen M. Ross School of Business, University of Michigan**

FRANCINE LAFONTAINE: Thank you so much, Chairwoman Ramirez. It is actually really a delight to be back here for this workshop. I worked with staff while I was Bureau Director up until the end of December, basically, on the creation of this workshop, and I'm really looking forward to the discussion. I am very pleased that people are all here gathered to talk about auto distribution. Bringing this to fruition did in fact require quite a bit of activity from the staff, and, like Chairwoman Ramirez, I want to thank each and every one of them for all their work on that.

When I started working on franchising, which is now about 30 years ago, doing my dissertation, one of the first things that I read, in fact, was a book by someone called Peter Pashigian, who was a faculty member at the University of Chicago at the time. His book was his dissertation. It was published in 1961, and its title was *The Distribution of Automobiles: An Economic Analysis of the Franchise System*. In the preface, he thanked in particular someone called Paul Herzog—and I apologize if that's not quite the right way to pronounce his name—but he was at the time director of research at the National Automobile Dealers Association. And Peter Pashigian was expressing gratitude for his help in getting data from dealers, and also for rekindling his interest in auto franchise dealerships in the process of doing a dissertation, which is a slow and painful process. So I'm very pleased that there are representatives from the dealer association here today who can share with us some of the information that they have gathered over the years.

One of the things that the association does is to keep track of data on dealerships in a way that is particularly useful when one wants to describe some aspects of this industry. I will mention one of the frustrations with dealing with some of those data by giving some statistics that relate to how big franchising is right now in car retailing, and that is, according to NADA, there are 16,400 car dealerships today in the United States. The latest numbers from the Census would put that at 21,000 something, and so there are 5,000 dealerships that I'm missing in between the Census data and the NADA data. That always hurts somebody like me, to just not know where these went. I would really encourage the association and other people that work with data on these dealerships to talk with the Census, and try and figure out where the source of these differences are, and to really try and make these things a little bit more comparable. There are definitional issues—I understand that, and that's probably the source of that—but it's difficult to talk about the numbers when you have these disparities in different places.

Now I want to get back to the world as it was when Peter Pashigian was thinking about franchised dealerships, and that is there were basically only U.S. car manufacturers in the market—six of them at the time, but the big three definitely had become the major force. There was at that time about 33,000—almost 34,000—car dealerships, according to the NADA data, and therefore twice as many as what we have today, so there's been consolidation in that market. In particular, there's been a reduction in the number of very small dealerships that used to exist—the ones that would sell just a few cars, but also gasoline and other things. That number has gone down dramatically.

At the same time, the system of laws that we will be talking about was not as developed. The states had begun by 1960—when he was writing his dissertation—to enact these laws, but the laws were more specific. They were targeting specific issues, and they were not yet as widespread across the states. About 20-some states had enacted such laws at that time.

By 1979, when somebody called Smith did a study trying to assess the effect of franchise laws on the cost of cars to consumers, many more states had established their franchise laws. In particular, 45 states had rules against termination. And when I say termination, they typically include also non-renewal and non-continuation rules. So that transforms a contract that had been of a certain duration into something that is in perpetuity. Also, 26 states had rules against establishing another dealership nearby, so that these would create exclusive territories around the dealerships.

By 2009, when I was working with Fiona Scott Morton—who's also going to be one of our speakers, and is sitting here right now—on a paper together on the prevalence of these laws, we found that all 50 states had these termination and non-renewal rules, and 47 states had rules that led to exclusive territories. We showed, for example, that these had consequences, in terms of the dynamics of this sector, by showing a map that compared what GM's dealership system looked like relative to Toyota, where Toyota's system had been put in place after many of these laws were known to exist, and therefore could adjust to that little bit more. What we saw was that GM dealerships were selling about a half to a third as many cars, on average, as what the Toyota dealerships were, and they were very often much nearer to each other, and not necessarily where the population had grown, in particular. So the point of that is to say that these kinds of laws about termination and non-renewal, as well as exclusive territories, make dynamic adjustments in this franchise system difficult.

Chairwoman Ramirez pointed out that the reason that these laws were put in place, in part, was because of dealership concerns over their investments, and protecting them. There are realities about that that we understand come to play in deciding how we should regulate or think about these industries. At the same time, the question becomes whether that is the right way to think about protecting those investments, and whether there are alternatives that might be preferable for consumers. Our first panel will examine exactly those kinds of issues that I just talked about—the non-renewal, termination, and exclusive territories.

As Chairwoman Ramirez pointed out, we're going to also have a panel that looks at an area that's been very active of late, which is the area of warranty reimbursement for the work performed at car dealerships. That topic is something that's of particular interest to some of us, because the fact that that's the place where the laws have changed gives us, perhaps, an opportunity to see what the effects are, empirically. So if we can put the right kind of data together, it might be one of the places where we can examine the economic effects of these laws.

We're very pleased to have Professor Carlton, who's going to give the keynote at lunch. He's going to talk more generally about these kinds of rules as they occur in other industries, as well, but also about the state action doctrine more generally. This is important, as it broadens a little bit the scope of this particular workshop, but also pins down some aspects of why we have these regulations.

The third panel—the first one after lunch—is going to get to exactly what Professor Pashigian was looking to answer in his dissertation, which is why would manufacturers use a franchise system. Why would they choose to delegate to somebody else, but restrict the number of dealers that they have? That was his main question. That's actually a question I've spent quite some time dealing with in my own work on business format franchising, the other side of franchising. The answer that you get from discussion with industry, as well as from empirical work that I've been involved with, and others have as well, is that there's kind of a trade-off between incentives for the franchise dealer (in terms of investment effort, local tailoring of products, and other things) and control. That's the thing that the franchiser lets go of, to some extent, when they delegate to somebody else. The control comes with this capacity to decide how changes should be put in place, and so it comes with the dynamic aspect that I was just talking about.

You couldn't ask the question of why franchising in the car industry anymore in the US, since the laws do prevent manufacturers from selling directly completely. But we do allow firms like AutoNation, and Warren Buffett has been able to buy a number of dealerships. The reason why we don't allow that for car manufacturers is an important question, one that Tesla, and Elio, and those other firms and other products that are on the horizon, all raise.

So the questions that these new industries, and new technologies, and the changes in the market bring to bear is what are going to be the likely effect of these technologies on the franchise system, and on the sale of cars, and on these laws? But at the same time, how are the laws going to affect the entry and the development of these innovations? That will be the focus of our last panel.

As we discuss all of these questions, the goal is to get – as Chairwoman Ramirez mentioned—people from industry, as well as people who study the industry, to discuss these issues, so that we can start to shed some light on these effects that we are particularly interested in understanding for consumers, in particular, in terms of prices, accessibility, quality, dealer and manufacturer behavior—all of these kinds of issues.

I'm looking forward very much to learning a lot from industry. I found during my days at the FTC that that was one of the blessings of being in that location. That is, firms and representatives would come and talk to us and explain to us various things. We're looking forward to these kinds of discussions here today as well, and to learning more about this system, but also thinking about it critically and seeing where to go forward.

Thank you. With that let me bring together the first panel, who will be moderated by both James Frost and—our two main organizers of the workshop. Thank you very much.

PANEL 1: STATE REGULATION OF DEALER NETWORKS

Panelists:

- **Jim Anderson, President and CEO, Urban Science**
- **Carl Chiappa, Partner, Hogan Lovells US LLP**
- **Aaron Jacoby, Chair of Automotive Industry Practice Group, Arent Fox**
- **Joseph Roesner, President, Fontana Group**
- **Henry Schneider, Assistant Professor of Economics, Cornell University**

Moderators:

- **James Frost, Attorney, Bureau of Competition, Federal Trade Commission**
- **Patrick Roach, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**

JAMES FROST: Good morning, everyone. Indeed, my name is James Frost. I'm an attorney here at the FTC. Sharing the moderator duties with me will be Pat Roach this morning. I do need to give the standard disclaimer that anything that I say today, or anything that Pat says today, will be our own opinion, and is not the opinion of the Commission or any individual Commissioner.

For those of you that are new to this topic, when we talk about dealer network issues, we're really talking about the ability of automobile manufacturers to do one of three things—terminate an existing dealer, add a new dealer somewhere where there isn't one, or change the current shape of the dealer—excuse me—change the area of responsibility or physical location of a particular dealership.

As you might imagine, when issues like this come up, the interests of both dealers and manufacturers can be significant. But if you're not an expert in these issues, what you may not realize is the degree to which the state is also involved in these areas. Today, states directly regulate in this space extensively. And the purpose of our panel today is really to talk about what is the ultimate impact on consumers for these issues, and how do these laws work today within the eyes of the market participants.

Every moderator, when they stand up and talk about a panel, says that they've got a great group of panelists. That's certainly true here. Let me just briefly introduce them to you. Carl Chiappa is a partner at Hogan Lovells. He's been representing automobile manufactures for over 35 years. He has extensive experience litigating issues related to the shape of the dealer network on behalf of his OEM clients. In those contested proceedings, Carl often squares off against Aaron Jacoby, who is a partner at Arent Fox, who has considerable experience litigating dealer network issues on behalf of his dealership clients.

Resolving these cases often requires expert testimony. And today we have two distinguished experts with a great deal of experience in testifying on these topics. Jim Anderson is the founder, president, and CEO of Urban Science. Among his many accomplishments, Jim has testified in over 125 cases related to the shape of the dealer network. Next to him is Joe Roesner, the president of Fontana Group, and likewise has a very long and impressive history of providing expert testimony in contested dealer network proceedings. Finally, Professor Henry Schneider is an economist at Cornell University who has studied and written extensively about the economics of the automobile industry.

The format we're going to follow here is slightly unusual. One of the benefits when you work for the federal government is you can convince people to do things that they ordinarily would never do. I have used that power to benefit all of you today. I've gotten Carl and Aaron to work together in providing you all with a brief background on the current shape of the legal landscape. Getting Carl and Aaron to work together for five minutes may not rank with bringing peace to Northern Ireland, but I thought it would be a useful exercise to try to get some agreement on the things which are not really in dispute before we get into the areas where people want to join issue.

So after that joint backgrounder, I'm going to give each panelist time to briefly present their own views on these issues. And before we get to the question and answer period, if you would like your question to be included in the question and answer period there are question cards available. Please just go ahead and write down your question. We'll be collecting those right after Henry gives his speech. And so we're happy to have your questions as well.

With that, I think I will turn it over to Carl and Aaron to begin.

CARL CHIAPPA: Thank you, James.

AARON JACOBY: Thank you.

CARL CHIAPPA: Well as James says, Aaron and I have agreed to do a joint presentation. Let me see if I can—here we are. One thing you don't know is that there's a large red clock here looking at me, which did not start to tick down during James's opening remarks. That's another advantage of being with the government I suppose.

AARON JACOBY: You're using up time.

CARL CHIAPPA: So Aaron and I have exactly eight minutes to describe to you an overview of the franchise laws that we're going to be discussing today. As you'll see in the PowerPoint in front of you, that is a 60-year history. So we have slightly more than a minute a decade.

These are very complex, very comprehensive regulations. Most of you I suspect are familiar with them. For those of you who are not, we'll give you just a brief look at them, and what's some of the jargon that we use that might otherwise be somewhat baffling.

We're talking about state regulations here—all 50 states, as Doctor Lafontaine just pointed out. There are two and only two federal statutes, which I'll talk about in a moment. But all 50 states now have statutes that specifically regulate the relationship between motor vehicle dealers and motor vehicle manufacturers. We're not talking about statutes that, for example, are relevant to McDonald's.

The first of the federal statutes was the Automobile Dealer Day in Court Act, which was passed in 1956. It simply says that manufacturers must act in good faith toward their dealers. That ended up having a very specific meaning through court interpretation. The statute is still pled, though I think it would be fair to say that today its great benefit is that it grounds federal question jurisdiction when you're not before a state board.

Since the 1970s—and Dr. Lafontaine just mentioned a number of these to you—there was a large group of state statutes passed, beginning with relatively simple provisions. Dealers could not be forced to take cars they had not ordered. There was limitations on non-renewals and terminations.

The rationale for the statutes—and Aaron and I have promised a nonpartisan look at this; the greatest exhibition of detente since Reagan and Gorbachev—was really unequal bargaining power; level the playing field between large manufacturers and their dealers. Many of the statutes also begin with a recitation that this is in an effort to promote the public welfare, because of the significance of automobile distribution for the states.

An important thing to recognize about these statutes is that they override any private contracts. Now that does not mean that the contracts are irrelevant, because they are frequently incorporated into the statutes. But it does mean that these very comprehensive regulations override the state provisions.

One other more recent, early part of the century—2001, I think—federal legislation was the amendment effectively of the Federal Arbitration Act to render arbitration agreements and dealer agreements null unless the parties agreed after the beginning of their dispute to arbitrate.

OK. Since time is going faster than I possibly could have thought it would, let me tell you a little bit about termination provisions. They were a core aspect and an early aspect of the protection afforded to motor vehicle dealers by these statutes. Essentially, they require that a manufacturer wishing to non-renew or to terminate a dealer has to prove good cause.

There are two basic versions of that. One is a multi-factor balancing test. And one is, has there been a material breach of the contract?

Dr. Lafontaine's already told you statutes override the terms of the contract, making them evergreen agreements. For the most part, a dealer does not have to show the normal preliminary injunction standards. There's an automatic stay if a termination has taken place, or a notice of termination has been issued. And in approximately 40 of the states, termination cases are heard by administrative bodies that may be specifically empowered to hear motor vehicle disputes, or may hear all kinds of administrative disputes.

AARON JACOBY: Let's move on quickly to add points and relocations, because as usual, Carl, you've run over your time.

In any event, going through quickly another area of oversight by the state governments is with regard to add points and relocations. What do we mean by an add point? An add point is an additional dealership that will be located in a market area that was otherwise allocated to one or more other dealers. These are not exclusive territories, but when a point is added to the market, because these markets are considered sensitive and important to balance—the time started over again. Look at that.

CARL CHIAPPA: You see that was—a special concession.

AARON JACOBY: There's oversight permitted to determine if that's an appropriate market action by the manufacturer who seeks to add that point. We refer to those as add points. And you'll hear us talking about an add point during the day. So keep that in mind. Add point equals government oversight for that market area.

A relocation is when an existing dealer that is not in a given market area is going to relocate a particular dealership from the market area where it is, to a new market area. And that also is considered a market action. And as with an add point, that market action can receive oversight if other dealers in that market area file what is called a protest.

As with the termination, a protest filed by a dealer in a given market area allows for government oversight. And in a government panel, typically an administrative law judge reporting to a board—similar to what the FTC or any government agency has in place—looks at whether it's the add point or the relocation, and considers a series of good-cause factors that I'll get to in a minute.

When can a dealer protest, and who can protest? Oh, I'm supposed to be manning this. OK. So The RMA statutes define who can protest. And different states do it differently. This is sort of the local control aspect that Dr. Lafontaine referred to.

And any state, as you can see in this slide, decides it slightly differently—California 10 miles, New Jersey 14 miles. Some states, it depends if they're rural, urban, et cetera. And burdens of proof seem to be slightly different in urban areas like Los Angeles compared to rural areas.

Other states do it by percentage of sales, as in Florida. And other states use either a county line or a 15-mile radius, like Texas. Again, these are not marking exclusive territories. They're marking the boundary by which it's decided whether or not there can be government oversight over a market action for either an add point or a relocation.

So the good-cause factors. This is how the hearings are conducted. And when there is government oversight triggered—and it's triggered by a protest by a relevant market area dealer—the decision over whether to allow an add point, or allow a relocation is based on these factors that you see here. It has to do with the dealer's investment, the effect on the market, the effect on the consuming public, the effect on public welfare, the adequacy of competition. And you're talking here about intra-brand competition, because you're moving, let's say, a GM dealer from one market area to a different market area, or a Toyota dealer, et cetera.

Convenience of consumer care for their vehicle with regard to recalls, warranty, service, et cetera. The states want to ensure the customers have adequate facilities to go to, and numerous facilities to go to. And what are the adequacy of those facilities?

And a lot of these factors, as you can see, focus on the public interest—not the interest of either the manufacturer or the dealer—although Carl would like to see that differently I think. And I think either side might like that to be different at one time or another. But the focus of the government is certainly on the consuming public.

Carl?

CARL CHIAPPA: As I said at the beginning, these are very comprehensive regulations. We talked about how, in the beginning, they were aimed particularly at terminations and at add points. But over the last now 40 years about, the regulations have expanded and deepened. So among the earlier additions to the protections of these state laws, were the post-termination obligations, which essentially means that the manufacturer has to buy back certain physical assets of the dealer if the dealer is going out of business. And that may in many cases be whether it's a voluntary termination, or a termination by the manufacturer's initiative.

The very last item—participation in advertising—is also, if we were archaeologists, this would be very low in the layers. There were in the very beginning issues about requiring dealers to belong to advertising associations. And that was planned early on as well.

More recently, there has been significant legislation on the issue of withdrawal of brands, where manufacturers have to pay dealers the value that the franchise had on the day before the withdrawal of the brand takes place. May also have obligations with respect to the rent or the value of the facility that the dealer had occupied.

And you're all aware that there have been many brand withdrawals over the years—Oldsmobile, Mercury, the late and unlamented Yugo. And similarly, proposals to sell franchises, called in our jargon buy-sells. There are restrictions on when a manufacturer can say no, that purchaser is unacceptable to us.

Allocations of vehicles. This is something that normally takes place only in the happy circumstance where the demand is exceeding the supply of the vehicle. But if you're in that situation, there are rules about how that has to be done.

More recently, there has been significant legislation on the issue of incentives, whether manufacturers can require dealers to be exclusive. Warranty reimbursement, labor and parts are legislated in terms of what the manufacturer has to pay the dealer.

Modifications of dealer agreements. There are filings required. There is the great music. And Aaron actually took longer with his three slides than I did with mine. So we'll end with that, and I think move soon to a more partisan discussion.

JAMES FROST: Right. So that concludes the sort of bipartisan part of this. We're now going to move, and go right back to Carl. But now Carl's going to give his own personal views as to what he thinks of all these laws.

CARL CHIAPPA: Yes. And let me stress as James did at the beginning that no client past, present, or—if there are any—future are responsible for anything I have to say here today. These are really my views of how the laws affect things on a practical, daily basis based upon what is now—as hard as it is to believe—37 years of representing automobile manufacturers and distributors.

I guess I'll start by saying that an obvious thing. Dealers are the face of manufacturers to the consuming public. And for many people, there isn't really much of a distinction. They understand the dealers to be the manufacturers. So it's a relationship of high interdependency. And I think that—I'll come back to this later—is something that is perhaps sometimes forgotten.

One of the things that I find challenging about the dealer statutes, especially as they have evolved over the years that I've been doing this, is that they impose a one-size-fits-all standard. And this is true of all regulations, of course. But it's particularly difficult here, because you have manufacturers whose sales are increasing rapidly, manufacturers whose sales are flat, manufacturers whose sales have decreased. You have manufacturers who sell luxury goods, manufacturers who sell volume goods. And all of these statutes apply equally in all of those situations. And so what looks like equal treatment on a piece of paper does not work out to be equal in practice.

The effects of these statutes are very disparate. But they're not only disparate from the brand's perspective. They're also disparate, frankly, from the perspective of the dealers.

The dealer bodies have changed enormously over the years. We now have public companies. We have Warren Buffett, as we've described. We have private equity companies. And so the makeup of the companies whose protections are being afforded by these statutes have changed dramatically.

Additionally, we have a situation where we have an enormously dynamic marketplace. It doesn't take a great deal to see that the internet has transformed the retail business. The question of whether these statutes—which I consider to be a somewhat blunt instrument for this kind of regulation—can keep up with what will be the millennial expectation of finding, going somewhere, and bargaining over it unusual, I think is going to be a big challenge for everyone on both sides of the equation.

Whether we like to say it or not, there are performance issues that manufacturers have to look at. There are weaker-performing dealers. And one of the questions I've always had about the statutes is whether the protection of weaker-performing dealers are in the interest of anyone. Are they in the interest of the consuming public? Are they in the interest of the manufacturer?

But curiously—and I'd like to come back to this—one of the questions I have is, are they in the interest of other dealers? And I think the answer to that may very well be no, that the statues ironically have a negative effect on dealers. And one of the ways it has that negative effect is that there are many dealers who are eager to invest in their franchises.

And one of the things that's happened over the years is that where the early statutes restricted a manufacturer's ability to take negative steps against dealers, more recently what they have done is to restrict the manufacturers' ability to incentivize certain dealer behavior, like superior consumer satisfaction, or upgrading of facilities. I'm not sure that's in the interest of the vast majority of dealers.

Now a classic example of this, it seems to me, are add points and relocations, which are not OEM or manufacturer against dealer disputes. The people who are getting the add points; in the vast majority of cases, the people who want to relocate are the dealers themselves. And the restrictions that Aaron and I described in our quick overview, it seems to me, do not necessarily work in favor of the dealers who are the ones who are going to be the beneficiaries.

Florida is an example of a statute in which the manufacturer must prove that the existing representation is inadequate before it can allow a dealer to relocate. Not, in other words, whether it would be better for the consuming public, or better for the dealers, but whether the situation is OK. If it's OK, then the statute sort of says, well, the dealer shouldn't be allowed to relocate. Unfortunately, that works to the disadvantage of dealers who in some cases have to relocate for one reason or another.

One of the things that's happened over the years is that add points are such lengthy processes, and are so expensive, that in fact now settlement agreements are reached early on. Well there's no spontaneous generation of a dollar, or as Milton Friedman said, there are no free lunches. That money has to come from somewhere, whether reduced investment, or it comes from the dealers, or the manufacturers. And I wonder whether that is also in the interest of the dealers.

As we've said, the add points do not look at competition and the public interest exclusively. They look at that as two factors among many multiple factors. So it seems to me we've got the one-size-fits-all problem. We have the question of innovation, and we have the question of whether it's advantageous to the dealers.

Now terminations. I'm going to say something that will probably cause some of you to question either my veracity, or my sanity, or both. But the truth of the matter is the manufacturer-dealer relationship is not inherently an antagonistic one. My partner Scott Golden likes to say that contracts are negotiated and written and signed, and for the most part they go into a desk drawer and are never looked at again. Well that's true for the vast majority of dealers, and it's true for the vast majority of dealers with respect to dealer statutes. They never have to deal with them.

Now we'll always hear anecdotes about abusive behavior by manufacturers. I can tell you that terminations are things that go through so many levels of review that frankly I find those anecdotes to somewhat strain credulity. But even if you assume that that is not the case, the question is whether these statutes are the best way to handle them. Is it really a good idea to say that a material breach of an agreement is not sufficient to ground termination?

One of the more extraordinary developments is a New Hampshire decision recently that forbade a dealer and a manufacturer to enter into a settlement agreement, because it constituted a waiver of the dealer statute. Well for those of us who think that the Outside Counsel Full Employment Act, is a good idea, those—that's a good idea. But it's a terrible policy issue. And I am now out of time.

Aaron now has [INAUDIBLE]

AARON JACOBY: I phoned it in. OK. I think the point that Carl is making leads to debate around the margins, and with regard to some of the nuances, and whether or not evolution of these laws needs to shift. And I would say that certainly in his view it seems that he believes these laws have now evolved too far in an over-regulated direction.

But laws are always subject to change. They modify over time. And I'd like to look at asking, why regulate in the first place? First of all, this is an important economic sector—the auto industry, that is. And like other important sectors, like health care, telecom, oil shipping, transportation and the auto industry are regulated. They're not different than these other industries. They're considered important.

And while regulatory schemes do evolve over time, the core reason for the regulation remains. And that is to provide an oversight process—that's what these state governments wanted to do; provide an oversight process—to weigh actions that might negatively impact what is a key market sector.

And I think many of us in this room make our living working in this sector. It was already mentioned how many dealerships there are, how many vehicles are sold per year, the importance of personal mobility. This is a very key and important economic sector.

When it's not doing well, it can nearly take the country down, as happened during the Great Recession. When it is doing well, it bolsters the economy. And so it's a very sensitive ecosystem that we all need to treat with a lot of oversight. And that's what's provided by these laws.

Now what do the state governments intend by the enactment and implementation and enforcement of these laws? And to answer that, I thought I'd look to a statement of intent by a state government. Of course, since I'm Californian, I'm picking California, because it's the best state, right?

And what California says in its legislative intent—and I'm just going to read this as a quote—"The new motor vehicle franchise system, which operates within a strictly defined and highly regulated statutory scheme, assures the consuming public of a well-organized distribution system for the availability and sale of new motor vehicles throughout the state, provides a network of quality warranty recall and repair facilities to maintain those vehicles, and creates a cost-effective method for the state to police those systems through the licensing and regulation of private sector franchisors and franchisees."

So I think that's a good statement of why these laws exist, what they're intended to do. And whether or not any particular component of one of these laws carries out that purpose to perfect effect I suppose is always debatable. And Carl and I debate that all the time in court. But the reasoning for the existence in such an important segment of the economy I think we can perhaps all agree on.

When did this all begin? And I think Dr. Lafontaine mentioned, but in case not, I'll repeat that really in the 1950s the states began enacting these statutes. The initial focus of the various states was to curb abuses of the OEMs, and to level the playing field in an area where there was unequal bargaining power. And the reason for that is to provide a stable economic system to provide the various services.

So why not leave the contract negotiations of franchise, franchisee, franchisor to the parties involved? Well there is unequal bargaining power. And when you have one individual dealer against the sole provider of its product—the vehicle—and when the provider of the product is typically giant compared to the individual dealer, there is necessarily unequal bargaining power.

Dealers cannot collectively organize like a union. That's prohibited by the antitrust laws. And it doesn't matter if you're Berkshire Hathaway, or Penske, or AutoNation. It's one dealership agreement at a time. AutoNation does not negotiate its entire company's agreement with a single manufacturer. They have multiple manufacturers. They have multiple dealerships. And each dealership is an individual entity acting on its own.

Even if AutoNation were to be allowed, or if it was possible for them to negotiate one agreement for the whole company, they actually represent a pretty small slice of the overall economy of dealerships. And that would not present a focus for change.

So instead, the state legislative bodies acted. And they developed these statutes, including the relevant market area statutes that we talked about regarding add points and relocations.

Now I think it's important to note these are not veto rights, and they do not create exclusive markets. I'm not sure why that is so often misunderstood, but it is absolutely not that.

This is a government oversight process. And that process allows for analysis of a market action that is taken that may negatively impact this very sensitive ecosystem.

Now we've all decided that personal mobility and having cars is very important. I know we would be the envy of the world in that regard, because there are many places where people would say cars are just not that important. But I'm from Los Angeles, where it's illegal to walk. And so certainly I grew up knowing that cars are important. And I think in the United States as a whole that that remains true. And because of that, this market is very important. And so these actions are subject to oversight.

So what happens with that oversight? Essentially, there's an administrative review process so that if the market action by the manufacturer—whether it's to relocate one dealer to another location, or to add a dealer to an existing market—a dealer can protest that action.

And there is then a hearing process. All of this takes place relatively quickly in litigation terms. And the hearing process considers various good cause factors. And the good cause factors we've looked through. And I'm running out of time.

So essentially, it's a balancing test. The statutes don't predict or dictate outcomes. They simply provide a process. And the process is before a new motor vehicle board or a commission. These are qualified agencies that have significant long-term expertise in the automotive industry. And they are experts at deciding these cases. And that is who implements this oversight process. And now I am out of time.

JAMES FROST: Jim?

CARL CHIAPPA: Want to pass him the clicker?

JIM ANDERSON: In the US, virtually all new automobiles are sold through a network of franchised new vehicle dealers. The primary purposes of the dealer networks are to provide consumers a competitive environment in which to shop, and convenient access to the product for both sales and service. Manufacturers initially appoint a number of well-located dealerships to compete with nearby same-brand dealerships on an intra-brand basis, as well as other brand dealerships on an inter-brand basis. Once established, dealer relocations are frequently governed by state franchise laws, as well as terminations and new add points.

When the individual needs of manufacturers, dealers, or consumers are not met, the system fails. Manufacturers and dealers have to make a reasonable return on their investments, and consumers must be provided superior products, a competitive environment in which to shop, and convenient access to the product for both sales and service to have a sustainable system. The franchise system has served manufacturers, dealers, and consumers relatively well. Generally speaking, the combination of centralized product knowledge, and manufacturer skill of the manufacturer, coupled with the franchise dealer's local knowledge, personal relationships, and sales and service expertise, has served both parties well.

However, in any type of business relationship involving two independent parties, there will be disputes. And they require resolution. With respect to the manufacturer-dealer disputes regarding the dealer network or dealership operations, state franchise laws often play an important role in resolving them. The process however, takes a long time—too long in my mind—and is expensive for both parties. So long as new vehicles are sold and serviced through franchised dealerships, however, there needs to be an effective dispute resolution process.

In the United States, the number, location, and certain operations of automobile dealerships are impacted to varying degrees by similar but not identical state laws. Judicial decisions have generally focused on whether or not a brand's current dealer network is providing adequate competition and convenient consumer care for consumers of the line-make vehicles in question. With readily available data, it is very easy to accurately calculate the effectiveness of inter- and intra-brand competition, as well as customer convenience.

However, the sales data on which these calculations are based are historical, and therefore not a forward look in time. This would not be as big of an issue if the auto industry was not changing all the time. At over 100 years old, the car industry is often thought of as a stable, mature industry. Much to the contrary, the auto business has always been—and I believe will continue to be—a dynamic business in a continual state of flux caused by, one, growth decline and geographic shifts of the customer base; two, competitors entering, relocating, consolidating, or exiting the market; three, dealership ownership changes resulting in different operating strategies in the marketplace; and four, product innovations, including disruptive technology.

A fundamental concept in dealer network planning is to locate automobile dealerships as close as practical to the people who purchase new vehicles. Dealerships are frequently designed to last 40 years or more.

But the US population has always been growing and shifting. In 1900, about 40% of the US population lived in urban America, in contrast to about 80% today. Obviously, if dealerships were placed where the customers were located in 1900, they would not be well located to serve the current customer base that has steadily migrated from rural areas to the cities of America. Population has also shifted from urban to suburban, and most recently back to the core cities. Beginning in the 1950s, there has been a steady migration of the US population from the North to the South.

The dealership landscape has changed continuously as well. Automobile dealerships, companies, are not necessarily small today. The largest dealer group in the US was formed in '96 and owned 293 dealerships in 2014. Today, the top 25 dealer groups own about 9% of the dealerships in the US.

The size of the US automobile market continuously fluctuates. Since 1946, there's not been a period of continuous growth or decline exceeding four years, except for the recent recovery. All other things equal, the better time for a new or relocated dealer to enter a market would be in a growth period. Due to the length of time required to process the add point, it makes sense to hear the case during a recession. However, the question frequently asked in trial is, why would you want to add a dealer during a recession?

In 1900 there were literally hundreds of car manufacturers in the US not here today. I find it interesting to see Detroit Electric and American Electric on the list of brands leaving the US decades ago, as we now see strong resurgence of electrical vehicles.

While some manufacturers have left the US, new competitors continue to enter the market. Start-ups like Tesla most recently; others like Apple, Google; and Chinese and Indian companies are hinting they will enter the market in the not-too-distant future. All new competitors that enter the US market have the opportunity to locate wherever they want, because there are no existing same-line-make dealers to protest. Their location choices typically include the newer, fast-growing, upscale areas in large metropolitan markets where new vehicle buyers continue to move.

Existing dealer networks have not been quick to respond to these demographic and competitive changes, leaving excess capacity in markets with declining population areas, and insufficient capacity in high-growth areas both locally and regionally. An unintended consequence of the state franchise laws is that well performing dealers may have to wait until their performance is degraded by the new competitors entering a market before being able to move to the best locations to serve that market.

Finally, innovation has been a staple in car company diets for over 100 years. From electric headlights over 100 years ago, to safety features in the '50s, and autonomous vehicles just around the corner, innovation—or lack thereof—has created enormous opportunities for inventors, and near certain death for those who don't keep up.

The transaction most new vehicle consumers experience is quite complex. The primary way they deal with this complexity is to comparison shop two or more dealers of the same line make in search of their best value proposition. When I'm asked about alternative go-to-market strategies, I begin with determining how to best provide consumers a competitive environment in which to shop, and convenient access.

Technology is causing unprecedented changes in how we shop today. But it is important to remember that the new car purchase process is complex. As changes to the new vehicle buying process are contemplated, an overriding consideration should be providing a level playing field for all competitors, unlike the situation I previously described, when new brands came to the US. What is good for one competitor should be available to all. Otherwise beware of unintended consequences.

JAMES FROST: Thank you, Jim. Joe?

JOSEPH ROESNER: Yes. I'd like to thank the FTC and Chairwoman Ramirez for inviting me to speak today. I personally have been at the Fontana Group working auto industry for over 25 years. My work has in large part involved dealership network analysis—in which I specifically look at relevant market areas and registration and sales performance given national and local market and economic conditions. I can say without hesitation that the state franchise laws as they are implemented today create a process to review and gauge the reasonableness of the manufacturer-dealer provisions in the franchise contracts, and focus on consumer impact and the public good.

First off, as noted by Aaron, it's key to note that these laws do not prohibit the termination or the addition of dealerships. That's a false premise. They simply provide a framework to review actions so that manufacturers don't act opportunistically, or without good cause, when adding a dealership, or taking the drastic step of shuttering a dealership. These laws help ensure that the manufacturer takes the time and makes the effort to adequately analyze and assess the need to terminate or add representation in the market.

To Carl's point, I think the manufacturers do look long and hard at terminations and additional points. But I think in part that is due to the laws that exist, that an independent finder of fact, that analysis may not actually occur. These laws simply allow for the protest right to be heard before an independent finder of fact. They lay out the criteria for a decision to be made based upon the reasonableness of the action, and whether or not good cause exists for the action.

So why is this important? Dealer manufacturer relationship in the auto business is truly unique. Auto retail is extraordinarily capital-intensive. Buildings, inventory, signage, billions of dollars in real estate. And unlike other franchise businesses, auto dealers can only purchase from one manufacturer. They can't go elsewhere to purchase vehicles.

Why are these provisions needed? They require manufacturers to do the in-depth analyses when considering shuttering a dealership. Franchise laws require them to present data in front of a neutral party.

I would invite any of you to read the take-it-or-leave-it contracts between manufacturers and dealers. In termination cases, heard before a neutral finder of fact pursuant to the franchise laws, the criteria typically central to the decision is whether the franchisee has complied with the reasonable requirements of the contract. Without the neutral finder of fact to determine reasonableness, the sales and service agreement, if so desired, could be forced as written.

Let me give you an example. Manufacturer sales and service agreements will typically call for dealership to have sales of at least at or above what would be expected at an average market share, calculated against some benchmark as nation, region, or—currently most commonly—state. Because this is an average, at any given time approximately 50% of dealerships will be above such average, and approximately 50% below such average.

In a contractual provision that by definition results in half of the contracting parties, no matter how strong their absolute performance, always to be a material breach, reasonable? Any given moment, there are provisions that approximately half of the dealer body are not meeting—and that's not an exaggeration. Literally impossible for the entire dealer body to be performing adequately at any point in time given those provisions.

You may ask, why would a dealer sign a contract like this? And as pointed out by Aaron, that's a great question. And the reason is antitrust. Sensible dealers would simply band together and negotiate their contracts with manufacturers. I think we could all agree that this would solve many of the problems.

But this is specifically prohibited by antitrust laws. Even the largest automotive retailing companies don't have the bargaining power vis-a-vis the manufacturers. Manufacturers work intentionally to make sure no dealer group has that kind of bargaining power. Through framework agreements, manufacturers specifically limit dealer companies' market power.

Bottom line, this is an issue that's far more complex than at first blush. As long as this imbalance exists between dealers and manufacturers, because of antitrust you have to create some balancing provision to create a level playing field, manufacturers and retailers.

A provision requiring all dealerships to be at or above average is problematic for other reasons as well. Analysis is needed to take into account differences between the benchmark and local market being analyzed. These differences can include the appropriateness of the assigned area of responsibility, demographic characteristics, relative number and mix of dealerships, competitive dealerships, commute patterns of consumers, relative popularity of leases, manufacturer incentive programs, manufacturer share of advertising voice relative to other manufacturers, allocation of vehicles provided to the dealership relative to other dealerships. And the list goes on and on.

So in the absence of the ability of the dealers to get together and negotiate with their manufactures, what do the franchise laws do in this instance? They provide that an independent, unbiased finder of fact weighs the various factors that can influence a dealership's sales relative to the manufacturer requirements, and based on that makes a decision of whether or not there's good cause to terminate a dealership agreement.

Similarly, in additional point—or add point cases—the criteria typically central to decision by the independent finder of fact is whether or not action is good for the public welfare. And this analysis of the need for additional points or relocation, manufacturers and/or their analysts typically will measure the market performance against the highest of a national, regional, state, or local standard.

In one of the more egregious cases I've seen, the market of the dealership involved was performing above both nation and the regional averages. It was among the highest performing in the state for the brand. In light of this, the manufacturer argued that the appropriate benchmark should be the market itself, that the market was experiencing lost opportunity, because every census tract in that market did not have market share equal to the market as a whole.

Well that case has not yet been decided by the independent finder of fact allowed for the statute. It is illustrative of the need for independent review. In the relationship between manufacturers and dealers, the manufacturer sets the facility guidelines, the size of facility commensurate with the market, the use of facilities, the amount of training. Many manufacturers control this compliance by tying incentive payments to having correct facilities and investment in place.

Because of the uniqueness and the intensity of capital, and the cost of that investment, the facilities required in the auto industry can run into billions of dollars in the case of the public companies. Therefore, by providing stability and hindering arbitrary manufacturer behavior, the franchise laws lower the cost of capital in the auto retailing market.

Because of the highly competitive nature the market, those savings are passed along to the ultimate consumer, buyers of vehicles, in the form of additional investment or lower cost. Evidence of this is in the risk factors sections of the SEC filings of publicly traded companies. It is recognized that the existence of these statutes result in lowering of risk, which therefore adds additional stability to the market. Creating stability is indeed in the public good. I can't imagine anyone would not agree with that. Thank you.

JAMES FROST: Thank you, Joe. Henry?

HENRY SCHNEIDER: Can you pass the clicker down?

OK. Thanks for having me on this panel. I'm Henry Schneider. I'm an economics professor at Cornell University. I'm going to provide what I'm hoping is an outsider's perspective as an economist on these issues. And so I'm just going to start by saying that I think dealers have some legitimate concerns. But generally speaking, the state regulations are generally a bit restrictive from an economist's perspective on this industry. So that's going to be my general tone.

So as I mentioned, dealers do have some legitimate concerns in this industry, in the sense that they're making large investments in their businesses in terms of facilities and training and advertising and branding, and all these kinds of things. And one of the aspects of these investments is that these investments have value primarily in their relationship with a car manufacturer. So the car manufacturer wants to terminate a franchise, or add another franchise nearby, or something of that nature, that investment is not easily repurposed, and loses a lot of its value. So this is something that is obviously a concern for anybody making an investment of that nature. And dealers certainly would be in that category.

So having said that, it's not clear to me why, as taking a sort of an outsider's perspective, why long-term contracts can't more or less address this issue, as it does in many other types of industries. That's not to say that exclusive territories should be ruled out in any way. But that kind of thing can be included in contracts.

In addition to that, you have a reputational concerns, especially on the part of car makers. And if they were to act opportunistically in too aggressive of a manner, that's going to make it hard, obviously, for car makers to attract new dealers, new folks to come and invest in their network. It's going to make it hard to convince existing incumbent dealers to continue to invest in their network. And so there are reputational concerns that should discipline car makers from acting too aggressively. So that's, I think, how I would see things from my viewpoint.

The costs of these state regulations, I think, can be large in some cases. Sometimes they're relatively benign. But sometimes there are issues. And I'm going to talk through some of these costs.

So first, there's the most obvious point is there's been huge changes in this industry, as one or two panelists have already mentioned. The top two lines is the market shares of GM and Ford. And we can see that over the last couple of generations there's been a precipitous decline in their market share as imports have come in and taken a healthy fraction of this industry.

The regulations essentially add sand to the gears, and slow down the process, and make it more expensive. And as a consequence, dealer networks have been slow to adjust. And you can see this is a map of the Pittsburgh area. The white dots are GM dealerships as of the last few years. The black dots are Toyota dealerships. And you can see that even though GM and Toyota at this point have market shares in the US that are relatively similar, there are way more GM dealerships than Toyota dealerships.

And I think the way that I would think about this is you can look at how the imports have come into this country, and set up the dealer networks, is how a new franchisor, car franchisor, would come into the market and set it up in what they perceive as a semi-efficient way to distribute their product. And you can see that generally speaking there are far fewer points of sale. And different choices of locations as well.

So one of the costs of having more points of sale for at least some car manufacturers and dealers is it makes it hard, for example, to reach economies of scale. Some networks would benefit from some consolidation, as has slowly been happening in this industry. Larger dealers allow more variety or choice of cars on the lots. There are all kinds of savings that you can get from being larger in terms of back office costs, financing terms, and so on. It's a complicated issue how large you want your dealer to be in terms of market power versus scale. But generally having more flexibility, I think, would be beneficial.

Here's another example, maybe a more extreme example. If you look at the luxury segment, you can see the first bar in these two graphs is Cadillac. And you can see on the left – yes—your left, Cadillac has almost 1,000 points of sale compared to the other luxury makes, which have 200 to 300 points of sale.

And the consequence is that Cadillac sells on the order of 200 new cars per franchise on average, whereas the other may sell 600, 700, 800, even over 1,000 new cars per franchise. And there are certain economies of scale and cost savings that result from a larger scale. Presumably those costs are passed on to some degree to consumers.

One of the other consequences of these regulations is obviously they protect dealers, and they give dealers a bit of market power. And the consequence of having market power, as an economist you would say the prices are too high. If prices are high, then fewer car sales occur. This is not in the interest of consumers, not in the interest of car makers to some degree.

Now you might point to profits per new cars is on the order of $1,000 dollars, $1,200 on average. And you might say that's a fairly small number. But in fact, a new car sale tends to bring in a trade-in, and that used cars sold at new car dealers tend to be a profitable business. Each new car sale also brings in a lot of repair work, either under warranty or off warranty, which again is quite profitable. And generally speaking, dealerships are a very nice investment in terms of return on investment, or return on assets. And I think that's a testament or an indication of having some market or monopoly power in their local area.

This is not to say that exclusive territories or things of that nature are necessarily bad. It's just that the regulations sort of entrenched these practices, and don't give enough flexibility, in my view.

So there is evidence exclusive territories do give some benefits, especially to new types of new firms, and new types of franchisors to help them get off the ground. But often, these franchisors have a history that they tend to phase out these protections over time, as the firm just gets more established. And this has not happened in car making.

I think this is my last slide.

The other argument that's sometimes given, and I think we've heard it on this panel, is that car makers and dealers play a very important role in the economy—especially local communities. They represent $700 billion in annual sales. New car dealers are a large fraction of state sales tax revenue and retail employment. And so therefore they deserve some kind of special protection.

But again, from as an outsider's economist perspective, my feeling would be that if you want to subsidize or protect local communities or economies, there are much more efficient ways to do that than to effectively have a subsidy paid by car makers, or especially car shoppers, and filtered through car dealerships. It's not a particularly efficient or fair approach to protecting communities and economies. So that's what I think is an outsider economist perspective. Thank you.

JAMES FROST: Thank you, Henry. Reminder—if anyone has questions, we'll be collecting those. Just pass your cards to the aisle. I'll get started on the question and answer session here.

I guess given that the FTC is interested ultimately in the impact of all these laws on consumers, I actually think I'd like to go down the panel and get everyone's view as to what the impact of the current regulatory structure is on US consumers, as opposed to on manufacturers or dealers. Carl, if you just want to start with that.

CARL CHIAPPA: Sure. I think from my point of view, any type of comprehensive regulation of this sort interferes with freedom of contract, that causes what Joe would call stability but I would call the incessant preservation or attempted preservation of the status quo, is ultimately not going to be great for consumers. The truth of the matter is it goes back to my point about the words on a page, as opposed to what happens in practice. Because manufacturers are in very different stages of their evolutions, but they're all subject to these same statutes.

The fact of the matter is we simply cannot respond to the marketplace the way we would like to. I think population shifts become very, very difficult to respond. If you take a state like New Jersey, New Jersey's add point provision has a protected area of 14 miles. New Jersey is, I believe, the most densely populated state of the United States. 14 miles is a lot.

In Texas, where the add point statute covers an entire county—it covers something like Harris County—we see add point protests from dealers who are 25 and 35 miles away from the add point. Well, we already know that that's further than consumers will actually travel, typically, to have their cars serviced.

So I think that we have the problem that these statutes don't create stability so much as inflexibility. And the two things can look alike, but they are very, very different in practice.

I think, moreover, we're in the situation that Jim talked about, where the buying process for America has always been an issue. Because we are not a country that culturally engages in a lot of bargaining. When we bargain even for a house, we use intermediaries. One of the reasons I think people find the process of bargaining for a car so difficult is in part because it's so unfamiliar to us. Well if it's been unfamiliar up until now, it's going to be more unfamiliar in the future to millennials, who are used to buying everything online.

The other thing is the innovation of the products. What are we going to do, for example, with the ability to remotely service cars? I think again the statutes—it's a template that makes it very difficult for the manufacturers to address the issue of what do we do in the future, when in fact we can beam a solution to a problem for a car wirelessly. Which means it doesn't have to go to the dealer, the customer doesn't have to spend the time to do it. But the truth is, it does have a negative effect on the dealers. So I think overall that's the issue.

JAMES FROST: Thank you, Carl. Aaron.

CARL CHIAPA: See? But the clock didn't go down. It was the special law of productivity.

AARON JACOBY: We need someone with a cane to yank. Those were good and interesting points. With regard to the effect on consumers, and also responding to a couple of things that Carl just said, I think the evidence is that the right amount of competition for intra-brand competition within a market area is good, keeps prices down, dealers compete against each other, et cetera.

But the preservation that everybody is talking about—and by the way it is preservation. It's not exclusive. So that's just a wrong premise. But the preservation that Carl is mentioning is to ensure that the distribution channel remains sufficient to service recalls, for example. We need sufficient dealers to service that, but not so many that it causes dealers to struggle within a given market area, because that can put one or both dealers in that market area out of business.

Addressing the point about slow reaction time to market shift—I know that my kids tease me if I react slower than five seconds to just about anything. They're probably text messaging me right now and wondering why I haven't bought them something. But in any event, we're adults, and we can deal with oversight.

An example of oversight that slows things down but might be necessary, the FTC reviews virtually every major transaction in the United States through a Hart-Scott-Rodino filing. Do we want that to go away? Do we want to have unfettered access to closing deals that might be anti-competitive? Or do we want to allow some period of time for the FTC to review it?

Well we're adults. We can be patient. These are not excessive proceedings. And if Carl's involved, he will ramrod a hearing through in six months. I can assure you of that. So slowing a deal down is not a reason, or slowing a market action down is not a reason to eliminate something.

I think the last thing that you mentioned is about innovation, which I suppose is related to market shift. The innovations that are happening in the industry—internet sales, direct sales, just as examples—autonomous vehicles—those are things that are not truly covered by a lot of the existing regulations. And everybody in the marketplace—regulators, lawyers, et cetera are trying to figure out how those should be applied.

I don't think any of us want autonomous vehicles, direct sales, et cetera to be totally unregulated. And we don't want them to be so over-regulated that we can't budge in the marketplace. But the right amount of regulation is probably right. California's trying to figure that out with autonomous vehicles. Whether they got it right or not is a different matter, but a month or so ago they came out with regulations. The Federal Transportation Agency is saying it's going to come out with federal regulations on the topic.

Will we be over-regulating? I don't know. But some regulation is necessary to make sure that it's safe, et cetera.

The direct sales issue. There's an issue of service and recalls. If there are only a handful of dealerships throughout a country as large as the United States, what will we do if there is a recall? How will we cause that to happen? If we go above 30,000 or 40,000 vehicles a year for Tesla, for example, and let's say they're doing 300,000 vehicles a year, how would we handle a recall that occurs?

And I understand that they would say, and Carl might say, well, we'll download the recall. And they'll hit an app on their car, and it will be downloaded. Not all recalls are related to electronics. Some are related to the physical components of the vehicle, whether that's steering or brakes, et cetera. And so that would be my response to both the consumer issues and Carl's issues.

JAMES FROST: Jim.

JIM ANDERSON: I would say in general the impact of the laws on consumers is in a marketplace that is dramatically changing, which I've described in many ways today. If the manufacturer is not allowed to respond in a timely manner, that means that there'll be less competition, or less selection in the marketplace, meaning less convenience.

In general, I see these laws taking one to two years, sometimes three years, to hear a full case from beginning to final conclusion. And in markets with 10 or 20 dealers to the same line make that are rapidly growing or rapidly declining in population count or customer count, that means you'd never catch up.

In addition, beyond the changing, increasing or decreasing, size of the market—and this is in response somewhat to what Joe has said as well—I've not ever seen a dealer that's, let's say, in rank 49 out of 100 be up for termination. I've never seen that. I can't recall ever seeing a dealer up for termination that wasn't in the bottom 5%, or bottom 2%, or bottom 1% of the whole state. And most often than not it's the lowest one in the state.

Just like in college, if your honor point average drops below a C average, below a 2.0, you get some friendly notices from the dean saying you're on probation. You have a problem. You must improve, or we won't allow you to graduate. I think manufacturers do the right thing when they advise their dealers that they're either above average or below average, and the degree to which they're below average and the rank they hold in that state, so that they understand whether or not they are doing a good job from the consumer point of view, and whether or not they need to improve, and whether or not they need to worry about whether they have long-term viability. I think that's a good thing. But by no means are terminations of dealers a common thing in the marketplace.

JAMES FROST: Joe?

JOSEPH ROESNER: I agree with Jim. They're not a common thing in the marketplace. And it typically is the bottom dealers. But I think that the state statutes are working to that in that regard. And in other words, they do give an independent process to look at those. And I think it helps for reasonable actions to be more likely to be brought.

In regards to the effect of these laws on consumers, look at the auto industry today. We're at all-time highs as far as the amount of new vehicles being sold. It's not a bad system. It's working well. The gross profit that dealerships realized on new vehicle sales has shrunk tremendously. From 1998, I think it was about 6 1/2%, and it's down to less than 3 1/2% on the front end of the deal.

It's not like, as Mr. Schneider here, or Dr. Schneider, is not a monopolistic situation at all. In today's world, the consumer can get on the internet, and from numerous different sources research exactly the price that is being charged by the manufacturer to the dealer, and the incentives that are out there. It's a very competitive world right now.

Now in regards to the used vehicles—because Dr. Schneider made the point that there's still a lot of profit in used vehicles—well, why is that? I mean the consumer wants a place to get rid of his or her vehicle.

There are a lot of other options out there. I mean, you can sell it on Craigslist. There are numerous places. The consumer, if they wanted to, could sell their vehicle.

But the dealers today provide a means to trade in that vehicle. If the consumers are choosing that, there's obviously a value being represented there to them. The dealers are making money, but a lot of those vehicles are wholesaled or gotten rid of. It is an outlet to get rid of those used vehicles. And I would say that the dealers right now are doing their jobs, and providing a very good service to the public in the system as it is now.

It is a good time to be a dealer. The dealers are making in general good money right now. But remember back in 2009. And remember the tough times.

Dealers are required to make investment in their dealerships, and willing to make investments in their dealerships. In a Toyota dealership in my town, you can get coffee, and lunch, and a big espresso—however many different types of cream you want in it, and flavoring. Well do we need that? No. But it obviously represents a value.

Would that dealership be willing to invest without some type of independent finder of fact looking at it? You could put another dealership in at any time. Probably not. So the consumers are being well served by the laws as they exist now. Thank you.

JAMES FROST: Henry?

HENRY SCHNEIDER: OK. So let me touch on just a couple points. So my point about market power, or monopoly power. I don't mean to imply that dealers have some kind of strong monopoly in, say, a Microsoft sense, or something along those lines. My view is if you look at the return on assets or investments, dealers generally do very well. And whether you look at the margins of individual business units within a dealership, some are more profitable, some are less profitable. But the fact that the overall profits of a dealer tend to be pretty good basically can mean nothing other than that there is at least some market power. If there were intense competition at the dealer level—either intra-brand or inter-brand—you would see tighter margins and so on.

And I'm not arguing that a dealer should make no profits. Certainly comfortable profits in order for dealers to be able to make investments in their properties and so on would be in everybody's interest for sure.

On the issue of the effect on consumers, I think, as an economist, I would think about this as you have an industry. There are three parties in this industry. You have the car maker, the dealers, and consumers. And you have a certain amount of surplus, or you might think of that as profits, to go around between these three parties. And it's a question for regulators or society through voting and so on to figure out how do you want to divide up those profits between those three parties.

And these regulations, especially state regulations—I don't want to argue this too strongly—but to some degree protect the investments and the profits of the dealer networks. And so it tilts the balance a little bit toward dealers.

And it's a question of is that the priority? Do you want to protect those investments? Do you want to give dealers equal bargaining power with manufacturers? Is that something that regulators should be in the business of?

And so that's sort of I think a key question. How do you want to weight the interests of those three parties? And right now, there's a certain weight being placed on dealers. And that's my point. Thank you.

PATRICK ROACH: Can I be heard? There we go. Good. I've got a pile question cards here. Here's some of them I think touch on some things that have been talked about before. But here is something that perhaps takes the discussion in a new direction. And let me restate it a little bit and direct it to everyone.

It says, "The boards hearing these disputes are governed by dealers in many cases who protect other dealers." This is the view of the questioner. "Shouldn't the boards not be comprised of dealer participants? How is that objective?"

JAMES FROST: Let's go with Carl. But let's go for a minute each on this one.

CARL CHIAPPA: The fact of the matter is that dealers are a very big presence on many of the boards, if not at the actual level of a hearing, then at the level in which the hearing officer's recommendation goes up. And the fact of the matter is that I do think it's somewhat problematic, because it's the rare case in which two classes of litigants with at least somewhat divergent interests have one class of the litigants deciding the cases, or at least reviewing the cases. And obviously if we start with statutes which are protective of dealers, to have them then reviewed and enforced and interpreted either immediately or intermediately by one of the classes of litigants is obviously, from the point of view of the OEMs, is quite problematic.

JAMES FROST: Aaron, you share that view?

AARON JACOBY: I do not.

CARL CHIAPPA: I'm shocked.

JAMES FROST: Well, tell us why.

AARON JACOBY: It is certainly true that dealers are on boards. In some states, the dealers are not allowed to participate in boards that are considered dealer actions. California would be one of those. But they are on boards.

I think it's relatively common for boards of sub-agencies to include industry players. So I don't think that's uncommon. The governor of a particular state often appoints these members of the board. So they've somehow proven themselves, hopefully not solely by other means.

But let's not ignore the role that the process plays. The board does not directly hear these disputes. There's a judicial process with an administrative law judge that hears the matter, and issues findings of fact and conclusions of law after well-reasoned arguments, evidence, witnesses by both sides.

JAMES FROST: Aaron, is that true in all cases? Or is there a lot of diversity across states?

AARON JACOBY: There's some diversity across states. There are some states that have a court proceeding. Most states would have an administrative proceeding. So the administrative law judge comes up with findings of fact, conclusions of law, presents those to the board. And the board then accepts or rejects that decision.

There's also an appellate process that follows that. You can do a writ of administrative mandate to a court in your state. And then it goes through the whole court system as well. So there's a lot of oversight over the overseeing committee.

Another piece is, let's look at the—I don't have statistics with me. But I think on this stage we could agree that as a practical matter, manufacturers win most of these contested proceedings most of the time. And typically a point is allowed. Typically a relocation is allowed.

And terminations are probably the most difficult for manufacturers. But when they are looking at the weakest dealers, even those are allowed—when it's the type of dealer that Jim was referring to earlier—the weakest one or two in a given zone. So I do not agree that having dealers or industry players be part of a commission or board is any sort of negative.

JAMES FROST: Jim, your view?

JIM ANDERSON: I guess I look at it the other way. I think to avoid all possibility of conflict of interest, we as professionals also frequently have to decline the opportunity to participate in some sorts of events. And I think these hearings are important. There are a lot of important things on the table—the dealership, the success of the manufacturer, but most importantly the consumers being taken care of, or not being taken care of in the marketplace. And so to avoid all conflicts of interest, I would say anyone directly involved in the problem should not be part of the decision-making process.

JAMES FROST: OK. Joe?

JOSEPH ROESNER: I can tell you that I think it's rare that the boards consist of dealers. It's normally between some finder of fact, administrator law judge, or sometimes in the court system.

But in the cases that I have been involved in, the few that were before primarily dealer boards, I think the dealers took it very seriously. And there was legal counsel for the state in the room. And the two that I can think of, they allowed an additional point, and allowed a relocation.

So I don't think that they are in any way, shape, or form—or the majority, and that's what makes the decision—they take it very seriously, and look at all aspects of the law, and judge it just like any other finder of fact would. I can see how Jim and Carl might think that there be some bias there. But that hadn't been my experience. And it is rare that these are heard before boards consisting of dealers.

JAMES FROST: Henry, anything to add?

HENRY SCHNEIDER: I just have a very quick comment. My background doesn't let me just speak to this very much. But anything that would allow too much influence by dealer networks wouldn't necessarily be good. But I don't know enough to say whether this is too much influence.

JAMES FROST: All right. We are almost out of time. I'm going to ask one more question out of, I don't know, the 30 that I have to do.

More and more dealerships are being acquired by these large companies. People are saying that therefore Berkshire Hathaway can take care of itself. So is the trend of public ownership, of dealership networks, mean anything to the continuing importance or viability of these laws? Or is that issue not something that we need to be thinking about? Again, let's do 30 seconds on that one. Carl.

CARL CHIAPPA: Well I suppose that if we look back on the rationale of the statutes, that in effect there was an unequal bargaining power, unequal playing field, Warren Buffett is a different player than a mom and pop store from the 1950s. Now obviously there'll be the response that this is one source of a product. But if you're Warren Buffett, I suppose you could just buy the source.

JAMES FROST: Aaron.

AARON JACOBY: I don't think that it makes much difference with regard to these regulations. And to the extent that we're simply looking at increased market power based on either Berkshire Hathaway, or AutoNation, or companies of that type, the statistics—I actually printed something on that, because I thought this question might come up—they control very little of the market.

First of all, I just want to say they do not control the market in any sense. But in terms of number at dealerships under their ownership, we have 1,060. And that's out of 31,266 points of representation. There are only 16,400 or so dealers, but they represent points of sale in that number—31,266. 1,000 of those are owned by public companies. It's a drop in the bucket.

JAMES FROST: Jim?

JIM ANDERSON: I think the percentage is relatively small. I have a statistic that had 7% or so, or 9%, of the dealerships being in that category. But in any event, I think it all depends on how they're operated.

I know how some of these organizations that we've talked about have been operated. And some are very well, and some are more focused on Wall Street and their stock price. So long as the consumer is the one that's in front of the line in who they are trying to serve, I haven't seen a big negative impact from public ownership.

JOSEPH ROESNER: I would agree with Jim. As his slide showed, it's a small percentage—7% to 9%. I think that as I pointed out, these public companies recognize as a risk factor that the repeal of these statutes would affect them as well. And having those statutes in there helps lower their cost of capital, and is good for the consumer in that regard.

The benefit maybe is versus a mom and pop, where the only source of income is that one store, there's some diversity of risk, because each of the stores is part of an overall organization. But still, the strength in that relationship is with the manufacturer.

JAMES FROST: Last word, Henry.

HENRY SCHNEIDER: Yeah. So I think the consolidation, the public companies, the larger dealers clearly are going to have a better ability to invest, to handle risk, to negotiate with manufacturers in a more sophisticated way. So basically, they seem better able to handle themselves compared to the small mom and pops or other smaller dealers.

JAMES FROST: All right. We are unfortunately out of time. We could easily spend all day just on this topic. But I want to thank all of you, and thank you for coming. We're going to take a 15-minute break. We will be back here at 11:15. Thank you.

[APPLAUSE]

[SHORT BREAK]

PANEL 2: WARRANTY REIMBURSEMENT REGULATION

Panelists:

- **James Appleton, President, New Jersey Coalition of Automotive Retailers**
- **Daniel L. Goldberg, Partner, Morgan, Lewis & Bockius LLP**
- **David Sappington, Eminent Scholar in the Department of Economics, University of Florida**
- **Richard Sox, Partner, Bass Sox Mercer**

Moderators:

- **Nathan Wilson, Economist, Bureau of Economics, Federal Trade Commission**
- **James Frost, Attorney, Bureau of Competition, Federal Trade Commission**

NATHAN WILSON: Good morning. My name is Nathan Wilson, and I'm a staff economist here at the FTC. Along with my colleague James Frost, an attorney in our Office of Policy and Coordination, I will be moderating today's panel on warranty reimbursement regulation. To briefly introduce this topic, all automobile manufacturers offer warranties to consumers when they buy a new car or truck. The states have historically regulated how repairs provided—excuse me, covered by these warranties are provided. Many states' laws allow only new car dealers themselves to perform warranty repairs.

Some states also regulate how the dealers are reimbursed for the warranty service they provide. In some cases, the state warranty reimbursement laws require that the reimbursement rate for service reflect the rates that the dealers charge to their retail, i.e. non warranty consumers. Historically, this has been especially common for the labor component of charges. Starting about a decade ago, however, many states enacted new laws requiring manufacturers to also reimburse their dealers for parts at the retail rates. Where such retail reimbursement laws are in force, dealers have the option, but not the obligation, to submit evidence of pricing for their non-warranty work, in order to set the warranty reimbursement rates. A number of the retail reimbursement states have also regulated whether manufacturers may attempt to recover some of the higher costs induced by the retail rate regulation.

Similarly, many states impose time limits on when manufacturers may audit their dealers warranty service logs, or challenge submitted warranty claims. Just as with our last panel, our interest today is in whether or not such direct regulation ultimately is in the interest of U.S. consumers. This is a question about which there is considerable difference of opinion within the industry, and these differences are very well reflected in the diverse views of our distinguished group of panelists. They are Jim Appleton, the President of the New Jersey Coalition of Automotive Retailers. Jim is also the immediate past chairman of the Automotive Trade Association Executives. New Jersey has been among the most active states in changing their warranty reimbursement laws, and Jim is deeply steeped in the background of these policies.

Richard Sox is a partner at the law firm of Bass, Sox & Mercer, which focuses on the representation of motor vehicle dealers. He has considerable litigation experience in these areas.

Daniel Goldberg is a partner at Morgan, Lewis & Bockius LLP, and is a fellow in the American College of Trial Lawyers. He, too, has considerable experience in writing about and litigating issues related to auto distribution.

Finally, Dr. David Sappington is an eminent scholar in the Department of Economics, as well as director of the Robert F. Lanzillotti Public Policy Research Center at the University of Florida. Doctor Sappington recently prepared an expert report on behalf of manufacturers in a recent action challenging the constitutionality of some of these reimbursement laws, a case in which both Richard and Dan were also active participants. To begin our discussion today, each of our panelists will give a brief presentation of their views, after which, we will turn to a question and answer period. For this, we very much invite questions from the audience. Jim?

JAMES APPLETON: Thank you. So why do almost all states in the U.S. regulate warranty reimbursement? Well, there are two reasons. The first should strike a familiar chord here at the FTC. Federal antitrust law prevents dealers from engaging in collective bargaining with automakers, so dealers and manufacturers must negotiate out in the open where decisions that affect the public and consumer interest are made by democratically elected state representatives, and that's a good thing. The second reason, without state franchise laws, dealers and consumers would be at the mercy of powerful automakers. And no business person in their right mind would ever invest the millions it takes to open a new car dealership.

Public policy in 50 states is designed, not to protect dealers, but to foster investment in the franchise system of neighborhood new car dealerships, because this system promotes competition between and among brands. And not just for new and used car sales, but also for vehicle financing, customer paid service, and even for manufacture paid warranty repairs. Consumers benefit from this competition. Better hours of operation, pleasant customer waiting areas, courtesy transportation, and, of course, cost. Even the dealers' well-documented, charitable, and civic involvement is driven by competition for sales and service, regardless of whether it's customer paid, or warranty work paid by the manufacturer.

That's why the courts and elected legislatures have consistently recognized that the extensive network of 17,000 franchised new car dealers all across the U.S. serves the public interest, promotes competition, and gives consumers ready access to warranty service from skilled technicians working out of properly equipped, conveniently located service facilities. The fact that these dealerships are independently owned, and that the dealers must be paid fairly, ensures that consumers will be treated fairly.

Understand this very important point. When automakers see warranty, they see expense. And experience tells us they will try to reduce that expense by shifting costs to consumers or to dealers. But when a new car dealer sees warranty, they see revenue, and, therefore, an opportunity to serve, to act as an advocate, to ensure their customer gets the full value of the warranty they've already paid for. Now let's talk about how the warranty business works, in the real world.

Study a dealership financial statement. You'll see that dealers make nothing, or often lose money on new car sales. They make two to 3% on used, 6% on parts, and maybe 8% on service. Examine every dollar that comes through the parts department at a dealership, for example, and here's what you'll find. $0.66 goes right back out the door to the manufacturer to pay for parts and the cost of goods sold. $0.16 goes to personnel expenses, $0.05 goes to variable expenses, $0.07 goes to fixed expenses, and that leaves just $0.06 as net profit before taxes in the dealer. Manufacturers mandate facilities, special tools, equipment, and training to carry out warranty repairs, which cost a lot of money, but that investment benefits consumers because neighborhood new car dealers are standing by to fulfill the warranty promises made by manufacturers, promises that the consumers have already paid for.

So when manufacturers don't pay retail on warranty parts—or warranty repairs to the dealers—they're not just cheating the dealers, they're cheating the consumers too. We surveyed New Jersey GM dealers and found that about 35% of all repairs are warranty. That is free to the customer and paid by the manufacturer. So when GM underpays their dealers on 35% of their parts and service work, the dealers take a loss where they must shift costs to the remaining 65% customer pay jobs. By unilaterally mandating a discount, manufacturers place a financial burden on dealers that inevitably results in losses for the dealer, or higher prices for everyone else.

So how did the reimbursement methodology used in many states to calculate retail come about in the first place? State laws requiring automakers to pay retail on warranty date back to 1977 in New Jersey, but it wasn't until 1991 that Bob and Elaine Robertazzi, the courageous mom and pop owners of Liberty Lincoln in Clifton, New Jersey, challenged Ford Motor Company and eventually proved the powerful automaker was underpaying dealers and shifting cost to consumers in what federal district court Judge Maryanne Trump Barry called a shell game. Still, dealers were frustrated. Automakers continued to devise burdensome reimbursement procedures in order to thwart dealer demands for fair compensation. And by the late 1990s and early 2000s, many legislatures were fed up too. They arrived at this hundred consecutive repair orders methodology, mostly out of frustration with automakers, who were quick to say what retail wasn't, but never offered a reasonable formula to meet their obligations under the law. So here we are, almost 40 years later, retail reimbursement laws were first enacted in 20 years since the courts, and many state legislatures started to try to force compliance. And the sad truth is that automakers continue to game the system because they know that every penny saved on the warranty, is a penny earned at the expense of consumers and car dealers.

Let's look at two common strategies the automakers use today to shift cost. Surcharges and manipulation of parts pricing and labor times. It's interesting. Thirty-seven states accounting for about 75% of all US auto sales require manufacturers to pay retail, but the manufacturers don't bake that price into the cost of the car. Instead, they up the surcharge dealers only in the states where they actually are forced to comply with the law, effectively charging consumers twice for warranty.

In New Jersey, GM agreed to pay dealers retail, but then turned around and imposed a surcharge on dealer invoice—a GM imposed charge intended to compensate them for what they say is their additional cost of doing business. We estimate GM collected $6.5 million in surcharges in New Jersey in 2014, and paid out just $3.2 million for reimbursement in excess of the 60% mark-up they themselves acknowledge is retail. In other words, GM collected $3.3 million more in surcharge money from dealers and consumers than they paid out. So GM made $3.3 million on their increased cost of doing business in New Jersey. You know, nobody ever asked how much does a manufacturer mark-up the cost of parts or a new car, but everyone knows exactly how much a dealer does.

The retail end of the business is completely transparent, while the wholesale end of the business is cloaked in secrecy. Here's another example of manufacturers' self-dealing and price manipulation. A replacement fuel tank at a North Jersey Ford dealership lists for $3,400 and it costs $315 to install. A total of just over $3,700, but that's when the customer is paying for the job. But in October of 2014, Ford announced a recall of 205,000 '07 and '08 Ford Edge and Lincoln MKX vehicles with defective fuel tanks. Now, all of a sudden, since the manufacturer is paying for the repair, the cost of the part drops to less than $1,200, and labor time is slashed to $250.

With just a few keystrokes, Ford reduced dealer compensation and helped itself to a generous discount of more than $2,200 on each repair. That's a discount that was worth $460 million, almost a half a billion dollars. Their defect, their mistake, but dealers and consumers pay. This is a powerful example that really illustrates the public policy concerns at play here.

Let me wrap up by simply saying the conflict between dealers and manufacturers plays out at the state houses all across the U.S., not because dealers want it that way, but because antitrust laws prevent dealers from engaging in collective bargaining with automakers and because the public and consumer interests are best served by having these policy debates in public, and decided by democratically elected state representatives. It's not really important what manufacturers earn or even how they chisel the dealers. What's important, though, is that the FTC understand this conflict and recognize that the agency is being used. That the automakers efforts to unravel state franchise laws, and avoid fair payment to dealers, won't benefit consumers, just enrich manufacturers. That's unfair to dealers, it's unfair to consumers, and it undermines the public interest in competition and highway safety.

NATHAN WILSON: Thanks very much. Rich?

RICHARD SOX: Thank you, Nathan. I'd like to thank the FTC for inviting me to appear on this panel. As my introduction said, we've got a lot of experience in this area. And our experience tells us that the basis for the dealer's pursuit of warranty reimbursement rates equal to market driven retail prices, was that overhead cost for dealers were continuing to increase over time, while the manufacturers were suppressing the warranty reimbursement rates.

For over 40 years, all of the major manufacturers—and that's an important point, all of them—had unilaterally determined that the parts mark-up to the dealer should be capped at 40% and were unilaterally dictating hourly rates to be paid to dealers. Dealers told us, in many cases, it appeared that same brand dealers, within the same market, had been approved for widely varying hourly labor rates for performing the same warranty work.

Yet, over time, these very same manufacturers were placing increased demands on the dealers to expand their dealership facilities, as Commissioner Ramirez has referenced earlier, to exclusively represent a single brand at great cost. These facilities were required to be larger than ever, and be built with very expensive materials. Engineering, construction, and architectural costs skyrocketed for the dealers. The bottom line is that dealers were being required to incur exponentially higher overhead costs, and yet those warranty reimbursement rates were remaining the same.

In addition to the substantially more expensive facilities being required by manufacturers, due to the increasing sophistication of the vehicles themselves, dealers were now required to purchase special tools and diagnostic equipment that, in some cases, cost as much as $25,000 per unit, per service stall to properly repair a vehicle. It cost a dealer, on average, $30,000 to send a technician to be trained and certified by the manufacturer. Modern day vehicle repair technicians have post-secondary degrees and command a salary of on average between $60,000 and as much as $120,000 per year. That didn't used to be the case. Vehicles are more sophisticated and require more sophisticated and expensive repairs.

Dealers were also being required by manufacturers to maintain a fleet of new vehicles to be provided to each warranty customer to utilize while their vehicle was being repaired. This required dealers to purchase additional vehicles from the manufacturer and then proceed to write down the value of those vehicles each month that those vehicles were in the loaner fleet.

So the manufacturers made more money by having more cars required to be purchased from them, and yet the dealers had to take a loss on those same vehicles in order to meet the manufacturers' needs to provide a loaner vehicle to the customers. All of these additional overhead costs are generally a benefit to the consumers, no doubt, but as dealership costs increased, the manufacturers were continuing to suppress the payment for parts at a mark-up of 40% and a labor rate that they unilaterally determined. As Mr. Appleton correctly points out, it's important for everyone to remember the mark-up on the cost to the dealership of parts should not be confused with profit.

The dealership's margin on parts and labor is used to pay many of the dealership's overhead costs before a nickel drops to the bottom line. Importantly, dealers have no choice but to provide warranty work on its manufacturer's vehicles. They are required, by contract, to provide warranty service on any vehicle brought into the store, whether they sold that vehicle to the customer or not.

Yet there is no certainty for the dealers as to how many warranty repairs they will be making, and the value of those warranty repairs, or the size of those warranty repairs. The manufacturers do not and cannot guarantee any level of warranty work to their dealers, yet they require all of those overhead costs. There are currently at least 40 states wherein the state legislature has independently determined that manufacturers were not reimbursing dealers for warranty work at rates which were fair and appropriate. Those state legislatures each vetted this issue, independently, and determined that a market driven retail rate was fair and reasonable and in the best interest of consumers. As Mr. Appleton mentioned, after many of these state legislators required manufacturers to reimburse dealers at rates equivalent to retail, manufacturers made it virtually impossible for dealers to obtain an increase in their parts mark-up and labor rate based upon the dealerships customer pay repair work.

So as a result, 22 state legislatures had to include a specific formula in the franchise laws, by which the dealers would submit the equivalent of their retail rates. These formulas vary from state to state, but are generally based upon the dealerships collecting some number of consecutive repair orders—customer pay repair orders—and then taking an average of the parts mark-up and the labor rate for each. In addition, certain non-warranty like repairs, such as fluid and filter changes, are expressly excluded from that calculation as non-warranty like repairs.

Our firm has assisted hundreds of dealers in the submission of warranty reimbursement claims, under these laws. In practice, the dealers submit both the repair orders used in calculating the average parts mark-up and labor rate, along with the intermittent repair orders that didn't apply because they contained non-warranty like repairs. After submission, the manufacturer either accepts the requested increase in reimbursement, or raises questions related to the submission. In many cases, the manufacturers make a counteroffer for a lower reimbursement rate.

Dealers are certainly within their rights to negotiate the parts mark-up increase and the labor rate increase, and often do. Where the dealer and manufacturer cannot agree that the statutory calculation has properly been made, most states provide for administrative appeal to resolve the issue. As was mentioned earlier, some manufacturers have used surcharges to circumvent the clear intent of the warranty reimbursement laws. The manufacturers were, in essence, giving with one hand, and then taking with the other. As a result, some 15 states have added an express prohibition on surcharging a dealer to recover the increased warranty reimbursement being paid to the dealers at retail rates. In addition to the example Mr. Appleton provided regarding General Motor's surcharge, we're aware of, other manufacturers such as Ford and Nissan doing the same thing.

Now it's critical for this record, today, to reflect pertinent decisions by the federal courts addressing the warranty reimbursement at retail and surcharge prohibition laws. In the interest of time, I'm not going to cite song and verse for each of these cases, but suffice to say that, since 1994, there have been no less than eight separate federal court cases addressing these issues under laws in six different states. In the earliest of those cases, Acadia Motors versus Ford, the court ruled that if the state legislature said that manufacturers must reimburse dealers at retail for parts and labor, then that's exactly what the legislature meant and that the manufacturers could not attempt to get around those laws.

In contrast, other courts have found that, if the state law doesn't clearly require retail reimbursement, but instead uses phrases like reasonable or fair, then that doesn't necessarily equate to retail. So it's important that that be clarified. With regard to surcharge prohibitions, the federal courts have consistently found that surcharge is directed only to those dealers that sought increased warranty reimbursement were a violation as they eviscerated the legislative intent to increase the reimbursement to dealers. And then, lastly, and I'll conclude with this point. Beginning with the Acadia case in Maine in 1994, continuing with the Gwadosky case in 2005, and culminating with the Currey case in Connecticut last year, the First Circuit Court of Appeals and the federal Second Circuit Court of Appeals have repeatedly determined that these laws do not violate either the contracts clause, the due process clause, or the commerce clause of the United States Constitution. Thank you.

NATHAN WILSON: Many thanks, Richard. Turn it over to Dan.

DANIEL L. GOLDBERG: Let me take a brief step back from warranty reimbursement, for a moment, and ask you to consider the following. How often is it do state or even federal legislative decisions involve setting minimum prices on products? When there are monopolies that are granted, whether they are public utilities or regulated insurance companies, what the legislators generally do is try to set a cap on prices.

So my quiz for you is name an industry, surprise what it's going to be, where the legislature, number one, adopts minimum pricing that certain buyers have to pay for products and services. Number two, where the largesse—the beneficiary of this legislative largesse are auto dealers, which contrary to what you hear, are not victims. According to the NADA statistics, on average, across the country, they make over $1 million in net profit a year. And where, number three, the legislature also take the next step of insulating that regulation from the politics of the situation by saying manufacturers cannot recover the increased costs imposed by those laws from the state that imposed them—from within a state that imposed them.

There's been some reference already to the historic unequal bargaining power, and some reference to the size of auto dealerships. To put a little bit of a finer point on that, average dealerships in the country now generate $50 million of revenue a year, are profitable, and the Fortune 500 dealer entities now generate billions of dollars. On average, the six largest dealer groups generate over $10 billion of revenues a year. That's according to their filings with the SEC.

Now you've heard statements made well, it's still the small dealer, you've got to negotiate one on one. No. Manufacturers, this is well known, like to have a policy which, if possible, is nationwide in purpose and effect. They don't go out and negotiate the amount that they're going to reimburse dealer A for warranty parts and dealer B a different rate. They like to have a uniform map. So dealers, whether large or small, get the benefit. They get a free-rider on the negotiating power of these enormous dealer groups.

So what about warranty? Is there some conflict in fact between what the market forces say about warranty? From a manufacturer's perspective, warranties help sell the new vehicle. That's what they're there for. So manufacturers compete with each other to try to increase the warranties that are offered. The only way that that can be done sensibly, is by having the dealers do a good job on the warranty work. Because manufacturers are dependent on the dealers to do the warranty work. Manufacturers are prohibited by most state statutes from doing it themselves or from naming independent repair shops to do the warranty work. So there is a confluence of interest in making sure that dealers are properly incented to do the warranty work.

Dealers are properly, therefore, given a profit or a mark-up. That was in the manufacturer's interest before these warranty reimbursement laws. And what did it result in? What it resulted in is not manufacturers providing parts, as it often happens with warranties on products, providing the parts for free to the dealer. Here, dealer, you need a new set of X, Y, Z parts, here they are for free. Install them, and we'll pay you for your labor. No. What happened as a result of the negotiations between manufacturers and dealers is that manufacturers pay a 40% mark-up, as you heard Rich say. That was before the situation of these retail reimbursement laws the situation.

And, from a dealer's perspective, again, these warranties are great for dealers. Why? A, they help them sell the new vehicles. B, they provide a captive audience for consumers to come in, because, during the first at least several years, now longer in many cases, that the consumer owns the car, they will bring it back to the dealer so the dealer has the opportunity to impress the consumer on its warranty and repair abilities. It starts to, therefore, get the non-warranty work that flows from it, with no need to advertise because it got a captive audience for these consumers. It keeps the consumer coming back to the dealership and exposing the consumer to the showroom, so you make the next sale. All kinds of benefits. It troubles me when I hear dealers complain that they are kind of the victims of having to do warranty. Warranty is a profit center, and always has been a profit center for dealers.

So what happened here with respect to these state laws? As cars improved, and the amount of warranty, therefore, decreased. How do you make sure that your revenues and your profits on warranty keep up with what they were historically? Look for the one source of revenue that a dealer gets from a manufacturer. There's only one that is required. It's the payment for the warranty. So go to the state legislators and get those laws. And you've heard references to the lead-ins to the state laws and so forth.

I quote from an article by two brilliant people, Francine Lafontaine and Fiona Scott Morton, "The net result of all these laws is to raise profits for car dealers…. Dealers represent an identifiable source of employment and tax revenue, while even large manufacturers can site manufacturing plants in only a limited number of states. The result is that new car dealers have an advantage over auto manufacturers when it comes to political leverage in state legislatures, and thus states enact laws that extract rent from manufacturers and redistribute it to franchise dealers."

Now as I say in addition to that excess cost that it's costing the manufacturers, the manufacturers, in many states, there are now I believe 19 of them that prohibit recoupment in the state. So it's not a question of a dealer saying you owe me an additional $2,000 and the next invoice comes back and they're charged $2,000. It's a question of a manufacturer saying state x, New Jersey, cost me an additional x million dollars a year because it enacted these regulations. So I'd like to put a surcharge on the vehicles and identify it as something, so that when consumers go to buy the car they know that they are paying an extra whatever it is, $125, because of the warranty reimbursement that has been enacted in the state, a simple thing that would allow the voters, those affected by the regulations, to have some political say in the process. But these recoupment bars basically say to the manufacturers you are prohibited from recovering the increased costs caused by the statutes from within our state. And therefore, as David Sappington will address, the enormous costs have to get reflected somewhere else in the system. All of which results in things that are adverse to consumers. I'll stop there. My time is up.

NATHAN WILSON: Perfect timing. Many thanks. David?

DAVID SAPPINGTON: Thank you, Nathan. It's certainly a privilege to be here, and I appreciate the opportunity to speak on this distinguished panel.

[WHISPERS]

I see my role on this panel much as Henry did on the first panel. If could get the slides to work, I could proceed, but I guess economists don't know how to work tech—there we go. So I see my role as bringing some economic perspective to the panel, and, in particular, the perspective of a regulatory economist. And I think the golden rule for a regulatory economist is that competition is the ideal form of consumer protection. And no matter how well intentioned regulation or legislation might be, it's cumbersome, costly, and subject to error. And I have great respect for regulators. I've had the privilege of serving with regulators, and I have great admiration for them, but their job is just impossible. So whenever possible, it's ideal to rely upon competition to protect consumers rather than turn to regulation or legislation.

So the fundamental question then before us is what is the source of market failure, the lack of competition, that warrants government regulation or legislation in the interaction between automobile manufacturers and automobile dealers.

And as we've heard a bit this morning, I think the basic story that tries to justify these regulations is that if we have a setting where there's a huge dominant manufacturer and a small dealer who is beholden to the manufacturer, it may turn out to be the case that manufacturer would abuse that power, and, in fact, withhold payments for warranty work, for example, from the dealers. And consumers would be harmed in the process, because dealers would not have the proper incentives to do the warranty work properly. Now that's a story that one might tell, but that's not the way I perceive the industry, and I think a more realistic depiction of today's industry is that, in fact, we have many manufacturers competing against one another to reach customers.

They do so through their dealers, but those dealers notice now in this new picture are not tiny little entities, as Dan has mentioned, they are in fact major players, major economic entities. So I think the better way to now view the industry is that we have teams of manufacturers and dealers working together, competing against one another, to attract consumers and make sure they can both sell cars. And so it's in the interests of both manufacturers and dealers to pursue the best interests of consumers. Otherwise, they will lose business to other manufacturer-dealer teams.

So a more realistic picture in my view of today's industry is that we do have substantial competition in the industry and this competition seems very likely to motivate manufacturers and dealers to work together to agree upon warranty reimbursement terms as a part of the overall package of terms that govern the interactions among these entities, in a manner that will best serve consumers, because failure to do so will leave them in a setting where they lose customers to other manufacturer-dealer teams.

And so, consequently, in my view, it is not apparent that we really need government intervention here to force these manufacturer and dealer teams to agree upon warranty terms that will serve consumers. It's competition that will do this itself, and, in fact, that's the better way in general to run an industry when possible. It's also not apparent to me that the dealers need the protection that they may have back in the 1950s. Again, for the reasons that Dan has already mentioned, and I won't go through the details, but if you just look at the statistics, revenues at the dealerships are increasing fairly regularly over time with exceptions like the great recession. If we just take a look at profit, Dan has already mentioned, there's a substantial profit of the dealers these days.

In addition, if we just take a look at the list of dealers who are now currently on the Fortune 500 list of the nation's largest corporations, we do see the dealers showing up there. So that picture from back in the 1950s really does not capture the industry today, in my view. And one other element of the interaction is that dealers today serve and sell the cars of many different manufacturers. So in fact they're not beholden to a particular manufacturer. So we do have a more level playing field, and therefore whenever possible—again, the golden rule of regulation is to let competition do the job wherever possible.

And part of the reason for that golden rule is that, when we try to do regulation, it's a very, very difficult process. So, for example, the first thing you need to determine is well, what is the right rule to insist upon to tell the manufacturers to the rate at which they need to reimburse their dealers for warranty work? Well that's not an easy question to answer, but the legislators seem to have done so by saying, well the right rule is to make sure the payment is the same for warranty work as the dealers are getting for non-warranty work. It's not clear to me that's the right answer. Because, for example, perhaps the manufacturer should be treated as sort of a large supplier of work for warranty work and, therefore, dealers often give discounts to their large customers. Perhaps a discount is reasonable for the manufacturers. It's not an easy question to answer, but again it's one that I think the market is better able to determine rather than regulators or legislators.

And even if you can see that that is the right rule, somehow, the legislators came up with the right rule, you then have to look at the details of how the rule is being implemented and, in fact, the way it is being implemented leaves room for the dealers to, essentially, not count discounts and sales that they make to their retail customers when calculating how much they're receiving on average for their retail work. And so, in fact, what they're actually receiving is above—I'm sorry—below what their calculated rates are. And so what we see over time is what's happened is that prior to the enactment of the rules in Florida, which happened in 2008, at the time before and rules were enacted, the dealers were getting larger rates of reimbursement for their retail work than for their warranty work.

But, more recently, because of this ability of the dealers to take out their discounts and sales from their calculated rates, now in fact the manufacturers are paying more for warranty work than the dealers are getting from their non-warranty work. So, again, this is just an indication of how complicated and difficult regulation is in practice, and sometimes it does not have the intended effect.

And the amount of money we're talking about here is not trivial by any means. I did a quick back of the envelope calculation—just for the four manufacturers for which I had data—and calculated how much more they are paying because of the laws in Florida than they would have paid absent the laws. And just between 2008 and 2012, for these four manufacturers, who accounted for just below 50% of the new car sales in Florida, over that five year period the increased cost due to these laws of warranty service was $80 million.

So if we extrapolate that to all the manufacturers in all the states over all the relevant time period, that's a huge amount of money. And we all know that's got to show up somewhere. Consumers are eventually going to pay some or all of this increase, and so it's not at all clear that these laws really are working in the best interests of consumers.

So in summary, from the view of a regulatory economist, market competition is the ideal form of consumer protection. Regulation and legislation are imperfect substitutes for competition. And, therefore, should be avoided whenever there is a reasonable possibility that competition can do the job. And, perhaps, a corollary of the golden rule is that when in doubt, leave. Or when in doubt, do without the regulation because competition should be the one in charge of the industry operations. And, in my view, the competition is quite pronounced in the auto industry today. And, therefore, other than serving to transfer wealth from manufacturers to dealer, it's not clear what role these rules are playing. And so, in fact, these rules have the substantial potential to distort market outcomes to the detriment of consumers.

NATHAN WILSON: Thank you very much, David. We're now going to turn to the question and answer portion of this panel. And at this time, I'd like to again stress that we very much welcome questions from the audience. Please submit them as was described in the previous panel. So the first question that I'd like to raise drills deeper into things, I think, some of our panelists have already touched upon: the impact of these warranty laws on consumers, our ultimate focus here today. So, in particular, it's pretty clear that the warranty laws impact interactions between manufacturers and dealers, but how does that translate to the consumer? If one state, for example, changes their reimbursement law and another does not, what types of effects on consumers might we expect? Would there be differential ones? Would they be shared? I would like to hear from our different panelists what their views on this question are. Perhaps in two minutes or less.

JAMES APPLETON: I'll do my best. Well, look, I think we all understand why dealers like these—or that dealers do like these franchise laws, and I think we understand now better why the manufacturers despise them. But I have no doubt that once the FTC finishes a full and fair study of this area, particularly the warranty area, that you'll have to conclude that these laws, although they're obviously not perfect, are good for consumers.

And, ultimately, that's the first panel, I don't think I heard the word consumer twice. And, at this point in time, I think we're getting down into a discussion about these laws. The assumption from the academics and from the manufacturers is that these laws were enacted to protect dealers, and this is just a fiction.

I've been involved in four separate different legislative initiatives in the state of New Jersey over the last two decades, and I can tell you I never went in front of a legislative committee and said we should pass these laws because they're good for dealers. I was always forced to go in front of a legislative committee and argue why they were beneficial to consumers, and it's never clearer than in the warranty reimbursement area. In the warranty reimbursement area, once that car is sold to the dealer, not to the consumer, once that car is sold to the dealer, that manufacturer wants no more expense associated with that car. And they will fight, and they will claw, and they will cheat wherever and whenever possible to avoid making further payments on those cars. And dealers, on the other hand, act in their own interest by attempting to garner as much and compete for as much warranty business as they can. Now consumers benefit from the system.

And let's be clear, the Professor's economic arguments are very sophisticated and way above my pay grade, but I know one thing for sure. Economic players in the marketplace will do what's in their interest every time, 100% of the time. And the dealers economic interest is aligned with the consumers, when it comes to warranty repairs, and the manufacturers’ is not. Manufacturers see every penny spent on warranty claims as expense.

Whereas dealers see every penny spent on warranty claims as an opportunity. And so the benefit—the downside of some states regulating this area and some states not, is that cost-shifting occurs within the dealership. And what winds up happening in a dealership environment where 35% of all work in the shop is warranty, and 65% is customer paid. In states like mine, New Jersey, where the manufacturers are obligated to pay a fair retail rate, there is an equity. Consumers don't wind up paying twice. Consumers don't wind up overpaying for customer paid work, and dealers are able to compete.

And, at the end of the day, what the law is intended to do is encourage investment, not to protect dealers’ investments, but to encourage investment in the franchise system. Because the franchise system promotes competition, the franchise system promotes economic benefits at the local level, and most importantly the franchise system gives consumers ready access to independent and qualified warranty and safety recall service. Without manufacturers being obligated to pay dealers fairly for that work, they would not be able to make the investment in the community, which state legislatures have insisted –

I know the counselor Goldberg was concerned about the fact that there are so many different state laws and all the rest. Well now we have this pesky 10th Amendment, and this pesky 10th Amendment tells us that the states should be in a position to regulate for the health, safety, and welfare of their citizens, as they see best. And that's what we've seen all across the country. And the implication that somehow dealers have more political influence at the state house—let me tell you something. Last year we had a very vocal, very high profile battle in the state of New Jersey over a franchise bill. Automakers spent $600,000 in paid media and they spent another 400,000 in contract lobbyists. Now the dealer association spent a hell of a lot less than—

DANIEL L. GOLDBERG: Can we get a little equal time here? I thought you said two minutes, Nathan.

NATHAN WILSON: Yeah.

JAMES APPLETON: I'm sorry. I didn't know you were trying to get my attention. I apologize.

DANIEL L. GOLDBERG: Thank you.

RICHARD SOX: We're going down the line?

NATHAN WILSON: Why don't we go back and forth? Dan, do you want to jump in?

DANIEL L. GOLDBERG: And I'll try to keep it to my two minutes. When you look at the legislative process for these statutes, you won't find any consumer groups that were banging on the door of the legislature and say our dealers in this state are not performing warranty well. We need the dealers to perform better warranty, and, therefore, please pay them more. You won't find any history showing that, before and after these retail reimbursement statutes were enacted, that somehow the quality of warranty improved.

And I would warrant that if you tried to do a study between customer satisfaction of warranty in states that did not have retail reimbursement, and states that did, you won't find a difference. Why not? Because there is a strong aligned view. Manufacturers, as I said earlier, want warranty to be done well so the customers are satisfied and will buy the next brand of their brand of vehicles. Dealers want consumers to be satisfied so they will come back and use that dealership. So there is no reason to think that the marketplace is not more than adequate, particularly given the changes in the relative leverage of dealers, that the marketplace is not adequate to ensure that those aligned interests result in adequate, proper, fair, and profitable, as they always have been, warranty reimbursements.

NATHAN WILSON: Rich?

RICHARD SOX: Thank you. The issue, and facts are stubborn, stubborn things. Courts have looked at the evidence—sworn testimony, documents—and have repeatedly found it's not just an issue of are the cost of the warranty work being covered at the dealership level. Those costs are going to be covered one way or the other. The dealer has to provide those services. It's in their best interest to provide the customers with the best warranty service they can.

So those costs have to be covered somewhere, and what the courts found was those costs were beginning to be covered by the customer pay—the non-warranty folks coming in and having work done on their cars. And so this was an effort to balance that by making the manufacturers pay their fair share of the warranty work under their warranty to relieve the pressure on the customer pay side. That's in several court cases. Again, after evidence has been looked at by the judges in those cases. And I'll stop there.

NATHAN WILSON: All right. David, do you have anything to add?

DAVID SAPPINGTON: Yes. I'll just follow up quickly on Richard's point. Again, to quote some very famous, distinguished economists who are sitting here in the room: if the problem is that the retail, the non-warranty customers, are paying too much, this particular law doesn't seem to do a particularly good job of solving that problem. Because, again, the way the law is set up, if the dealers get a higher payment for their non-warranty work, they're then allowed to charge more for their warranty work. So, in fact, this law provides an incentive to increase the prices charged for non-warranty work. So, again, it's just another illustration of how regulations, even if they're well intentioned, don't always achieve their standard purpose.

And, Nathan, just to get back to your question, which is clearly exactly the right one. How are consumers affected by these type of laws? And part of the difficulty is that we—this is extremely hard to measure, as Francine talked about this morning at the very outset, measuring these things are difficult because it's so difficult to get really good data. But what we've seen over and over time in different industries is that, when regulators do step back and repeal the legislation, we just see dramatic improvements in industry performance.

I don't think there's a better example than in the railroad industry, for example. Regulators tried for many, many decades to sort out the problems in that industry and impose all sorts of regulations to try to make the industry work, but in 1980, they essentially gave up and said we're going to deregulate the industry instead with the Staggers Act. And there's been just dramatic improvements in that industry since, and this unlimited potential in many industries that is only unlocked when you take away the regulations. And, again, when in doubt, do without the regulations.

NATHAN WILSON: Thank you. And that actually segues quite nicely into my next question, which is that in other industries where we see a seller supplying to a network of independent retailers, we don't necessarily expect to see laws governing price levels, in order to maintain functioning markets. What exactly is unique about the car market that would otherwise keep reimbursements unacceptably low?

JAMES APPLETON: Well, we—

NATHAN WILSON: Again—

JAMES APPLETON: You already spoke. I'll try to keep it to two minutes this time. Sorry. We already spoke a little about the unique aspect of the car business, which is the public interest in warranty and highway safety. There's a close link between having a ready network of independent franchisees in the community, who are not financially interested in denying warranty claims, but are rather financially interested in seeking them out and performing. So I think that's the major point that he made.

NATHAN WILSON: OK. Dan? We'll do it in the same order. Do you have anything to add?

DANIEL L. GOLDBERG: I think the thing that is unique about the auto industry is what I referred to before, and that is the remarkable political power that the dealers have in every state. And I'll put it this way, if the elevator operators had had the same political power that dealers did, we wouldn't have self-operating elevators.

NATHAN WILSON: OK. Richard? David? Do you know anything to add?

RICHARD SOX: Yeah. I would just emphasize what Jim said in terms of what's one of the very unique things about this industry is that a vehicle is a dangerous instrumentality. It is something that, if it's not repaired correctly, it can cause death. And the state legislators, as Aaron mentioned in the last panel, found that governing that relationship and governing the repairs of those vehicles is critical to the public safety in the state. And I also want to point out that there was mention of price-fixing in one of the opening statements. And, if you read these laws carefully, you will understand this is not price-fixing at all. This is tying the warranty reimbursement to a market-driven rate that is going to be different for every dealer depending on the market, and the cost of doing business in that market, and maintaining facilities, and conducting those repairs in those markets.

NATHAN WILSON: Thanks.

DAVID SAPPINGTON: Nathan, I'll defer to individuals on the panel who are more informed about the details of the auto industry than I am. But my perception is that there really is not something fundamentally different about the auto industry, in terms of basic economic issues. And so I think we would then need to look for other explanations for why we see this large difference in regulation. And I think Dan's suggestion in that regard, the political influences, deserve serious attention.

NATHAN WILSON: Thank you. I'd like to now to turn to a question that we've received from the audience.

JAMES FROST: Multiple times—

NATHAN WILSON: From separate people. It's not just one insistent person. I'd like to hear the panel's thoughts about allowing non-franchised dealers to perform warranty work, perhaps independent mechanics, or chain repair shops. Perhaps two minutes again per person?

JAMES APPLETON: Sure. Let me just back up a second on—I drew a blank earlier on the price control question. I just want to be clear.

I can't tell you how much I disagree with the premise that there is price control in this market. You have a free market, 65% of the business consumer paid. And you have a captive market, 35% of the business which is warranty paid.

Dealers don't have a choice where they buy the parts. Dealers don't have a choice about taking that work or not taking that work. So what we do in the state legislatures is, they decide that in order to fairly compensate that 35% of the work, they will survey what is happening on the other side. There's no control about what happens on the other side. So price control is an inapt characterization of the way these statutes work.

I'm sorry, what was your question?

[LAUGHTER]

Oh could independents—very quickly on independents—I don't think either manufacturers or consumers would welcome that business model. As we've said already, the cost to dealers is extraordinary for training, special tools, equipment, facilities. To disperse those costs across a much wider network might result in more access for consumers to service, but would it result in better quality? And I think the clear answer is no.

There's an ecosystem that it is involved in the automotive industry, where there is an optimum, maybe sub-optimum, maybe slightly more than optimum number of sales and service locations which serve the public interest. They don't serve the dealer interest. They shouldn't be here to serve the manufacturer interest. They're here to serve the dealer—the consumer interest.

NATHAN WILSON: Thanks. Dan?

DANIEL L. GOLDBERG: Well, I guess I would say in that regard, we ought to let the marketplace determine who can adequately perform warranty. If a manufacturer says, great, for certain kinds of warranty work, we're happy for consumers to have more points of access. And so as long as an independent repair shop can establish to us satisfactorily that they can do a good job on warranty, we will appoint them, because it may be closer to a particular consumer.

I believe that the European Union block exemption allows for just this kind of a process. That is, an independent repair shop who can establish they are able to adequately, properly, safely perform the warranty, they're allowed to do it. Why shouldn't the marketplace allow that to happen? And then, a manufacturer can determine whether that makes sense or not, or whether it disperses the warranty work too much, and therefore, will dissipate the quality of warranty work that's done for consumers. Let the marketplace decide. Let there be some experimentation in the marketplace, so that we can determine these things.

And I know one of your panels kind of will talk about what happens in the future. We're talking about more car-sharing in the future. When Google and Apple decide to come into this marketplace, or existing manufacturers say, you know, the millennials, they really want to share the vehicles. Maybe there doesn't need to be somewhere down the road, even a retail sale.

Maybe manufacturers continue to own the vehicles and work out sharing arrangements for consumers, so the manufacturers do the warranty work themselves. Who knows? But why should this part of the industry be mired in the 20th century, when all other aspects of this industry are proceeding into parts unknown, which are not wedded to this historical model?

NATHAN WILSON: Thanks. Richard?

RICHARD SOX: I'll be brief, because I think Jim covered the point well. I would just say that it's easy for the manufacturers to suggest that the market should drive this pricing. When the dealers have already incurred the costs of constructing those repair facilities and manning those repair facilities at the demand of the manufacturers, based upon expected units in operation, and repairs that the manufacturer tells the dealers, we expect you're going to be making on average this number of repairs per year based on sales in your market.

So they've incurred the cost, and now, it's easy for the manufacturer to say, well, now we want the market to dictate. Well, those costs, again, have to be covered. And the state legislatures and the courts have determined that this is the fairest way to do that, and not put it on the backs of the customer paying non-warranty repairs that are made at the dealership.

DAVID SAPPINGTON: Nathan, I think the most direct answer to your question is, we don't know whether this is a good idea or a bad idea. But again, that's what markets are for, to try out different modes of operation. And if it works, it'll catch on and everyone will do it. If it doesn't catch on, no one will do it. And so we don't, again, know what the potential is until we try it.

NATHAN WILSON: Thank you. So seguing slightly to a different topic, where there are new laws which tie warranty reimbursement rates to retail charges, we understand that there are some dealers who do not take advantage of the higher rates guaranteed to them by statute. Why might that be? And if some dealers do not take advantage of these new laws, because they fear repercussions from manufacturers, why don't those constraints apply to everyone?

JAMES APPLETON: Well walk on to any playground. There are kids who are bullied, and there are kids who are not. There are kids who stand up and fight for their rights, and those who don't. And it's no different when you become adults, and you enter the business world.

Let me tell you, automakers are not nice people. They don't treat their dealers respectfully. And if you think I'm exaggerating, think about this, the sole supplier has the ability to withhold product that is desirable, has the ability to come in and audit your dealership, and claw back through an open account.

If you don't know what an open account is, it means you have to maintain an account which the manufacturer has access to at all times. They can come in. They can take money out of that account. You have no recourse. You can't stop them from taking the money. And then, you have to claw that money back. So it's warranty audits, incentive audits.

And if you think that the manufacturers don't use their superior power over the dealers to enforce their will, let me tell you about one thing that happened just at the end of last year. General Motors has a pay plan for their dealers, where in New Jersey they agreed to pay a specified mark-up on parts used in warranty repairs and a labor rate. What GM did at the end of last year is they went out to dealers in the Northeast, not just New Jersey, went out to dealers, and they said, if you have the temerity to ask for full retail over and above the amount that we say is OK to pay, then two things are going to happen. One, we're going to take you off the labor rate payment that you have currently. And we're not going to give you automatic cost of living increases on your labor rate. And we're going to come in and audit you on your labor rate.

You know, look, I'm from New Jersey. It's hard to shock me. But that looks like racketeering to me. It's strong arming. It's using your superior economic strength over a weaker business partner to exact your will—extract your will from them. If you think it's—and if you think that the manufacturers are good-willed, you're wrong.

NATHAN WILSON: Thanks, Jim. Dan, I'm going to guess you have a response.

DANIEL L. GOLDBERG: Well, once again we're hearing about the auto dealers as victims. And I dare say that AutoNation, Penske, Group 1, Sonic, Asbury Automotive, and Lithia Motors would not all be involved as they have been over recent years at buying up more and more dealerships only to find that every time they buy a dealership, they're once again going to be a victim. It doesn't happen. Dealerships are very attractive purchase opportunity.

And in terms of fearing repercussions, it's really quite interesting. And you shouldn't legislate by anecdote, obviously. But we hear these anecdotes. I submit to you that there is another reason why a lot of them—why a lot of auto dealers have not put in for the retail rate. And that is because they were already paid what they regarded as a fair return. Not only the 40% that many manufacturers offered, but some offered to reimburse warranty parts at MSRP for those parts, more like a 67% return on the parts.

And auto dealers may well say, hey, I'm content with that. I think that's a fair return. If there are a lot of dealers who are not in fact putting in for the retail reimbursement, doesn't it make you scratch your head and wonder how necessary these retail reimbursement laws were? I'll stop there.

RICHARD SOX: It's just the opposite. I think the question proves what again, courts after looking at lots of evidence and state legislatures have found over long periods of time, that the manufacturers have an economic power over their dealers. And that's why some dealers are afraid to pursue the retail rates, because the manufacturers, in writing, over and over again, have told dealers, don't do this. Don't do this. And so a lot of them are scared to do it. And some of them, as Jim said, stand up for their rights. And they do that.

Now, as it relates to public companies, what's not being mentioned here, and it's important for the record. Every public company is required by manufacturers to sign what's called a framework agreement. Framework agreement limits the amount of business that that public company can do with that manufacturer, so that they are limited in their economic power by virtue of those framework agreements. So they are not all powerful. They don't come close to rising to the power of the manufacturers.

DAVID SAPPINGTON: Nathan, I wish I could wrap it up by telling you the exact answer to your question. But I really don't know. There are interesting competing theories here. But I do think this is an area where there could be some very relatively simple empirical research to try to find out why this is going on. Just have, perhaps, an anonymous survey, perhaps conducted by the FTC to ask dealers who are not asking for reimbursement why they're not. And if you could guarantee their anonymity, I believe you could get to the answer to your important question.

NATHAN WILSON: Thank you. Now, I'm going to turn from thinking about the state of the world today to thinking about how things might look as we start to move forward in time. Auto manufacturing and distribution, like other sectors in the economy, are becoming increasingly reliant on computers. For cars in particular, how should we think about software updates being handled? Are there any reasons why software updates should not be done over-the-air at manufacturer's discretion?

JAMES APPLETON: Well, I think the guide star for the FTC, for the automakers, I know for the dealers, has to be what's best and most convenient for consumers. If ever significant numbers of over-the-air updates can be made, then they should be made in a manner that is most efficient and most beneficial to the drivers of the vehicle. And I don't think there are any dealers that would object to that approach.

But let's keep in mind that the reason these franchise laws require reimbursement at a retail rate for warranty is because there needs to be investment. And we need to encourage investment in this independent network of franchised new car dealers that sits in the community ready, willing, and able to serve the needs of the consumer. If manufacturers are willing to stand down on what are considered oppressive and over the top facilities demands, as a result of technological changes that may or may not ever take place, then I don't think you'll hear any complaints from the dealer communities about being able to build smaller dealerships, hire fewer people, and engage in less intensive training for their employees. It's about the consumers.

NATHAN WILSON: Thank you.

DANIEL L. GOLDBERG: Well, I agree with part of what Jim said.

JAMES APPLETON: Uh, oh. I must be wrong.

DANIEL L. GOLDBERG: And that is—

JAMES APPLETON: I must have said something wrong.

DANIEL L. GOLDBERG: And that is to the extent that I can get a software update on my vehicle over-the-air, I should be able to get it the same way I get my update on my Apps on my smartphone. It alerts me that I have an update. I push a button, and it's updated. I don't have to bring it to the Apple store. I don't have to pay somebody, some middle man, for it. And I get it. That's the way that over-the-air repairs should happen.

And I think that the FTC needs to be very attentive to this issue. Because in a letter six months ago to certain congressmen, NADA took the position that the security concerns—there aren't security concerns when I get updates here—security concerns means that certain features, attributes, or systems must be limited or delayed, quote "a secure physical point of access to service vehicles is critical." Well, guess what they propose is that physical point of access for my over-the-air update?

So as we look down the road at the ability to do over-the-air repairs, it should be—and this is where Jim and I absolutely agree—it should be what is the most convenient, beneficial, for the consumer. And if the consumer can get it by pushing a button, and not having to drive to a dealership, and not having to absorb either directly or indirectly through the system commissions to the dealer for not doing anything, then we agree. That's how it should happen.

RICHARD SOX: I would just add—I'm aware of that letter as well. And I think you took some of that out of context. I believe NADA's concern, and it would certainly be mine in my own vehicle, is I don't want someone to have access to changing something in my vehicle that could cause harm to the vehicle and cause me harm as the driver. And I think that's the focus, is the safety of the vehicle and making sure that whoever has access to the computers in that vehicle are qualified and responsible. That's all I would add to that.

NATHAN WILSON: Thanks.

DAVID SAPPINGTON: So I think on this issue, we all—there is a substantial amount of agreement. It's got to be the consumer's interest that dictates the answer to this issue. And then also, I do think that it's got to be the joint action of the manufacturers and dealers working together to decide what is best for consumers. And again, I don't think we want the government telling them it has to be done this way, or it can't be done that way. Let the market decide what's the best way to do it, with the goal of consumer interest in mind.

NATHAN WILSON: Thank you. Well, having found an area successfully where folks broadly agreed, let me turn to one where I suspect there may be slightly greater differences. So if we were to follow David's advice and liberalize the system of warranty reimbursements and warranty exclusivity laws, what would be the expected impact, looking perhaps 10 years out, on dealers, on manufacturers, on consumers?

JAMES APPLETON: Well, look, the laws that are in place are designed to encourage investment in an extensive network of dealers that stand ready in the community to carry out the promises that the manufacturers have made, and which consumers have already paid for. What's the logical impact of changing those laws? There'll be less encouragement, and less desire, to make that investment.

And you know, I think when you listen to the panel this morning, and when you listen to this panel, there seems to be some thread running through this that maybe we'd be better off with fewer dealerships? Is this—? I mean, consumers don't see it that way. You know, 17,000 dealers competing across the U.S. for customer business is a better model than 22 manufacturers. Maybe 17,000 isn't the right number, but the marketplace should determine that, with the consumer's best—with the appropriate mechanisms in place to protect the consumer's best interest.

And that's what these warranty laws do, is protect the consumer interest in an extensive network of independent franchisees who stand ready, willing, and able in the community to carry out the promises the manufacturers make, which the consumers have already paid for.

NATHAN WILSON: Thank you. Dan?

DANIEL L. GOLDBERG: Man, I don't know what it would look like in 10 years if these laws were gone with respect to warranty reimbursement. But I think there's a high likelihood it would be different from what it is now. And that difference is going to be driven by the market forces that we've talked about.

In terms of encouraging investments, you know, in every other industry where there's a distribution system and a need by someone down the distribution chain to invest, the marketplace takes care of it. The showrooms for appliances—you can go down all your major consumer goods. And the manufacturers have a strong interest in making sure that there is investment along the distribution chain, because that's how they get their products to consumers.

The thought that the marketplace is somehow incapable and needs state intervention, I think, is born of a bygone era. And I would love it if in 10 years, we were back and had the opportunity to see what those 10 years meant without having these laws, which as I say keep us wedded to a historical distribution and warranty repair system.

NATHAN WILSON: Thank you. Richard?

RICHARD SOX: The premise that this is all based upon a bygone era is false. We all still purchase vehicles. It's the second largest purchase we make in our lives other than our home. It's still something that can kill you and your passengers if it's not repaired properly. That hasn't changed. And that's not going to change.

These costs, again, have to be paid somewhere. And so the answer would be, if you went back to the days of the manufacturer dictating the rates of reimbursement, you would have the cost shift to other customers purchasing products and services from the dealership.

NATHAN WILSON: Thanks. And I guess that means David, you get to sum things up for us.

DAVID SAPPINGTON: I'll do what I can. Again, I think it's extremely difficult to predict exactly what would happen if we took the gloves off and just let the market work for 10 years. But I do think that there is sufficient competition in the industry that the manufacturers and dealers would then have the right incentives to get together and make sure they're doing what is best for consumers.

And I do think that if a manufacturer were foolish enough to try to expropriate the investments that dealers have already made, when the gloves come off, I think that manufacture is going to be punished by the marketplace in the long-term. And that manufacturer won't be able to attract the best dealers in the future, and therefore won't be able to just sell their vehicles to consumers. So I do think the market would discipline manufacturers against this legitimate concern.

And I do think that, although we can't predict what things would look like in 10 years, we can be relatively confident that the arrangements that would come about through market competition will best serve customers.

NATHAN WILSON: Thank you very much. And thank you all very much. I think this has been a very informative, interesting panel. And with that, I would like to release everyone for lunch.

[APPLAUSE]

JAMES FROST: If we could have the panelists down here please for a lunch, and everyone else—

[LUNCH BREAK]

KEYNOTE PRESENTATION

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

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

[APPLAUSE]

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

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

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

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

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

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

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

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

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

You can imagine then, when economists who really have very little familiarity with the law, come upon the case Parker v Brown. To slightly over-simplify, in the case of Parker v

Brown, the state of California allows, or enables, raisin producers in California to basically get together, cut output, and raise the price of raisins throughout the country. The Supreme Court says: “That's OK. A state is allowed to do it under the state-action doctrine.” So economists say: “What's going on? How could that be?”

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[APPLAUSE]

PANEL 3: DIRECT DISTRIBUTION

Panelists:

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

Moderators:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PATRICK ROACH: Joel.

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

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

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

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

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

[LAUGHTER]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PATRICK ROACH: Thank you Maryann. Paul?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PATRICK ROACH: Thank you. Steve?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

DAN CRANE: Sooner or later.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PAUL NORMAN: I'll take that one.

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

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

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

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

PATRICK ROACH: Paul, sorry.

PAUL NORMAN: No, that's OK.

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

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

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

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

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

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

TODD MARON: Want me to take that one?

PATRICK ROACH: Yes.

TODD MARON: Good question.

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

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

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

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

PATRICK ROACH: Joel, are you waving?

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

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

[SHORT BREAK]

PANEL 4: FUTURE TRENDS

Panelists:

- **Avery Ash, Director of Federal Relations, American Automobile Association**
- **Ashwini Chhabra, Head of Policy Development, Uber Technologies**
- **Robbie Diamond, President and CEO, Securing America's Future Energy**
- **Fiona Scott Morton, Professor of Economics, Yale University**
- **Bryant Walker Smith, Assistant Professor, University of South Carolina School of Law**
- **Peter Welch, President, National Automobile Dealers Association**

Moderators:

- **Ellen Connelly, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**
- **Patrick Roach, Attorney Advisor, Office of Policy Planning, Federal Trade Commission**

ELLEN CONNELLY:—everyone. I'm Ellen Connelly, an Attorney Adviser in the Office of Policy Planning here at the FTC. My co-moderator for this panel is Patrick Roach, whom you've already met a number of times, I understand, today.

We want to welcome you to our final panel of the day, which is entitled Future Trends. On this panel, we will explore recent developments in the automobile industry, such as connected cars, autonomous vehicles, and ride-sharing. How will these technologies affect the car ownership experience?

Will they require adjustments to the existing regulatory structure that governs automobile distribution? What lessons for future regulation of new auto technologies may be drawn from our experience with the current system? We have a very impressive line-up of panelists here to discuss these and other issues relating to future trends in mobility. I'll just give some brief introductions, because in your handouts, you have complete bios for all of the panelists.

First, all the way on the end there, we have Avery Ash. Avery is Director of Federal Relations for the American Automobile Association, and is responsible for strategy development regarding connected cars and electric vehicles, among other things.

He and others at AAA have spent a great deal of time thinking about the trends we will discuss on this panel, and how they are likely to affect car ownership and auto consumers. Next, we have Ashwini Chhabra. He is with us from Uber Technologies. Ashwini serves as Head of Policy Development at Uber and has on the ground experience with these new technologies, as well as with their regulation.

We have Robbie Diamond, who is Founder and President of Securing America's Future Energy. And he is also President and CEO of the Electrification Coalition. In these roles, Robbie has developed extensive experience in mobility issues and in alternative vehicles.

Over here, we have Professor Fiona Scott Morton, who's joining us from Yale University. Fiona is an economist, and she has worked on many of the issues discussed earlier today. She'll be able to help us think about the new technologies in the context of the current franchise system.

Then, we have Professor Bryant Walker Smith. And Bryant is one of the world's foremost experts in the law of autonomous vehicles. And finally, last but definitely not least, we have Peter Welch, who's president of the National Automobile Dealers Association. And Peter brings a very extensive perspective of the automobile dealers to these issues.

I'd like to just go over a few procedural things before we get started. We're going to run this panel as a structured question and answer session, so it'll be a little bit different than the other panels. We'll direct each question to a particular panelist to start us off, and then we'll be taking responses from the other panelists.

Panelists, if you would like to respond to a particular question, please just turn your name tag on its side, sort of like that. Or if I don't notice that, just sort of flag me down. We may limit discussion around certain questions just to make sure that we're able to move through all of the topics.

And finally, we will be taking questions from the audience. If any of you do have a question that you'd like to submit, please just flag down—we have some friendly conference staff around with some comment cards, and they'll collect the comment cards and bring them to us.

PATRICK ROACH: To me.

ELLEN CONNELLY: To Pat, more specifically.

So without any further ado, I'd like to just start us off by asking Robbie if he could give us some background on the new technologies. Take us through the key levels of vehicle automation. What technologies are on the road now? What will be the next wave? In two or three minutes.

ROBBIE DIAMOND: So this was a very exciting panel, because it was the most like a take-home exam I had with questions. And we only get to respond to people's comments if they mention us in a name [INAUDIBLE] response. So thank you for inviting me here.

So I run Securing America's Future Energy. And we're concerned about the economic and national security of the United States, based on its oil dependence. And so, when I look at the automobiles, I think back to 1886, when Benz put out the first vehicle. And I'd say that if you dug up a car today to the car that Benz had initially put out, the DNA of that car would be the same in many respects.

But over the 140 years, there's been this ecosystem that has evolved around it. And I think the next 10 to 15 years will see most likely the most revolutionary change in that, and then to society. And when you think about 1886, when that first car came out, to 1903, where it took 65 days to drive across country, to 1916, when you could do it in five days, to 1948, when you had your first drive-through for cars, and gas stations started appearing, and then the '50s, when we had our highway system, and all society has gone around that.

And then in 2008, you have your first electric vehicles after the EV1 experiment, but real electric vehicles come on the marketplace. And then just fast forward to 2010, when Google puts its first autonomous vehicles on the road. And in the last three years, you have over a million miles driven on those vehicles. You have Tesla that's got a valuation of over $25 billion. You have Uber, whose valuation is—well, every day, it goes up at the moment.

You'll have to tell us in the beginning. And just because of this rapid change. It was amazing that two weeks ago, I spent my time at the Consumer Electronics Show. And while I was there, Daimler says that they have over 200 engineers that come in from Germany just to go to that show. And that just shows you the rapid changes that are going on.

And when we think about this use of the vehicles, we now have 250 million vehicles on the road in the United States. We're using over 19 million barrels of oil a day. And that has caused both economic harm, environmental issues, as well as national security.

And so this total dependence on oil is incredibly deep seated in our society. Now it's funny that I say this on a day when oil is only priced at $28. Gasoline is now under $1 in many states. And SUV sales are at an all-time high, because the population forgot about 2007, when the price went to $147.

But at the same time, I do think that the accelerated trends are here. And you see that with autonomous vehicles. And for the first time, as I said, Benz, when it put out its car in 1886, the car essentially does the same thing, and it's built in many ways the same. It gets you from point A to point B.

And most people don't care if they fill that up on gasoline, diesel, biofuel, natural gas, electricity, fuel cell. They just don't care. That is, I think, what we've discovered, for the most part. I mean, there's a few who do. And really, autonomous vehicles, for me and why this trend will accelerate, are offering the consumers a value proposition that's very different. It's offering them a value proposition of time and especially safety.

And that will drive it. It's like your smartphone. Everyone has a smartphone. You don't really buy it for the phone. You never go into the store and say, give me the best phone you got. No, you say, what's the operating system? What apps can I get? And that's really what the vehicle is likely to become, which can accelerate these trends.

And I think one of the other trends I would bring up is watching this ride-sharing. And when I started say, 12 years ago, it was really a question of fuel economy standards, and how do you reduce your oil dependence, and it's a mile a gallon a year, and it takes 15 years to turn over your fleet.

Then comes along car-sharing companies that really completely changed people's habits quicker than I think anyone would have ever suspected. So in my mind, those three trends are coming together, which is a trend of ownership and value proposition, a trend of electrification of transportation, as cars become more electrified internally, and then ultimately, potentially a change in its entire system, not just hybridization. And then finally, this ride-sharing question. And that's all accelerated by this autonomous future.

ELLEN CONNELLY: Thank you. Ashwini, is there anything you'd like to add from the ride sharing perspective?

ASHWINI CHHABRA: Sure. Yeah, no. I think a lot of these trends that Robbie is describing are ones that we've seen and have applauded over the last few years since Uber's been in existence, and the trends that had been going on even before we came along were, there was sort of a reduced dependence on direct car ownership.

You notice trends over the last 20 years in reductions in people getting driver's licenses. A lot of that is tied up in the livability of cities, and the fact that more people are living in cities. They're more walkable. Transit options have improved in some places. The licensure requirements have become stricter for younger drivers. So there's a lot of criteria, and a lot of elements to some of those trends.

And I think we play some part in that. Ride-sharing generally—mobility services that you'll find in cities do generally. And so, the two things that I take away are you're going to see different patterns in urban and non-urban areas. And you're going to see a variety of factors. Some of it's going to be behavioral changes, and this sort of reliance on the automobile I don't think is going away. I think perhaps it's lessening. I think people are, especially millennials, are not focused on what car they own so much as if they can get from A to B. But I don't think that's a, by any means, a sort of a monolithic change. I don't think it's across the board.

So I think what you're going to see is trends continuing to the extent that cities can take advantage of this to improve transit, and sort of tap into these movements. That's going to be to the benefit of those cities. And so ride-sharing and the development of new technologies and vehicles can help accelerate that. But I do think it's important to look at this in the context of the last few decades.

ELLEN CONNELLY: Thank you. We've had some pretty interesting recent announcements coming out of the CES a couple of weeks ago. Lyft's partnership with GM. Google and Ford announced a partnership. And I also read a report that Ford announced it was planning to triple the size of its driverless fleets.

I'd like to talk a little bit about and get some perspectives on the trajectory for the more widespread adoption of these technologies. How do you see the trajectory towards commercialization happening? What is the timeline that we're talking about? Bryant, maybe you could start us off there?

BRYANT WALKER SMITH: Sure. I'd be happy to. And I appreciate your questions, because it's essential to start a discussion of the legal and policy issues surrounding these technologies with a clear understanding of the technologies themselves. And I'm not going to do that. Sorry.

But what I will say—and I speak as both a lawyer and as an engineer—is that the assertion that the technology is "ready" is incorrect. It's been incorrect for several years. It will continue to be incorrect as it relates to the vision of the fully self-driving vehicle that is capable of going anywhere and doing anything a human can while that human is asleep in the back or asleep at home.

So the question that you posit is, even as a technical matter, before we get to the commercial matter, how do we move toward that vision? And there are two leading approaches, both of which represent incrementalism. The first is what I would call something everywhere. It's the traditional notion of a car that can automate the easy stuff, or can assist the driver with the expectation there is still a human driver reasonably well awake in order to intervene as necessary.

These are the kinds of systems that automakers have announced, that companies like Tesla, and Daimler, and Nissan offer on vehicles today, and that will get better and better in the intervening years. Now, this mushy middle of automation, where the human does some things, and the computer does other things, raises all sorts of difficult questions that are lumped into the category of human factors.

That's a nice way of saying that humans aren't perfect. Actually, we're kind of lazy and kind of stupid sometimes. So other companies, most prominently Google, but not limited to Google, have said, well, what if we could just jump over this whole human problem and go straight to the truly driverless car? The kind of the vehicle that has no technically, if legally identifiable driver.

Now the challenge there is that the technologies have not yet reached the point where they can maneuver all the ridiculously complicated situations we have over the 3 trillion vehicle miles traveled every year in the United States. And that's before you add in the snow.

And so this is an everything somewhere approach. Yes, it's truly driverless, but the conditions are quite limited under which these systems initially operate. They might be slow. They might operate in very simplified environments. Perhaps some roads in some communities. And as the systems get better, they expand, and they expand.

Both of these approaches might eventually lead us to the vision of truly, fully driverless everywhere vehicles. But let's paint an intermediate vision that does touch on some of the marketing, commercial, and other implications of these technologies.

We're in DC now. Imagine that I were to invite you to my city of Columbia, South Carolina. Please, come on down. You might fly, or you might get into a vehicle, perhaps one that you still own, drive it in some sort of manual mode, perhaps with some safety system assistance, to a freeway, get on the freeway, lean on back, and let the vehicle drive you more or less uninterrupted down to Columbia, South Carolina.

That means you do not get on a plane. That means you do not stay at a hotel. Once you are in Colombia, you realize that you have forgotten your toothbrush. Well, what do you do? You have particular demands in toothbrushes. You might walk or bike down to the neighborhood store, in which case these technologies may keep you safer.

You may call up what would be the Uber of the future, and have a driverless vehicle pick you up and take you to the store. Perhaps you'll share that with other people, and it will be much cheaper as a result. You're frankly unlikely to take the bus as we traditionally understand that mode. A lot could change.

But those aren't the only options. You may call down to the store and have that toothbrush or other piece of equipment sent by a little robotic shuttle that travels along the sidewalk at low speeds. You may have that product delivered by aerial drone. Or you may simply ask the hotel to print it off on their 3D printer in the lobby.

All of these represent a much broader vision of the future. And it's important as we discuss these technologies that we not limit it to the particular notion of the car that we've had for 100 years.

ELLEN CONNELLY: Thank you. I know, Peter, you and I have had some conversations about this in the course of preparing for the workshop. I wondered if you had any comments about how you see the trajectory for commercialization, and more widespread adoption of some of these technologies? In a couple of minutes or less.

PETER WELCH: Well, I'd have to agree with Bryant. What we've seen for the last 100 years is incremental change, continuous improvement, whether it's safety, whether it's maneuverability, whether it's performance, whether it's utility. And certainly, fuel economy. And propulsion systems have changed. They will continue to change.

I think that it is absolutely correct. We will see this incremental incorporation of these new technologies, as we have seen for the last 10 or 15 years. The vehicles have already dramatically changed. And we will get to the point—you know, the holy grail is the level four autonomy.

Quite frankly, for most of the materials that I've read and seen in the various interfaces I’ve had, seem to indicate that the primary safety benefits really sort of interject themselves at level three, where there's very little distraction, there is the majority of the functionality of the vehicle is done robotically, for lack of a better description. But yet there is a driver there ready to take the helm.

And of course, there's a myriad of other research, which I'm sure we could get into—liability issues and others that could shape and, in effect, act as hindrances to the introductions of some of these technologies as well.

ELLEN CONNELLY: Thank you. Do we have any other comments on this topic? Avery?

AVERY ASH: Yeah. I think that there's been some really good points that Robbie and others have laid out here about the tremendous potential for the technology that we're discussing here, whether that's autonomous vehicles, whether that's connected vehicles, whether that's ride-sharing, car-sharing opportunities. They really offer both an experientially changed motoring experience and a mobility experience.

I think the real key, though, is in all this discussion should be following is, how do you realize those benefits? How does a motorist and a AAA member actively realize the benefits of these changes in technology? And what that really comes down to is ensuring that the right questions are being asked, and that consumer acceptance ultimately takes place. And that consumer acceptance really comes down to consumer education, ensuring the consumers are educated about how these technologies work, and how to effectively use them.

That there is trust the technologies will work correctly, that they have control over them, and that consumer protections are in place to make sure that whether it's increased data being generated by a vehicle, or liability with an autonomous vehicle, that all of these questions are addressed in the process. And I think all of those up and down this panel today and from those earlier have a role to play in both that education and that acceptance.

ELLEN CONNELLY: Robbie, did you have something to add?

ROBBIE DIAMOND: No, I just wanted to say that—I don't work for Google, and I'm not necessarily taking their position. I think it's interesting to note that Google, who has the real experience on the road—I mean, at the end the day, they're the ones who've driven the most autonomous miles, and they'll tell you how difficult it is.

But they originally started with the driver and the steering wheel, and came to the conclusion that they had to leapfrog that. That, in fact, it was a driver and the steering wheel that were the problem, and that it's a very difficult for a driver, for a human, to get, as you heard before, situational awareness when they're lazy. I think we were described as lazy. And well, I'm lazy, so.

And I think that that's very telling. And that gets to liability issues and everything else. And so the simplicity of that. And lately, you've heard Ford say the same thing. And that doesn't mean there won't be incremental approaches. And yes, more safety features are going to be added to cars and more autonomy.

But I think ultimately, I think that that human, that situational awareness question, is so powerful—do we get there? The other thing about the power of full autonomy are all the people who will be able to take part in mobility that have never taken part. And that's from disabled people—50 million people in the United States are disabled. You have 2 million of those people never leave their homes. Over 500,000 of those people, it's because they have no access to mobility.

And so, I think there's a whole group of people—elderly people as our age population, and you have to take away the keys from your parents. We've all probably experienced that. And then, it is going to happen to us. So I think there are these trends that are going on that will help push this full autonomy future forward, as well as the technological revolution as things get cheaper and everything else.

ELLEN CONNELLY: Thank you. So we spent a lot of time earlier today talking about how people buy cars in this country. And I'd like to try to make some linkages between this panel and those discussions by talking a bit about how a move towards autonomous vehicles and more expansive use of ride-sharing technologies might affect the car buying and ownership experience in the United States.

There have been some predictions. For instance, the University of Michigan's Transportation Research Institute has suggested that in the U.S. alone, adoption of autonomous vehicle technology would lead to a 43% decline in vehicle ownership, going from 2.1 cars per household to 1.2.

Some others have suggested—actually, very recently, an executive from a company called Faraday Future, which is an electric car start-up company, that people might move away from ownership altogether, and instead rely on a subscription-based model.

So I'd like to get the panelists' views, maybe starting with Avery and then moving to Peter, on how more widespread adoption of these technologies would affect car buying and car ownership in the U.S.

AVERY ASH: Sure. I think that's a great question. I think that it might be first important to look at, we're already seeing a tremendous evolution in the technology that's being rolled out in new vehicles today. And what that really further underscores is the need for consumer education, more effective consumer education.

As there's more technology, this education process is going to take longer, and people frankly aren't going to want to sit in a half day seminar to figure out how to use their car. So how are you more effectively able to deliver the information necessary to make sure that people are using their vehicles, understand their vehicles, and are using them effectively?

A lot of these safety technologies are only effective if they're used correctly. But it's not just about new technologies. It's about now there's an increased spectrum of technologies as well. So if I have three vehicles in my driveway, and one of them was manufactured five years ago, one I'm purchasing today, one I purchase five years from now, they are going to have radically different technologies included in them.

When I get into a vehicle in the morning, and I get into an incident where I am forced to confer quickly, do I know whether or not I have active or passive lane assist in this car? How do you as a driver understand the vehicle that you're driving, understand the benefits of the car, but also understand the limitations as well.

And I think that sort of consumer education is really incumbent on all parties in this process, and it's really going to take a rethinking of some of the processes that is currently goes through. And I'm sure that we can certainly—you look through the dealer process today, at the education that takes place at the dealership, and it's a tremendous process. They do a very good job. There's great training.

But a lot of that challenge will be incumbent on thinking up new and innovative ways to effectively address these changes. We're seeing some interesting new ways of tackling that. We've heard from our clubs in the Northeast that some dealerships are actually leveraging high school students, very tech savvy high school students, to come and explain these new systems to new vehicle buyers.

We're certainly not saying that's maybe the approach moving forward, but that's sort of the out of the box thinking to allow people to understand the technology that comes with the car that they buy is going to be paramount to ensuring the trust and success of these technologies.

ELLEN CONNELLY: Thank you. Peter?

PETER WELCH: Well, the question of acceptability and the marketability of these vehicles, I think we'll probably all agree on the panel that autonomy is coming. The question is whether it's full autonomy, and what the timeline is. And technology will take control of that.

From a marketing perspective, I think it's actually a pretty big leap to go from autonomy to all of a sudden people are going to abandon personal ownership of vehicles. Right now, our fleet market, the way we look at markets, dealers are merchants. They stock, sell, and service what consumers want. They can't afford to inventory vehicles that there's no demand for.

Consumers are very smart when they make those decisions. I've heard earlier the average price of a car is rapidly approaching $34,000. They take a lot of time and energy and research to make that purchase decision, which they're going to making payments on typically for a couple years.

So they're really smart when they do that. So right now, the fleet side of our business is about 27%. And of course, we sell cars to the rental car companies, and the van pool companies, and taxi companies, and everybody else.

So roughly 70%, 73% today are vehicles that we sell to personal owners. There is a little variance there. We're selling cars to all of the Uber drivers over here, and those probably don't count his fleet sales in the traditional sense. So we will have to start looking at these differently.

But we have a very rich sense of freedom of independence and mobility in this country, much of which goes around the automobile. And I guess if I had to bet money, and I have talked to our business partners, the auto manufacturers, is that the predominant trend is still going to be, even if these vehicles are 100% autonomous, that individuals are going to want to own them and use them, which is an interesting intersection between the ride-share community.

So I see most of the ride-share activity going in that 70%. Now might that shift from 70% to 35% and whatnot? For instance, the American Truck Dealers Association, which is a sub-unit of the National Auto Dealers Association, about 98% of their customers are fleet customers. And in fact, that will probably be the most efficient use of automation, will probably occur in the heavy duty commercial truck segment.

These are your trip down to South Carolina. These are organized, regular routes, where you have issues with how many hours drivers can drive, et cetera, et cetera. So it will be a very dynamic situation, but it will evolve, and I think the tools are already in place.

And I agree with the panelists, the other panelists, on consumer acceptability on this. And some of it will be generational. A lot of it will, quite frankly, depend on the reliability of it, and quite frankly, affordability of these machines. Is it going to be too expensive for private ownership of an autonomous vehicle? Or are we going to see Google or Apple be the Henry Ford, so to speak, of the autonomous vehicle industry by producing very cost-effective vehicles that are, in fact, going to empower a larger segment of the population. We might actually see vehicle sales go up if we can get all of the disabled people, blind people, elderly people, et cetera, into the marketplace.

ELLEN CONNELLY: Thank you. Fiona?

FIONA SCOTT MORTON: Yeah. I just wanted to expand on that last point. I think if you consider an autonomous vehicle as a higher quality vehicle, it can be driven by you, but it can be driven without you, and so you can expand the market to teenagers and disabled people, and whoever, that suggests that you would sell more cars.

If, on the other hand, these objects are expensive and the technology evolves so that we can share cars more easily, then we need fewer cars. So I think it's not clear how many more cars you would sell at the end of the day. What's definitely clear is that more miles will be driven by these things, and that we can spend today—we will spend today—talking about cars. But there's certainly other issues I think that we need to be considering, such as zoning.

I'm going to be very happy to live a three hour drive from my job in the city if I get in the car in my PJs and sleep for two of those hours, and then open up the portable restroom, or whatever. So then, we'll have exurbs and cutting down forests, and so on, which might be counterproductive to the electric vehicle. It's all very complicated.

ELLEN CONNELLY: Bryant?

BRYANT WALKER SMITH: Just two notes on this discussion. The first is that we often talk about new technologies as the domain of the wealthy. In some ways, we may see poverty as a driver of automation, to the extent that a network organizer can identify pockets of demand that are ill-served and by combining trips can compete favorably with traditional suburban bus service, both in time, money, and perhaps even in environmental performance.

The second is when we're talking about the impact on vehicle sales and other models, it's important not to confuse vehicle miles traveled with vehicles sold or vehicles owned. It is entirely possible that fewer people will own vehicles, but each vehicle that is sold may be driven more miles each year as it enters service into a fleet, or into the automated version of Uber or other models, such that those vehicles are actually renewed and replaced much quicker than the average vehicle in the United States, which is about 11 years old.

So we may see a very long tail, particularly of individually-owned vehicles, even as we see much more dramatic changes in the vehicles that we actually use and the vehicle miles that we actually travel.

ELLEN CONNELLY: Thank you. Ashwini?

ASHWINI CHHABRA: Bryant and I were talking before the panel began, and we were sort of discussing this question of what actually happens to vehicle miles traveled? Do you see people driving around a lot more, living in the exurbs, or sending a car to pick up a toothbrush? Or do you see people sharing these cars more because once you no longer conceive of it as an asset that you own and only you would use, but you view it as a means for getting to from A to B, then sharing that backseat with someone becomes more palatable?

And really, I don't know that there's one clear answer there. I think you're going to see some of both. Some of the data that we've got from operating Uber Pool, which is our carpooling product in the dozen or so markets that we've launched in now—so we launched in

San Francisco in September 2014. So that was our first market. And currently, half of our trips there are Uber Pool trips.

That's in line with what our projections were, and obviously, it sort of trended up over time, and part of that is driven by there's a cost savings. It's a lot cheaper to get around if you'll share that ride, so long as that ride doesn't really inconvenience you, you don't have to go more than 10% out of your way to pick up another passenger.

So L.A., which is car central, a third of our trips there are Pool trips. So I think you will see this, again, in cities. You will see it in some instances. And other people will choose, it's my car. I have a friend—I live in New York. I have a friend, and I'm bewildered by the fact that he has a car, until he points out that he has three kids, and he's got his three car seats, and there's no Uber product that's going to be able to address that.

And so there's always going to be different fact patterns. Which I think you'll see a little bit of both. But what's interesting, what's curious for me, is what does that mean for vehicle miles traveled? If it is disabled passengers? If it is people sending their kids to school? If it is the elderly? And we are quickly reaching the point where the Baby Boomer generation is going to be aging out of comfortably driving themselves in many instances—then those are new vehicle miles traveled.

I would argue those are virtuous vehicle miles traveled, and it's not—and it's sort of important for us to think about, what does the profile of those trips look like? And to the extent that that's something we're concerned about, what are the policies we can put in place to address that?

ELLEN CONNELLY: Robbie?

ROBBIE DIAMOND: I agree with basically everything that's been said. I continue to come back to say a few facts. But one previous point that I made, which is the consumer proposition, and the money that is both to be made by businesses, but then also to consumers themselves, both to save money and to offer a value proposition.

And what's really exciting about this trend potentially is that it's going to be driven by consumers. And in fact, it might be just for government to get out the way, certainly initially. And I think that Secretary Fox's announcement last week, in comparison and in contrast, to what the California DMV did—or if you don't know, the California DMV said that you can't have an autonomous vehicle unless you have a licensed driver in the vehicle, which then negates the whole concept of potentially offering this to elderly, and to disabled, and everything else. Whereas I would interpret Secretary Fox as sort of like, wait, let's watch this a little bit. And you see that in the British government and other governments. And I think that that's a really interesting, because this could be pulled instead of pushed. Our government pushes fuel economy, and our government pushes electrification. And we push all these things. But this could be a pull.

So two facts I just say is our cars sit 95% to 96% of the time. It's just second biggest asset we all buy, and yet it sits in the most valuable parking spots in the world, real estate in the world. And I think that is really telling, and if we can open up that economic value, which in many cases, is somewhat what Uber has done for these drivers who have these cars, and then allowing them to use it more frequently to make money, I think that's really telling.

It costs about $1.60 to operate a current car per mile. We take insurance, and maintenance, and everything else. And some people say electric miles in a shared environment to be $0.15, to $0.20 to $0.25. And I then give you one other statistic, which is public transportation.

So in a city like Washington, which is dense, or New York, the authorities or the government subsidizes about $1 per trip above the fair that you pay. And in a city like Richmond, which is less dense, it's about $7 per trip. And when you look at disabled public transit, it's about $35 per trip.

So here you have, if this is really $0.25, an electric vehicle that doesn't have the maintenance, doesn't have the fuel requirements, because electricity is so cheap, you now could have the government actually providing free miles to people and still making money at the end.

So I really think that the economics here are just so vastly different than anything we've ever thought. Just as we talked about different vehicles, and not even think of them necessarily as cars, and that's just really interesting here.

ELLEN CONNELLY: Thank you. Oh, sorry. Peter?

PETER WELCH: Just a quick comment to that. I spent most of my professional career, in fact, in California. And I rarely thought that I'd be here defending the California DMV. But there were 2,900 disengagements over a 14 month period, and I actually think that the California DMV has been acting responsibly.

And I also know that they will be very quick to change the regulations when the technology catches up. And their number one job is to protect their citizenry for safety with respect to it. Other observation I'll make. I do read widely about the fact that most vehicles to sit idle for 80% or 90% of their useful life.

But the challenge before us is, in fact, that it's a highly bimodal distribution. So 80% of the time that they are an operation is typically between 6:00 and 9:00 AM in the morning, and 4:00 and 7:00, when the demand is there. With respect to the cost, we will have to gage that, as I mentioned before, particularly consumer acceptability with respect to these products.

We've never had more transportation options now. I will observe, though, that yes, I think everybody in this room uses Uber, including myself. But it's probably about $2 a mile, and I'm willing to pay for it for the convenience. It's a great model. But the cost going down with ride-sharing, and the effects of that may have, quite frankly, on mass transportation transit systems and others is another policy issue that I think we have to examine very carefully.

ELLEN CONNELLY: Any other comments on this? I'd like to think for a moment about a world where autonomous vehicles have been adopted by consumers, and consumers really love them, and have really adopted ride-sharing as well, and think for a minute about how that would affect the regulatory system that currently governs auto distribution, some of the topics that we've discussed earlier today.

Some of the things that I've been thinking about, just to sort of start us off—Peter, you I think mentioned this earlier, is this concept of fleet sales. Well, suppose that, as a result of the more widespread adoption of ride share and autonomous vehicle technology, auto sales move less to individual consumers and more to large, sophisticated corporate or government fleet purchasers? If one of the rationales for the current distribution system, which as I think we heard earlier today many times, is the need to sort of protect consumers and provide service to the individual consumer, who may not be fully sophisticated about their automobile, would this type of shift really undermine or change that rationale?

Another thing I've been thinking about is, suppose that we have a number of new entrants that consumers really love. I'm thinking of things like people are really loyal to their Apple products. Suppose there are new entrants of that caliber who do not want to use the franchise system? What type of pressure might that put on the direct distribution laws that are currently in effect?

Similarly, and I think we've heard about this in the warranty panel, there's more and more ability to deliver over-the-air repairs. Once consumers start to realize that this is possible, and is much more convenient potentially than having to go to dealers, will that put pressure on the dealer system and some of the regulations that are governing it?

I'd like to start off with Fiona, and then maybe move to Peter and some of the others.

FIONA SCOTT MORTON: Sure. So I'll just repeat, Ellen, your suggestions and a couple of others. I would say this morning what we discussed is that the laws surrounding auto distribution in the United States are largely frozen and prohibit innovation. We talked this morning about the population moving from the cities to the suburbs between say, the 40s and the 80s, and how the US manufacturers were put at a disadvantage compared to imports who could make a distribution network that matched the new population. And higher costs were thereby borne by manufacturers who had the old network.

So that's one shift. Bigger shifts have now happened in the way that we buy everything, primarily due to the internet. And the inability of auto retailing to change, I think, is becoming more and more obvious to an ordinary consumer. I think the additional cost built into the U.S. labels in 1980 was not obvious.

But I think if you buy something on Amazon, it's sort of obvious that you can't get a car that way. And I wanted to make a parallel. Let's imagine the state legislature said we are very concerned about the local family-owned video store. It's important to local communities to have a video store. And to help these communities, we're going to pass a law outlawing Internet Movie downloads and requiring consumers to visit a video shop and rent a video if they want to watch a movie.

OK. So we could have had our state legislature do that 10 years ago, and we could all be driving to the video store to pick out a tape and bring it home and watch a movie. Instead, we have streaming videos from Netflix and a whole range of other sources over the internet.

So I think this is the kind of parallel that we're facing now, and that the consumer is going to be less willing to go along with franchised auto dealers capturing their state legislature and prohibiting innovation, because they can see the value of that innovation more clearly.

So what would those innovations be? Remote updates of software are an obvious one that Ellen pointed out. This is very handy for the consumer. Saves them lots of time and schedule hassle. And it omits the need for a physical presence in their local area. Efficient manufacturing, just in time manufacturing. So this is the Dell model as it used to be called. I produced to demand and not to inventory. I make cars that people want. In fact, I make cars that people have already paid a deposit on. So I don't even incur the cost for the parts until I have cash in hand. That saves carrying costs for both the manufacturer for parts and the dealer for inventory. Moreover, you're never marking down a car, because every car is already bought. So that, the estimates on the savings of that changing a system from producing to inventory to producing to demand are quite large. So then, you don't need a local dealer to hold inventory for you.

You do need to test drive, look at the features of the car, physically touch the car perhaps. There are many interesting ways to organize that. It's not clear that the franchise model would be the one. It might be a company-owned store. It might be something else. I don't know. But we could experiment there.

Shared cars would be likely owned by a corporation. Such a corporation would buy in bulk, and would not be confined to probably a single city, but would want to deal directly with the manufacturer, and perhaps customize that car. We see today Uber has individually owned cars, but you can also easily see how Uber might service a very efficient group purchasing mechanism, and would have also specifications and quality issues that they would care about in the cars that their people are buying.

Again, the local dealer would have less of value-added in that world. Self-driving cars. OK. Self-driving cars will be a business with significant economies of scale, due to the way software works. Software has a large fixed cost to create and zero marginal cost to deploy. So if I have very good software for my autonomous cars, that's going to cause me to want to have scale in order to deploy that software in lots of cars.

That firm is likely to want to choose the car that it puts its software in, and perhaps work with the manufacturer to customize the car in particular ways. For example, how are we setting up the driver's seat? Is there a driver's seat? Where are the sensors on this car? How do they deliver information? What's the power of the computer built into the car?

Are we going to have bunk beds that fold down from the floor, fold down from the roof, like in a train? Lyft and GM would be an example of this kind of partnership. So here again, it doesn't seem like the local dealer is going to play an important role. In that environment, the demand and the choice and the pricing and so on would be negotiated between two large parties, a buyer and a manufacturer.

And then we have some remaining activities. And as David Sappington and Dennis Carlton have said, the market is good at figuring out how to organize a firm when consumers are choosing among different options, and firms have the flexibility and ability to change the way they organize themselves to meet those needs. So that was my shortlist.

ELLEN CONNELLY: Thank you, Peter?

PETER WELCH: Hey, Fiona, you found a clever way to make an opening statement. To answer your question, to tie this up with some of the earlier panels, quite frankly, I think most Americans and maybe people in this room take for granted what an incredible private and personal transportation system we have here in the United States, which makes us very different than many other people, and many people in other parts of the world envy us.

Last year, our dealer members sold 32 million cars. If you include new cars and used cars, we performed 285 million repair orders, 59 million of which were warranty or safety repairs. We take it for granted that within about a half an hour drive of any direction here, you can find just about any make and model that's produced by the 32 manufacturers that our dealers represent, and the nine heavy duty truck manufacturers that they represent.

You can find them in probably different trim lines, colors. You can find a factory trained technician to fix those vehicles. And you can find a ready supply of inventory of parts and vehicles. It's an amazing system, and it's all private enterprise, private capital, that runs it. It really sets us aside from any other ecosystem, transportation system, and it is the backbone of America's transportation system.

It's been honed for 100 years. Yes, it's a living body. It improves. It changes. I wasn't around when they switched from the manual crank to the automatic starting systems, but that was a revolutionary system when we looked at it through the evolution as we go through.

I can tell you one thing. These vehicles continue to get more sophisticated, and with sophistication, many problems arise. Cyber security is the number one issue. We're going to have autonomous vehicles. They better not be able to be hacked.

We need to have secure processes to lock down those systems to make sure that they function. If the useful life is 11 years, the warranties are probably going to have to be longer in autonomous vehicles, because who's going to be responsible if one of the sensors go haywire, and God forbid, someone is injured with respect to him?

Somebody mentioned over-the-air, that's a big issue. Absolutely over the air is coming. Americans, as we talked earlier, we want to be able to download this stuff. But you just can't download fixes for every car. OK? We can't fix the GM ignition switch issue with a download.

We can't retrofit Volkswagens with cheater devices on them to fix them to make them come within the parameters of our emission laws. We can't replace Takata airbags with over-the-air transmissions. There are fundamental differences.

Can we upgrade navigation systems? Absolutely. Can we change gear ratios and other systems? Absolutely. And our customers will absolutely demand that we do that. I think the primary area when we look at marketing into the future is, what's the face of our customer going to be? I mentioned before, 70% of it are individuals.

They've got individual budgets. If we move to ride-sharing and others, who's going to own these vehicles? We talked a lot about ride-sharing, but we don't talk about who's going to own the vehicle that's going to be shared. All right. There's a myriad of issues that go with that. So you got five people that want to share a car. How's it going to get title? How's it going to get financed?

You're going to create an LLC? Who's going to be liable if one of the partners that owns the vehicle gets into an accident? These are all issues that we need to collectively work through together to make sure that our market remains vibrant. And we also have to be respectful, as I mentioned before, of the great independence that Americans put in to freedom of mobility.

ELLEN CONNELLY: Fiona?

FIONA SCOTT MORTON: Yeah, I think the complexity of this issue is really real. Peter has identified a lot of good points. And I think that what economists would say about that complexity is that there is no need for the state to legislate that the franchise dealer is going to solve all of it. I think that's really what's a better solution is for different kinds of parties to experiment and see whether they're good at it, see whether they have economies of scale.

For instance, a franchise dealer that works in my town of New Haven, Connecticut might not be the right party to think about insuring a million vehicles that are shared up and down the East Coast. So that's the kind of thing that we need to, I think, be very innovative and creative about.

There was a lot of talk this morning about investment and auto distribution, and how consumers want this large and very expensive dealer network. We heard a lot about all the money that dealers invest in their show rooms and equipment. And one of things that puzzles me is, how do we know this? How do the people who say customers want this large and expensive dealer network, how do they know that?

Because of course, the costs of that network are built into the cars, at the end of the day, that the consumer is buying. The network has to be paid for. So if a consumer had to drive 10 minutes further to a dealership every time she went there, but her car cost $3,000 less, and her repairs cost 40% less, would she prefer that trade-off or not? I don't know.

What if the legislature said we want to encourage investment in TV stores? TVs can only be bought in physical stores. And we will require TV manufacturers to increase payments to those stores, because it's important that every consumer has a short trip to the TV store. Would the consumer prefer that, or would they like to be able to buy a TV from Amazon?

OK, we know in the case of TVs, because the market has told us, and consumer behavior has told us. I don't think I know of any study that's told us that consumers want to see auto distribution organized the way it is.

PETER WELCH: If could just briefly respond to a couple of those issues. First of all, I don't know if you really appreciate how consumers buy cars these days. OK? Our dealers are into electronic commerce like never before, and like no other business with respect to it.

The average consumer—and we do studies on this constantly, our business partner manufacturers do studies on this constantly—the average consumer spends 13.75 hours researching the purchase of a new car. In just 10 short years, the average number of dealerships that a customer visits before they make a purchase, an actual purchase, has gone down from 4.1 dealerships in 2005 to today, it's 1.3.

When the customer shows up at the dealership today, they typically have researched it, they've talk to somebody at the dealership, either through email, through text, or on the old fashioned telephone. They've located through inventory searches the model they want, the trim line they want. They probably have submitted a credit application.

It's probably been approved. They've already negotiated the price, which is as transparent as any business I know. And I know of no one in another business which can go on the internet can find out what a dealer's dead drop cost is on any car. And yes, while they drive, my time practicing along and running the California says there are 54 Ford dealers in the Los Angeles market. They all advertise on the same TV stations. They all advertise, less and less, in the same newspapers.

Yes, people drive two hours to save $200 on a $34,000 car. It's an emotional purchase, and it's one that there's a lot of excitement with respect to it. Competition has never been better. We heard today, which unfortunately—although we both submitted this Phoenix study that was done, which as we know, is the only empirical study that has been performed just a year ago, that looked at some 250,000 actual real-time transactional prices in the Texas area, and found that there was over a $500 difference with smart consumers that had choices between Toyota and Honda dealers to go and exercise their individual economic power to make purchase decisions.

So it's a system that works. Is it a system that can be improved? Absolutely, it can be improved. Everything needs to be improved. But it is still the best system we have in the world. It's the most cost-effective and efficient system, and the auto manufacturers, the large volume auto manufacturers, somehow seemed to be out of disfavor these days in favor of the new entrants, they're pretty darn sophisticated. Even though the discussions we had earlier about the differences of opinion that we have from day to day, they still embrace it as the most cost-effective and efficient system to mass market vehicles to millions of Americans.

ELLEN CONNELLY: I'll give Bryant a few moments, and then see if anybody down here has any thoughts.

BRYANT WALKER SMITH: And the issue here is whether consumers should decide, or a regulator should decide on this. Can I pick on an industry that's not here to defend itself?

ELLEN CONNELLY: Sure.

BRYANT WALKER SMITH: Thank you.

ELLEN CONNELLY: We already covered TV.

BRYANT WALKER SMITH: [LAUGHING] Indeed. So taxi cabs, and the taxi industry broadly construed, an area in which the FTC's been involved with for decades, has been waging a lonely largely unsuccessful struggle against Uber. And there are a lot of critiques that can be made of Uber from a legal, or perhaps an economic perspective.

But when the taxicab industry pushes back against it, it's frankly kind of sad. And the reason why is because many of these ads and promotions start from the perhaps genuinely believed perspective that people actually like taxis. They actually like getting in one. They find them to be safe. They find them to be clean. They find the drivers to be courteous.

That's sad, because I have met no one outside of the taxicab industry who believes that to be true. And so my caution is as we're discussing new models and the serious disruptions they may bring, to bring that dose of reality into the conversation.

Now given that we have an economist down here, and I am not, I am fascinated by what some of the repercussions may be, regardless of whether they may demand a legislative or regulatory response. When we think about the traditional notion of taxis, one of the historical arguments for regulation has been the fear that lack of regulation would result in flooding the streets with all manner of drivers and vehicles, and that as a result, there would be a saturation whereby no individual owner or driver would make enough money for it to be worthwhile. And there would be serious swings, and it just would not be a healthy industry.

Now, I wonder what that means for even a driver-based model, like Uber is currently, going forwards. If Uber has essentially a monopoly position, it can act as that regulator, and it can limit the number of drivers. If Uber and Lyft and others are competing, or if there's not that desire to limit the number of drivers, then you could potentially again have that frustration coming from individual drivers who perhaps make a little, but don't make a lot.

If we move even further into the future, where the driver is out of the equation, and it's no longer a question of consumers and labor, well, then I also wonder what happens in a world where mobility is truly a commodity, where the consumer has an immediate knowledge of what competitor A's price would be, what competitor B’s price would be, and can immediately select based on pennies of a difference. Likewise, a future where the competitors themselves have information about their pricing, and you can subtly or directly signal or match each other's prices. So I ask that as someone who does not understand economics professionally, and fascinated to hear your perspective.

FIONA SCOTT MORTON: I think I'm afraid to tell you it's just going to be competition, like the good old-fashioned American competition. I mean, let's assume you had two or three autonomous car firms in your city, and they competed for consumers on the basis of price.

And as you say, consumers might be very price sensitive, or they might not. It might be that one of those autonomous cars is more of a luxury car. Nice leather seats, nice air conditioning. It's a more pleasant ride, and they charge a little more. Or it might be that another one promises to get to you within two minutes.

And a cheaper one says, we'll get there within six minutes. So you get differentiation in products, just the way we see in many, many markets. And that differentiation allows different business models to be sustained. And ultimately, if there are too many driverless cars and they're not earning money, they will exit. They'll take those cars and bring them to a different city, or slow down production of those cars, so that then the remaining ones will be able to earn a return.

So the good news is we don't have to worry. We don't have to regulate how many autonomous cars we need in the city, because actually, the market will take care of it for us.

BRYAN WALKER SMITH: Even given the ideal, the economic ideal, of perfect consumer information?

FIONA SCOTT MORTON: Well, the consumer does need to know her choices. If there are three firms in the market, and she only knows about one, she can't price compare. So yes, but that's what a marketing department is for, and that's what an App store is for, so that you can have all three apps on your phone, and someone will find a way to compare prices across those three.

So yes, consumers do need information. They don't need perfect information. They need to know, this car promises to arrive in two minutes, and this one promises to arrive in six. And do I care about that? And how much am I willing to pay for that difference?

ELLEN CONNELLY: OK. I want to give this end of the table a chance to respond. Do any of you have any comments on the topics we've just been discussing?

AVERY ASH: Yeah, I mean, I think, not as much on the autonomous and the ride-sharing piece, but I think you touched on over-the-air updates, which I think is a really kind of important segue into the topic of connected cars, which I think have kind of fallen off this discussion, but I think are inherently complimentary to autonomous vehicles. They're certainly separate, but have a lot of the same themes that go along with it, and frankly, from a consumer perspective, are where a lot of the consumer misinformation, need for education, and need for consumer protections are in place. From a AAA perspective, when you're thinking about that connected car, we think it really comes down to three primary principles, two of which have really been on display here today. The first would be transparency, an understanding of what it is the car you purchased can do, what data it's transmitting, who it's transmitting that to.

Second would be security. That's a very key one. And I think the over-the-air update issue is one that really highlights this, the potential of ability to remotely deliver fixes to a complex problem. Cyber security was touched on earlier, and we saw in play just earlier this year, where you have a potential vulnerability for a jeep that was taken advantage of to remotely hack into that vehicle. Those jeeps would need to be brought into the dealership to have those repairs conducted to ensure that they were no longer vulnerable.

You contrast that with same time report on a Tesla vulnerability that, once announced, it was shown to be a known vulnerability, and they were able to announce, though, that Tesla had already delivered over-the-air update to those vehicles. It was able to patch the vulnerability.

I think we're really seeing there the potential for substantial consumer protection, and substantial increases to consumer safety. And really, the benefits ultimately to a consumer of A, right now with recall rates, we don't see people bringing in their vehicles to get fixed at the rate that we, certainly, as a motorist organization or really anybody at this table will be happy with. In a world of over-the-air updates, you can get that recall participation rate much closer to that 100% threshold that really is the ultimate goal.

But then I think the final piece, the final question here too, is just the choice question. That a lot of the potential that we're talking about here for these vehicle technologies are predicated on data being generated by a consumer, at least in the immediate term—the consumer's vehicle.

And then the question becomes, I, as a consumer, what are my rights? And what is my ability to control the direction of the data that my vehicle is currently transmitting, whether that would be to a dealer that I trust who was able to provide me with repair and potential recall information, whether that's back to the manufacturer, so they can make changes to drive cycles, they can make improvements to safety, they can more quickly identify recalls?

Same thing to a government institution like a NHTSA, who might also be able to better identify potential safety issues for those cars. But really also to the third parties of a consumer's choice. We can sit here and prognosticate on where the vehicles are going to be in 10 years, but we really don't know.

I could say with a pretty high degree of certainty, we're not thinking of a lot of the big innovations that are going to come along over the next decade here and now. And a lot of that is a need predicated on setting up a system that prioritizes competition, which will ultimately allow consumers to benefit from these technologies.

ELLEN CONNELLY: Ashwini, or Robbie, do you—

ASHWINI CHHABRA: Yeah. Just something that Fiona had mentioned that brought to mind the issue of equity. And it's come up in a couple of conversations I've been in now. The point that she made about the market solving for the oversaturation, under-saturation.

I think it's a very powerful point, and it implicates something about where these vehicles are available, and who has access to them that we need to explicitly acknowledge at least.

More sophisticated vehicles, whether it's clean technology, or whether it's automation, are more expensive. And as a result, they are more out of reach for lower income consumers, people who can't otherwise afford them, or certainly won't be the first people to benefit from them. And if, as is anticipated, there are safety gains to be had, whether it's from level three or whether it's from level four, people who can't afford cars are potentially going to be even less able to afford these more expensive cars now that the price may come down. And so, that's one way we can solve for that. But how do we proactively think about the safety benefits being realized by people across the board.

So looking at a city, for example, you can see it in a couple ways. There is the concern about, are you going to have too many autonomous vehicles on the road? If you take New York as an example, if you take—because we've operated there now for four years, so we've got—we've got a track record there. If you look at where are most of our growth is, it is outside Manhattan. It is outside the central business district. And obviously, when the business launches, it launches where the demand is going to be the greatest. But as prices come down, because you release new products, so you go from an Uber Black product to an UberX product to Uber Pool product, you put it within the reach of more and more people.

So to the point where a third of our trips to New York today are outside Manhattan, compared to about 10%, 15% from taxis. If you look at Chicago, it's something like six out of every 10 trips begin or end in what the city classifies as underserved areas. In DC, Wards seven and eight have seen 800% year on year growth in terms of the trips we provide.

So the way you control for this is you innovate, and you bring the price down, so that it puts it within the reach of more people. I think inherent in that is some degree of sharing, because that's a level change in terms of cost reduction.

But as we're thinking about the wonders of the new technology, it's just important to keep in mind who's benefiting from the safety gains, and the environmental gains, and so forth.

ELLEN CONNELLY: Robbie, do you have anything to add?

ROBBIE DIAMOND: Yeah, it strikes me that everyone here acknowledges that the world is just totally being turned upside down, and really, no one knows what the future is. So when I think about that world, I want consumers and the American public to begin to make decisions for themselves, and not be forced into a system that already exists across the board.

When you look at Uber and what happened in New York, and how the democratic mayor tried to basically regulate them, who rose up? Consumers. I remember here in DC, it was the same sort of question. The consumers spoke.

So I agree with Fiona, but you need to give consumers that opportunity. When it comes to these safety features, and autonomy, and everything else, I mean, that's really the key here. If they're given the opportunity to see it and touch it, and feel it, and it's not stopped before it gets out there, I think you'll see a very different world.

For me, the biggest danger is that cronyism in disguise of safety will stop all this. And I think that's a real question. The question is, what is safe? So right now, 33,000 Americans die every year in an automobile. 1.2 million people in the world. If we got to an autonomous world where 90% of lives were saved because 94% of accidents are caused by human error, well, that's a world that you'll save 3,300 lives every day that this is accelerated.

That's a world of matters. And the hacking issues and all these things matter, but the gains are so tremendous, that we have to allow for this to have regulators watching it very carefully, but not to get in the way of it initially.

And so the question is not what is safe. Because what we have today is, yes, the vehicles are for the most part safe. But the system itself isn't. 33,000 people, that's on the order of the amount of people who die of certain cancers. And so that is not to impugn an industry at all. That's to say that safer—it's compared to what it is.

And I think that safer matters tremendously, and we just need to make sure that the definitions that people use are not—there are incumbent today that will lose tremendously. There is no doubt the world will be turned upside down. There are people who are not incumbents today that will be incumbents of tomorrow, who will want to stop the system advancing in its tracks.

And to me, it's the question of how do you allow consumers, the public, to have a role, and have a smart regulatory environment that's watching it and dealing with it as it's needed, but not getting in the way of it before we even get started.

ELLEN CONNELLY: Thank you. Just a quick reminder to the audience. We have about 15 more minutes left. So if you do have questions that you'd like to have us consider asking the panelists, please flag down one of our conference staff for a comment card.

I'd like to spend a few moments talking about an issue that I think Robbie has sort of set up nicely here, and that's the issue of adaptability. We also heard a lot about this in the earlier panels. I believe it was Steve McKelvey, in particular, in the last panel who talked about how the current system may be impeding the ability of manufacturers and dealers to adapt as the situation changes.

And it seems, to me at least, that when you are sort of sitting on the cusp of technologies of the type that we're discussing on this panel, adaptability is really important. The saying adapt or die comes to mind. And I've read some things that maybe the current system is not adaptable enough, and maybe the dealer system is not the best, or it's not in the best position to be responsible for the introduction of new technologies, such as electric vehicles and autonomous vehicles.

I'd like to get my panelists' thoughts on that, perhaps starting with Peter, and then moving to Robbie, Fiona, Avery, others.

PETER WELCH: Well, not to repeat myself, but I will. The dealer model is tried and true. And again, dealers are merchants. We derive all of our revenue from consumers. And like any other merchant, we stock, sell, and service. We're quite frankly agnostic as to your proposal.

I think anybody that—notwithstanding the fact that oil is down to $28 a barrel, and it isn't going to stay there, it's a finite commodity. Everybody knows the global warming issues, and so on. Consumer acceptability to these products is key. Education is key. I agree with Avery down there, that a lot of education will be done.

But the fact of the matter is the average person that's buying a car is still struggling in America. It's not the $400,000 a year average or whatever it is the owner of a Tesla or a Ferrari for that matter. It's a working mom with a couple of kids struggling to make monthly payments to qualify for financing, to find affordable mobility, to have a job, to improve their life.

I mean, that is what we see on Main Street day in and day out at our dealerships. And that is the face of consumers. That is the mass market. Those are the 32 million Americans that bought cars new and used last year. So we have to have a robust system that is out there that can cater to all of them.

Certainly, electronic commerce has played wildly into that. I will actually disagree, surprisingly, with some of the earlier panelists. You asked about the numbers. There are about 31,000 franchises in the country. We've got—let's see. I had them actually run the numbers, if I have the data here—18,082 rooftops, and about 16,400 franchise dealers throughout the country.

OK. 39% of those 18,000 dealers sold 300 or fewer new cars a year. These panelists earlier that talked about our biggest member, which is true—the AutoNations of the world and the Penskes are not representative of mainstream. They worked in large metropolitan areas, that is a high concentration of the public. They would do a wonderful job of servicing their customer base.

But it's the single Ford and Chevy dealer or Toyota dealer out in the community, and there are myriads of different communities. They range from agricultural communities, to educational communities. The mix and blend of the inventory that is an agrarian area where they're buying trucks and four wheel vehicles is completely different than a metropolitan Los Angeles dealer that may have a very large fleet.

Our dealers sold all the cars to Avis. They sold all the cars to Zipcar. We're not strangers to shared mobility and ride-sharing. We, in fact, are out there selling the cars. We're doing the warranty work on them, the repair work on them.

And yeah, if we have shared technology, I think Bryant made an excellent comment, vehicles are going to wear out quicker. The useful life, 11.4 years right now is the average age of a vehicle on the road right now. If we have more mileage on it, they're going to wear out more. We're going to sell more probably. Probably going to have more robust service arrangements with fleet owners.

To me, the key to this is who the owner's going to be. We were joking on the prep call about Uber, and the business model is very different, and very limited certainly. They don't own the vehicle. They got independent drivers out there. We're selling the car. We're servicing the vehicles.

In an autonomous world, I don't know that you're going to have an independent contractor that wants to finance an autonomous vehicle and lend it to the Zipcar, or whoever, Lyft, or whoever's going to be out in the future with it.

So that's why we like this business so much. It's very vibrant, and it's huge. It's a trillion dollars a year out of the American economy.

ELLEN CONNELLY: Fiona, and then the others.

FIONA SCOTT MORTON: That's a description of the industry as it is today. But I think the question from Ellen is about flexibility. And I worry about flexibility in such a highly regulated setting. So we're having trouble being flexible enough to think about the manufacturer selling direct through stores.

We're nowhere close to autonomous vehicles, or shared rides, or anything else. I mean, we're stuck on the most basic thing. And I just want to expand on that for 30 seconds, because my name was used in an earlier panel, and I don't want my research, anyone here, to go away with the wrong impression of my research.

OK. So there's a lot of confusion about intra-brand competition versus inter-brand. If the manufacturer sells to the franchise dealer, then both it and consumers want a lot of those dealers. That's true. Because once the car has passed into the ownership of the dealer, and the manufacturer would like a consumer to buy it, then a lower retail margin is good, and it's critical to competition with other brands.

If I'm Nissan, I want to low retail margin to compete with Honda. OK. A single franchise dealer that owns the car has market power in its local area, and it will set a stiff retail mark-up. This is called double marginalization, so you have two mark-ups, one on the manufacturer, and one on the retailer.

That's why I, in this piece cited, and others have found that the retail mark-up falls with more dealers and more intra-brand competition. However, this issue disappears with vertically integrated auto retailing. There is no retail margin because there's no retailer. There's just one guy. He manufactures, and he sells to consumers.

OK. So you don't have double marginalization. It doesn't matter how many of the stores you have, because one guy is setting the price, and that's the manufacturer. OK. So there is zero second mark-up, and cars are cheaper, if you have market power in two layers compared to if you vertically integrate. So if you're really trying to help the working mother with a couple of kids, then we should let the distribution system of this industry and any other respond to market forces and competition, and deliver those results that consumers want. If they want lower prices, then maybe vertical integration is a good choice.

PETER WELCH: Fiona, if I could respond to that.

ELLEN CONNELLY: Peter I'm sorry. I'm just going to, because we're running out of time. I'm terribly sorry. Do any of you have comments on this topic? No. OK. I'd like—

PETER WELCH: Then could I respond? There's a big difference between selling a car out of an order book and selling it out of an inventory, OK? A manufacturer that sells directly—and it's only six states out of 50 that have any kind of prohibitions. And I think the gentleman from Tesla even acknowledged that.

And guess what? They've been doing a pretty good job of going to those state houses—and by the way, that is the appropriate forum for them to go to change the laws. But 46 states have different laws. OK. I came from a state, for instance, in California. They had 10-mile limit with respect to it.

There's many, many different models with respect to it. But a manufacturer that owns and sells direct has the exact same expense for retailing a car. Now they may save some money because they don't yet have to advertise. They may save some money because they don't have to inventory vehicles.

But that's a function not of the system, but of the product that they've sold. And by the way, they came up with a very clever product that's very desirable in the niche that they have decided to service to. But if you had a regular large volume manufacturer that wanted to sell direct, they're going to have the exact same expense that they offload to our dealer members. So there is no mysterious middleman expenses added to the formula. That's a myth.

ELLEN CONNELLY: OK. We're going to move on. I'd like to address one question that we got from the audience, which is, should Congress consider federal legislation that preempts the patchwork of state laws and overrides a number of the special interest laws that freeze auto distribution? Bryant, do you have any thoughts on that question?

BRYAN WALKER SMITH: Not particularly.

[LAUGHING]

ELLEN CONNELLY: Do any of our other panelists have thoughts on that question?

AVERY ASH: Send it back down to the end.

PETER WELCH: I have an opinion.

ELLEN CONNELLY: I'm sure you do.

PETER WELCH: Talk about going out of your swim lane. What happened to 10th Amendment? I mean, these are the exclusive province of the states, and they do a darn good job. They know what's best in the interests of their citizens. I have to tell you that having practiced law in Los Angeles and having represented both sides of the equations here, having lobbied the California legislature for nearly 20 years, I can tell you, this concept of a crony capitalism is just not true.

When I'm around talking to California legislators, they're asking a really serious policy issues. And they take very seriously the laws that they pass. And they're very well-documented, the abuses, unfortunately, that they have to correct.

ELLEN CONNELLY: 30 seconds, Fiona. I'd like to spend the last five minutes—

FIONA SCOTT MORTON: Some of these businesses are large in scale, and are going to cover a lot of states, and require a lot of investment. You could imagine that in a legal environment that was more certain and covered a broader amount of demand in geographic area, would be good for business.

ELLEN CONNELLY: I'd like to move on and talk a little bit about the future of regulation. We spent a lot of time debating the current system. I'd like to address the question to really all of the panelists to get your thoughts. There are a lot of legislators out there at the state level, and also at the federal level, grappling with a lot of these issues about how to address these new technologies, how to properly balance consumer interest and consumer protections with innovation and the desire to make sure that consumers have access to technologies that will potentially improve their lives.

So what would you advise legislators grappling with these various issues if you had maybe a top three list? Maybe I'll just go down the line. I'll start with you, Peter. We have four and a half minutes, so 30 seconds.

PETER WELCH: Keep an open mind, listen to all the parties, and do what they're elected to do. Make good public policy.

ELLEN CONNELLY: Bryant.

BRYAN WALKER SMITH: The details matter, but the broader social context determines how many of those details will be interpreted. So states need to begin by closely auditing their existing laws, identifying all of the potential obstacles and impediments to particular technologies, in consultation with developers who should be doing the same thing.

But in addition to that detailed approach, rather than the superficial approach that we've sometimes seen from state legislatures with respect to automated vehicles and other technologies, both the public sector and the private sector needs to build a public safety case for these technologies—to start talking about what safety means, how that safety will be measured, and how that safety will be monitored for the lifetime of the systems.

ELLEN CONNELLY: Fiona? Robbie?

ROBBIE DIAMOND: Yeah, I go back to my original point, which is I think that the revolutionary changes are incredibly profound and incredibly important to our country, and the lives of its citizens, and the entire world. And therefore, at this cusp of this moment, what we need to do is allow the technology to get out there, and have a very watchful and careful eye about it.

So not to prejudge what is going to happen, what the business model should be, what is safe—I was reading someone's testimony to the DMV, and it was pretty funny, because he said, you know, he got all the answers right to the question—he had to redo it at 70 years old. And his wife got two wrong. He was pretty sure that the machine would get all right. So is the machine safer than his wife?

So look, we're living in a new world. And for me, the real question is, this is what made America great. This could be the next revolution of productivity. This could get people who haven't been able to come out because of mobility issues, coming out. This could save so many lives. This could stop us on oil dependency.

So there'll be problems. There'll be hiccups. There'll be bumps. All that is true. But let's allow consumers to have an opportunity. Let's allow these companies, both automakers and new entrants, to get their products on the road, see how it works, and then come in afterwards and make sure that if something goes wrong, to deal with it.

But not think that we can prejudge this sitting in Washington or sitting in any state capital. I mean, it's almost laughable that we could.

ELLEN CONNELLY: Ashwini.

ASHWINI CHHABRA: Sure. The one thing that I think is—there are a couple things that I think are necessary in fashioning good regulation. And I say this as a former taxi regulator.

There's the need to be expert in your area where you are regulating, which means staying current with new technology trends, and being nimble. And regulation is often incremental. Much to the frustration of people who are innovating in an industry. But that can work so long as a regulator then keeps up, and the process is such that it allows for regular and frequent updates, because the technology's just moving that fast.

I think sometimes, we have this rep as being opposed to regulation, and nothing is farther from the truth. We advocate for sensible regulation. It's just the process takes so long, and there are entrenched interests, and so forth. But whether it's auto distribution, whether it's permitting new vehicle technology, whether it's regulating for higher services, it's clear that all of these sectors and many more require a degree of expertise that regulatory agencies have historically not had, or have not been able to stay current in.

And I speak as someone who was at the New York Taxi Commission when Uber came on the scene. People there, I myself, others, didn't understand it in the way that I think people are understanding it now. And I think you see that repeating itself with the various bodies that are looking at self-driving cars now.

And so there's a difficulty in attracting the folks who understand the technology, because in government, you don't pay big bucks. And so it's hard to attract the experts, because the private sector will hire them away. But that's one thing I think is very, very necessary in devising good regulation, is having experts on board, and then being open enough to tear down whatever you regulated just the year before, because things will have changed.

ELLEN CONNELLY: I realize time's up, but I do want to give Avery a chance to respond.

AVERY ASH: Yeah, and I think kind of building on what Ashwini, I mean, really, whether you're a federal or state legislator, it begins with educating yourself about the technology, and then asking smart questions. Figure out the right questions to ask, and to identify where or if regulation or legislation is important.

And then it really comes down, from our standpoint, it's back to those principles. If you're thinking about it from a consumer perspective, it's about transparency and understanding the technology. It's about security and understanding there's a safety behind it.

And then it's promoting consumer choice. I think with all those three, that's how you really realize the benefits of this technology.

ELLEN CONNELLY: Well, thank you. I know we went a little bit over. So thank you for bearing with us. I hope you found this to be as interesting as I did. And thank you very much to my panelists for a really spirited and interesting discussion. James Frost will conclude.

CLOSING REMARKS

- **James Frost, Attorney, Bureau of Competition, Federal Trade Commission**

JAMES FROST: I'm here. I just have a few quick announcements, and then we will let you all go. The first one is I want to remind all of you that the public record remains open for this event. It will be open until March the 4th. So if you would like to submit any comments about any of the issues that we talked about here, even though we spend a whole day talking about these issues, we left a lot of things uncovered. So we'd be happy to hear from you. There are instructions on the website on how to submit comments. That's available until the 4th of March.

Next, I want to thank all of our panelists, not only on this panel here today, but all the preceding panels. They've been very gracious in providing us with all their time. I want to thank you for all that. I also want to give a special note of thanks to Jonathan Hill over there on the corner, who has selflessly taken on a huge amount of logistical work associated with bringing you this program today, and we could not have done that without you.

There are also a lot of other folks whose names don't appear on the agenda. I can't possibly thank all of those people today. But let me just at least single out a few other people. All the folks on the FTC event staff, the technical crew in the back, the press office—a lot of other folks have spent a lot of time putting all this together. I want to thank all of them for helping us out.

Again, thank you all. And then I want to remind all of, please, turn in your security badge on your way out. And that completes the program for today. Thank you all. Have a good afternoon.

[END OF WORKSHOP]