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AUTO DEALER BROKERS FRANCHISES

House Bill 4738 (Substitute H-1)
Sponsor: Rep. Kim Rhead

House Bill 4740 (Substitute H-2)
Sponsor: Rep. Tom Alley

First Analysis (6-24-97)
Committee: Commerce

THE APPARENT PROBLEM:

Like many other areas of business, automobile retailing has undergone tremendous changes in recent years. As a result, automobile dealers -- many of whom own and operate family businesses -- have experienced a number of threats to their continued effective functioning as independent small businesses. For almost two decades, auto dealers have argued that they have needed statutory protection from the unfair amount of power held by auto manufacturers in their agreements with their dealers. The first state law addressing auto dealers' concerns was Public Act 331 of 1978, which defined in statute "fair dealing" in agreements between vehicle manufacturers and their dealers. As the House Legislative Analysis Section analysis for the bill that became Public Act 331 noted, "In the absence of any such general principles [defining "fair dealing"], the unequal power balance between dealers and manufacturers leaves a great potential for arbitrary and unilateral decisions by manufacturers about contract arrangements. Dealers believe there should be some statutory guidelines outlining the rights and responsibilities of both parties in such dealer agreements." Despite passage of Public Act 331 of 1978, however, some people believed that dealers' problems with manufacturers still remained and that dealers needed further protection. As a result, in 1981, Public Act 118 replaced Public Act 331 of 1978, creating a new act to regulate dealings in new motor vehicles between motor vehicle manufacturers and dealers. As the Senate Analysis Section analysis of the enrolled bill said, in part, the new act replaced Public Act 331 of 1978, "incorporating and expanding many of that law's provisions, especially provisions stipulating the actions manufacturers would be prohibited from taking and provisions outlining what constituted 'good cause' for termination of agreements between manufacturers and dealers." Two years later, in the wake of the recession that resulted in the closing of 200 dealerships in those two years, it was felt that the

surviving auto dealers should be afforded further protections. Consequently, the new auto dealers franchise act (as Public Act 118 of 1981 came popularly to be known) was revised, because, as the Senate Analysis Section analysis said, "it [was] believed that, due to manufacturers' relative economic and bargaining strengths, neither the statute [i.e. Public Act 118 of 1981] nor private negotiations [were] adequate to protect dealers."

Once again auto dealers have asked for legislation to further increase protection for them in their relationship with auto manufacturers. In addition, at the auto dealers' request legislation addressing the dealers' concerns with third-party automobile brokers also has been introduced.

THE CONTENT OF THE BILLS:

The bills, which are tie-barred to each other, would amend the Michigan Vehicle Code and the automobile dealers' franchise act to address concerns raised by the automobile dealers. House Bill 4738 would prohibit automobile brokering except by licensed automobile dealers ("auction dealers"), while House Bill 4740 would prohibit automobile manufacturers from requiring new car dealers to pay for manufacturers' refunds or rebates, from "arbitrary and capricious" vehicle allocation, from requiring certain expensive "essential" service tools without a good faith estimate of the number of vehicles to be allocated to the dealer, and from preventing a change in the executive management of a dealer unless the change would result in management by someone who was "not of good moral character" or who didn't meet certain ("reasonable, preexisting, and equitably applied") manufacturer/distributor standards.

House Bill 4738 would amend the Michigan Vehicle Code (MCL 257.1d et al) to add definitions of

"auction," "auction dealer," and "broker," and to restrict the brokering of motor vehicles to licensed automobile

dealers (more specifically, those licensed as "auction dealers"). The bill also would rewrite language added by Public Act 300 of 1993 that took effect on July 1, 1994, and that replaced other subsections that expired, in whole or in part, on that date, and eliminate language that would then be duplicative.

Automobile brokering. Currently, the vehicle code requires an automobile dealer license in order to "carry on or conduct the business of buying, selling, brokering, or dealing" in vehicles that must be titled under the act. The code also requires the secretary of state to "classify and differentiate" vehicle dealers according to the type of activity they perform, prohibits dealers from engaging in activities of a particular classification unless licensed for that classification, and allows dealer applicants to apply for dealer licenses in one or more of nine classifications.

The bill would delete the term "broker" from the list of dealer classifications, replace it with "auction dealer," and prohibit a person from acting as a broker of motor vehicles except through "auction dealers." The bill also would rewrite the license requirement language, (a) to add the "exchange" of vehicles to the list of activities (buying, selling, brokering, or auctioning vehicles) currently prohibited without a dealer license; and (b) to prohibit a person from buying or acquiring a distressed, late model vehicle or a salvageable part through a salvage pool, auction, or broker without a license as a salvage vehicle agent.

New definitions. There are nine dealer classifications currently listed in the vehicle code: new vehicle dealer, used or secondhand vehicle dealer, vehicle scrap metal processor, vehicle salvage pool operator, distressed vehicle transporter, broker, foreign salvage vehicle dealer, and automotive recycler. The act defines, directly or indirectly, each dealer classification except for "broker." (See BACKGROUND INFORMATION for the vehicle code's definition of "dealer" and of eight of the nine dealer classifications.)

The bill would add the following definitions of "auction," "auction dealer," and "broker" to the vehicle code:

"Auction dealer" would mean "a person who conduct[ed] a private or public auction for a fee or other valuable consideration from either the buyer or seller, or both, of motor vehicles in which that person d[id] not have title or any other legal interest."

"Broker" would mean "a person, other than a dealer or an employee or agent of a dealer, who for a fee or other valuable consideration, brings a buyer and a seller of a motor vehicle together." The bill would specify that "broker" would not include a motor club (or its

authorized representative) "that, as a referral service for prospective purchasers, makes referrals to franchised new motor vehicle dealers" so long as the motor club didn't receive "consideration" for the referral and so long as all sales resulting from the referral were made by franchised motor vehicle dealers.

And vehicle scrap metal processors, who currently are not required to obtain dealer licenses if they don't buy

"Auction" would mean "the sale of a motor vehicle by a dealer at wholesale for the highest bid," but would not include in the definition the sale of vehicles titled in the name of a manufacturer by the manufacturer or his or her subsidiary. (The act currently defines "manufacturer" -- somewhat redundantly, given the act's definition of "person" -- to mean "a person, firm, corporation or association engaged in the manufacture of new motor vehicles, trailers or trailer coaches or semi-trailers, as a regular business.)

Dealer license expiration dates. Currently each dealer license expires on the last day of the month in the quarter for the business year in which the license was issued; under the bill, each dealer license would expire on the last day of the month one year after the month in which the license was issued.

Duplicative language. In response to major problems with car theft and illegal "chop shops," the dealer licensing provisions of the vehicle code were amended in 1978 to create a salvage vehicle title and to require that businesses specializing in insurance company salvage vehicle recycling and repair be licensed. These provisions were further amended in 1988 with regard to the titling, sale, repair, dismantling, and disposal of late model vehicles sold for their salvage value instead of being repaired. A sunset date of January 1, 1993, was put on certain of the subsections in this section of the code, which the legislature extended to January 1, 1994, by Public Act 304 of 1992, and then again to July 1, 1994, by Public Act 300 of 1993. Public Act 300 of 1993 also enacted virtually duplicate subsections -- which were to take effect "on and after July 1, 1994" -- regarding the necessity for dealer licenses, the application form and contents, the requirement of separate licenses for each county, and the classification of dealers by the type of activity they performed. The bill would delete one set of these duplicative subsections, and rewrite the license application content section to incorporate all of the current required information.

Distressed/salvageable parts. Finally, the bill would allow a person to buy, sell, deal in -- or, in addition, exchange or auction (instead of "broker") -- distressed parts not only under a used or secondhand vehicle parts dealer license (or as an insurance company authorized to conduct business in Michigan), but also under an automotive recycler license, or a salvage pool license.

vehicles from unlicensed persons, would be allowed, under the bill, also to buy salvageable parts under these same conditions.

House Bill 4740 would amend the law regulating automobile dealer franchises (Public Act 118 of 1981, MCL 445.1573 and 445.1574), specifically the sections of the act regarding prohibited requirements of dealers by manufacturers (Section 13) and prohibited conduct by manufacturers (Section 14).

Refunds/rebates. Currently, the auto dealers' franchise act prohibits manufacturers and distributors from requiring new car dealers from doing a number of things. (The act defines a "manufacturer" to mean "any person who manufactures or assembles new motor vehicles; or any distributor, factory branch, or factory representative." A "distributor" means "any person, resident or nonresident, who in whole or in part offers for sale, sells, or distributes any new motor vehicle to a new motor vehicle dealer" -- or who controls any person, resident or nonresident, who does this, or who maintains a factory representative, resident or nonresident.)

One of the things that manufacturers cannot do is to require dealers to participate "monetarily," at the dealer's expense, in any advertising campaign or contest, or to buy any promotional materials, or display "devices," decorations, or "materials." The bill would, in addition, prohibit manufacturers from requiring new motor vehicle dealers from having to pay or assume any cost of a manufacturer's refund, rebate, or discount to ("or in favor of") a consumer in connection with the sale of a new motor vehicle, unless the dealer voluntarily agreed to do so.

Vehicle allocation. Currently, among other things, the auto dealers' franchise act prohibits auto manufacturers or distributors from:

(a) failing to deliver new motor vehicles, parts, or accessories within a "reasonable" time and in "reasonable" amounts ("relative to the new motor vehicle dealer's market area and facilities), unless the failure is caused by "acts or occurrences beyond the control of the manufacturer or distributor" or results from a dealer order "in excess of quantities reasonably and fairly allocated by the manufacturer/distributor";

(b) refusing to disclose to dealers the "method and manner" of distribution of new motor vehicles by the manufacturer/distributor; or

(c) refusing to disclose to dealers the total number of new motor vehicles of a given model sold by the manufacturer/distributor in the dealer's "marketing

district, zone, or region," whichever geographical area is the smallest.

The bill would delete each of these provisions and instead prohibit manufacturers or distributors from:

(a) adopting, changing, establishing, or implementing a plan or system for allocating and distributing new motor vehicles to dealers that was "arbitrary or capricious";

(b) failing or refusing to advise or disclose to any dealer having a dealer agreement, upon written request from the dealer, the basis upon which (i) new motor vehicles of the same line make were allocated or distributed to dealers in the state and (ii) the current allocation or distribution was being (or would be) made to that dealer;

(c) refusing to deliver, in reasonable quantities and within a reasonable time after receiving a dealer's order, vehicles that were covered in the agreement between the dealer and manufacturer and which were "specifically publicly advertised in the state by the manufacturer or distributor to be available for immediate delivery." However, the failure to deliver a motor vehicle wouldn't be considered to be a violation of the act if the failure was due to an "act of God," a work stoppage or delay because of a strike or "labor difficulty," a freight embargo, or any other cause over which the manufacturer/distributor had no control.

Essential service tools. Currently, a manufacturer or distributor cannot require a dealer to order, or accept delivery of, any new motor vehicle, part or accessory, equipment, or "any other commodity not required by law" that was not voluntarily ordered by the dealer. In addition, under the bill, if a manufacturer/distributor required a dealer to buy "essential service tools" (not defined in the bill or the act) costing more than \$7,500 in order to receive a specific model vehicle, the manufacturer/distributor would be required, upon written request, to provide the dealer with a written good faith estimate of the number of vehicles of that specific model the dealer would be allocated during the model year in which the tool was required to be bought.

Dealer management control. The bill would add a new provision that prohibited manufacturers/distributors from preventing (or trying to prevent), "by contract or otherwise," a dealer from changing executive management control unless the manufacturer/distributor (who would have the burden of proof) could show that the change would result in executive management by a person or persons who were "not of good moral character" or who didn't meet reasonable, preexisting, and equitably applied manufacturer/distributor standards. If a manufacturer/distributor rejected a proposed change in

executive management, it would have to give written notice of its reasons to the dealer within 60 days after having received written notice by the dealer of the proposed change ("and all related information reasonably requested by the manufacturer or distributor"). Otherwise, the change in executive management would be considered approved.

BACKGROUND INFORMATION:

The Michigan Vehicle Code defines "dealer" to mean a "person" (defined in the act as "every natural person, firm, copartnership association, or corporation and their legal successors") who does any of the following:

- (a) "engage[s] in the business of purchasing, selling, exchanging, brokering, or dealing in vehicles of a type required to be titled" under the act;
- (b) "negotiates the purchase, sale, deal, or exchange of those vehicles and who has an established place of business for those purposes in this state";
- (c) "engage[s] in the actual remanufacturing of engines or transmissions, or both"; or
- (d) "engage[s] in the business of buying vehicles to sell vehicle parts or buying vehicles to process into scrap metal."

Under the act, a "dealer" doesn't include "a person who buys or sells remanufactured vehicle engine and transmission salvageable vehicle parts or who receives in exchange used engines or transmission if the primary business of the person is the selling of new vehicle parts and the person is not engaged in any other activity that requires a dealer license."

The nine dealer classifications listed in the vehicle code are as follows:

- (1) New vehicle dealer (The act doesn't define "new vehicle dealer," but does define "new motor vehicle" in section 33a to mean "a motor vehicle, which is not and has not been a demonstrator, executive or manufacturer's vehicle, leased vehicle, or a used or secondhand vehicle.")
- (2) Used or secondhand vehicle dealer (The act doesn't define "used or secondhand vehicle dealer," but does define "used or second-hand vehicle" in section 78 to mean "any motor vehicle to which a certificate of title and license plates have been issued and which motor vehicle has been registered for use on the highways by a consumer or by a dealer.")

(3) Used or secondhand vehicle parts dealer (Section 78a: "a person engaged in the business of buying or otherwise dealing in vehicles for the purpose of dismantling the vehicles to sell used parts and remaining scrap metal or a person engaged in the business of buying, acquiring, selling, or otherwise dealing in salvageable parts.")

(4) Vehicle scrap metal processor (Section 79b: "a dealer engaged in the business of buying or otherwise acquiring vehicles for the purpose of processing and selling the metal for remelting," and who is prohibited from selling "major components or other parts for vehicle repair purposes, unless [the processor] first obtains a used or secondhand vehicle parts dealer license.")

(5) Vehicle salvage pool operator (The act doesn't define "vehicle salvage pool operator, but section 79a does define "vehicle salvage pool" to mean "a person engaged in the business of storing and displaying damaged or distressed vehicles as an agent or escrow agent of an insurance company.")

(6) Distressed vehicle transporter (The act doesn't define "distressed vehicle transporter," but section 12a defines "distressed vehicle" to mean "a vehicle that has a major component part that has been wrecked, destroyed, damaged, stolen, or missing to the extent that the total estimated cost of repairs to rebuild or reconstruct the vehicle, including parts and labor, is equal to or exceeds 75 [percent] of the actual cash value of the vehicle in its predamaged condition," and section 76 defines "transporter" to mean [a] "every person engaged in the business of delivering vehicles of a type required to be registered hereunder from a manufacturing, assembling or distributing plant to dealers or sales agents of a manufacturer, and [b] every person certificated by the Michigan Public Service Commission to engage in the business of moving trailer coaches or mobile homes.")

(7) Broker (The act doesn't define "broker.")

(8) Foreign salvage vehicle dealer (Section 17a: "a person who is a licensed dealer in another state and is engaged in this state in the business of purchasing, selling, or otherwise dealing on a wholesale basis in salvageable parts or vehicles of a type required to have a salvage or scrap certificate of title under the act.")

(9) Automotive recycler (Section 2a: "a person who engages in business primarily for the purpose of selling at retail salvage vehicle parts and secondarily for the purpose of selling at retail salvage motor vehicles or manufacturing or selling a product of gradable scrap metal.")

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, House Bill 4740 would have no fiscal impact on the state. (6-23-97) Fiscal information on House Bill 4738 is not available.

ARGUMENTS:**For:**

House Bill 4740 is necessary to protect dealers' investments, including the many dealerships that have been family-owned for generations, as well as to protect the communities in which such dealerships play such an important economic and social part. The changing marketplace -- including the proliferation of new automotive products and dealers and the expensive technology that is needed to service these new products -- has put auto dealers at an increasing disadvantage in their dealings with the automobile manufacturers.

For example, given the immense popularity of the so-called "sport utility" vehicles (which, according to one estimate, comprise as much as 40 percent of the new motor vehicle market), some Ford-Lincoln-Mercury dealers were dismayed to learn that Ford Motor Company planned to limit the availability of its new luxury sport utility vehicle, the Lincoln Navigator, to only those Ford-Lincoln-Mercury dealers whose localities had averaged a minimum of at least 70 annual retail luxury car registrations over the past four years. The January 1997 letter informing those dealers who would be shut out from offering this new product said that Ford's decision was "due to the limited volume of units to be produced" and their plans to focus their marketing and retailing efforts in "those high potential areas where [their] target customers reside." As one dealer from northern Michigan pointed out in a letter to Ford, northern Michigan demographics are such that although people don't usually buy certain luxury vehicles because of the difficulty of driving these cars in the snow, the market for upscale "4x4" trucks and utility vehicles, as well as "highline" conversion vans, is enormous. So to deny northern Michigan Ford-Lincoln-Mercury dealers the opportunity to sell an upscale sport utility vehicle such as the Lincoln Navigator based on the fact that the dealers had not sold enough Lincoln Continentals or Town Cars is not only illogical and absolutely counter to the specific demographics of this area of the state, but prejudicial to northern Michigan dealerships, who will lose their upscale sport utility customers to competing brand dealerships.

However, in addition to this potential threat to small-to-medium sized "outstate" dealerships, dealers have been alarmed by a trend in the automotive industry toward

"super-sized" factory-owned dealerships (sometimes called "megastores"). Although factory-owned dealerships are an anomaly in the United States because factories have preferred to have individual entrepreneurs sell their products, Ford Motor Company recently rocked the world of traditional auto dealerships by indicating that it wanted to acquire control of all Ford and Lincoln-Mercury dealerships in metropolitan Indianapolis. In early May 1997, Ford asked its Ford and Lincoln-Mercury dealers in the Indianapolis market to sell their dealerships to a new company that would be owned by Ford and the dealers and that would reduce the number of dealerships from 18 to five experimental "megastores." The new megastores would be operated as a single company and overseen by a Ford-appointed manager, probably one of the current Indianapolis dealers, and would be supplemented by a new network of four to five free-standing Ford Auto Care retail service centers. While one Indianapolis Lincoln-Mercury dealer believes that what Ford is proposing is ultimately what will happen with all manufacturers, and that inevitably the number of auto dealers will be downsized, the implications for small-to-medium-sized dealerships are certainly less than positive.

Given the economic and social importance of these dealerships in non-metropolitan areas -- which, in Michigan, means most of the state -- this trend could have disastrous effects not only on the dealerships themselves but on the small communities in which they play such an important economic and social role. And from a strictly business point of view, studies concerning customer satisfaction not surprisingly reportedly all show that small-to-medium-sized dealers have the highest level of customer satisfaction and loyalty, which is certainly in the best interests of the manufacturers. Small-to-medium-sized dealerships know their customers personally, and customers rely on their dealers to provide them not only with sales and services, but with the kind of community participation -- from volunteer community work to running for elected office -- that both sustains and strengthens their communities. Should small-to-medium-sized dealerships disappear, either through loss of customers due to being cut off from offering new automobile products or through replacement by megadealerships located in metropolitan areas, the resulting loss to their communities could truly be devastating.

The bill would address some of these issues by prohibiting manufacturers from capricious or arbitrary distribution of their products to dealers, and by supporting the continuation of family-owned dealerships through guarantees that changes in executive management would not be restricted on arbitrary grounds, as well as adding provisions regarding

manufacturer rebates and "essential tool" requirements. The bill, which is pro-people and pro-small business, is the result of compromises worked out between automobile dealers and manufacturers, and reportedly if any amendments to the bill are attempted, both sides will consider the agreement to no longer be in effect.

Response:

In a time when many markets are being "globalized" the unfortunate fact is that many traditional ways of doing business -- not to mention working conditions -- have been changed drastically, and automobile dealerships are not -- and should not be -- immune to changing market pressures. If, as many people believe, the free market is the best way to maximize the quality of goods and services available to consumers, then the bill is a step backwards from promoting the rule of the free market.

Against:

At a minimum, the bill is anti-consumer, and will raise car prices while reducing competition. On a more philosophical level, the bill -- and the act itself -- is unjust: from the point of view of those who argue that the proper role of government is to protect the rights of property and contract, the increased restrictions on franchise agreements proposed by the bill would use the government to take rights away from one set of persons (namely, consumers) and give them to another (namely, auto dealers). Rather than amend the act to increase protections for auto dealers from competition on the open market, the bill should be decreasing these protections if not outright repealing the act itself.

As a May 1997 paper from the Hillsdale Policy Group, Ltd. ("The Effect of Motor Vehicle Franchise Regulation on Vehicle Prices, Consumer Choice and the Political Process," co-authored by former state Representative Lynn Jondahl and former Michigan Deputy State Treasurer for Taxation and Economic Policy Gary Wolfram), points out, the effects of state restrictions on vehicle distribution that is embodied in vehicle franchise legislation is well-established in economics literature: such legislation creates a monopoly situation that gives dealers the ability to restrict the supply of vehicles and increase vehicle prices. Increases in vehicle prices result in fewer sales, and fewer sales will reduce employment in vehicle manufacturing and related industries. Thus, by increasing the restrictions on manufacturers in their contractual relationship with their dealers, the bill would serve to increase vehicle prices, increase vehicle search costs for consumers, reduce services, and reduce the number of vehicles sold. Rather than further protecting a special business interest -- the automobile dealers -- the legislature should be benefiting consumers, which would entail doing just the opposite of what the bill proposes. That is, the legislature should be reducing --

or even eliminating -- the franchise restrictions and allowing the market to determine what the individual dealer's market area should be and what should be in the contract between franchisers and franchisees.

More specifically, the paper quotes studies showing that state franchise restrictions increase vehicle prices to consumers anywhere between 6.14 percent and 14.1 percent, a transfer of wealth primarily from consumers to dealers as a result of higher vehicle prices. In Michigan, applying the 6.14 percent figure to new vehicle registrations of 680,713 and an average new vehicle price of \$20,000, this transfer from consumers to dealers comes to more than \$830 million annually (and obviously, the 14 percent rate would more than double this amount). In addition to a 1986 Federal Trade Commission report supporting these conclusions (which originally were drawn from earlier studies), at least three states -- Florida, Tennessee, and Texas -- also have released reports concluding that laws regulating the relationship between motor vehicle manufacturers and their dealers are unnecessary and result in higher consumer prices. The bill cannot stop the current pressures on auto dealers and should not try to do so. As unfortunate as economic dislocation always is to those directly and adversely affected, the state should not be involved in trying to protect private businesses from the forces of the marketplace.

For:

House Bill 4738 is needed to protect dealers from unfair competition by automobile brokers who, unlike dealers, are not required by law to have the kind of facilities and employees to service automotive products. The bill also would protect consumers, because brokers also aren't under any requirements to inform their clients of dealer "specials" or special financing that might be available. The bill is necessary, in short, to level the playing field and to protect consumers, and would do this by requiring that automobile brokers also be automobile dealers, and thus subject to the same legal requirements as auto dealers. Finally, the bill would exempt from its definition of "broker" groups like Amway, which reportedly has acted as a referral service for its members, though not, apparently, for a fee.

Response:

The bill is yet another attempt by automobile dealers to ensure that they can control their competition through laws that interfere with the free market. Why shouldn't consumers be able to use the services of an auto broker rather than be forced into the kind of negotiations with dealers that many people would prefer to avoid? Unlike most other segments of the marketplace, virtually all automobile consumers realize that the "sticker price" on a motor vehicle is not the actual price of the vehicle; depending on the consumer's persistence and willingness to haggle over prices and optional features,

he or she may wind up paying more or less than someone else for exactly the same product. Many people find this process not only time-consuming and distasteful, but also worry that their ability to get a good price depends on other than market conditions, such as their ability to negotiate with the auto dealers. As in the case with the auto franchise law, many people believe that such state interference with the marketplace not only is unwarranted but actually harmful, and can or does result in artificially higher prices to consumers. Eliminating independent automobile brokers will reduce consumer choice.

POSITIONS:

The Michigan Manufacturers Association supports House Bill 4740. (6-23-97)

The American Automobile Manufacturers Association (which represents the Chrysler Corporation, Ford Motor Company, and General Motors) does not oppose House Bill 4740, and has no position on House Bill 4738. (6-23-97)

Analyst: S. Ekstrom

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.