MD JOHNSON, INC.

Auto Distribution; Current Issues and Future Trends

A Federal Trade Commission Workshop

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Workshop Comments and Industry Insights by:

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Dear Attorney Roach and Attorney Frost,

This letter is in response to a request for comment regarding the FTC's upcoming workshop on the Franchised Automobile Industry and more specifically how the Franchised New Vehicle dealer network system affects consumers. Below please find my comments regarding the four topics the Commission seeks to review.

- **Dealer Location**
- **Warranty Services and Reimbursement**
- **Direct Sales**
- **New Development and Future Trends**
- ***Access to Automotive Retail Installment Loans (Suggested)***

In each topic category the Commission seeks to enhance their knowledge and consider options and review the public policy goals that govern the activities above as it relates to Franchised Automobile Dealers, Manufacturers and Consumers.

As a preface to my commentary, here is some background on me. I am the president of a financial advisory services firm that advises franchised new vehicle dealers on the purchase, sale, value and succession of their dealerships. Our clients are both public and privately owned dealerships and dealer groups. Our entire practice is focused on those key bullet points the commission seeks to address in their workshop. I am also formerly a new vehicle dealer. Collectively I have 34 years in the automobile industry, the majority of this time working daily analyzing, advising on and addressing those very questions the commission seeks to more fully understand. I have also been qualified in State, Federal and Family court as an expert in the topics the Commission seeks to understand and address.

Secondly I also strongly agree with the Commission that as a regulatory body, it should examine how the law and policy affect the people it is designed to protect. I fully embrace and concur that the people rely on all branches of government to ensure their rights, to the extent possible and permissible. As a preface to my comments I would like to briefly outline the evolution of the system we now all operate under in the new vehicle dealer business sector.

A Brief History of the New Vehicle Dealer Franchise System

The franchise system in the US started in the early 1900's as a system of **wholesale distribution**, not as a franchise as we know it today. Car manufacturers distributed their products with the help of business people. The notion of creating a *protected territory* later evolved into a *franchise.* Like the first franchise sold to a dealer in 1896 by General Motors, the franchise or wholesale distribution system has been around for more than a century. Franchise laws as we know them today have evolved into its current 50-state uniformity mostly since 1978. The real difference that needs to be distinguished between distribution and franchise was that a distribution agreement was an *intentionally informal arrangement* between a car maker and the company selling the car to a consumer. The original franchise or distribution agreement did not protect the dealers' market, nor determine the length of an agreement. In fact most agreements ended at the end of the model year. The most accurate definition(s) of a franchise as it relates to the automobile industry is as follows;

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A* franchise *is a type of license that a party (franchisee) acquires to allow them to have access to a business's (the franchiser) proprietary knowledge, processes and trademarks in order to allow the party to sell a product or provide a service under the business's name.

Investopedia

The right or license granted to an individual or group to market a company's goods or services in a particular territory;* also*: a business granted such a right or license* (2)*: the territory involved in such a right*.** ***Merriam Webster

Manufactures of all types of automobiles did not have the desire, capital or expertise to sell cars and trucks to consumers at the point when vehicles became accessible to the middle class. They were in the business of manufacturing a product and came to understand that if they could sell their product to a local gas station owner or farm supply store at a profit, they could use their capital for manufacturing tools and machinery and developing new products (R & D). Car makers had no interest in putting together real estate and sales teams to sell their products; they simply needed to sell their cars and trucks to someone who believed they could sell it to an end user for more than they paid the people who made it. To illustrate, the typical difference between what a manufacturers sells a vehicle to a dealer for and what a dealer sells to a consumer for is around, on average $2,500.00. It is widely held and agreed and taught through the theory of elasticity of demand that if the dealer network did not exist, neither would the $2,500.00 difference in the retail price a consumer would pay a manufacturer for their product. There would be no reason for the manufacturer to discount their products given no competing sources from which to purchase.

At the inception of the establishment of a retail network, factory representatives for the most part simply visited with business people that had a location and were willing to buy a few cars, some parts and signage and sell their cars and trucks to those businesses' current customers. Often it could be an appliance dealer, farm store or in the case of Honda, a Honda motorcycle dealer, and in some cases a business person without a location but with deep community contacts and community respect.

"The economic significance of the franchise system in the automobile industry is illustrated by the following figures: in *1954*, the industry turned out a total of 9,177,919 cars and trucks. Its investment amounted to 7 billion dollars (62 Billion in 2015 Dollars); 780,000 persons were employed in the process of production. Distribution was handled by 42,000 franchised dealers, whose total investment amounted to nearly 5 billion dollars (44 Billion in 2015 Dollars). The investment of the average dealer amounted to $118,000 (1 Million in 2015 Dollars). The dealers in turn employed 660,800 persons or 9.7% of all employees engaged in retail selling. Thus, the cost of distributing cars, in labor and capital, is almost as great as the cost of manufacturing them."

Automobile Dealer Franchises; Vertical Integration by Contract.
Yale Law Review Volume 66, 1957, Professor Friedrich Kessler

As you will note from the paragraph above, it is more expensive to retail cars than to produce them. The bargain the manufacturers have made to access unlimited capital to retail their products, with no capital risk or investment in distribution, is the appearance of a $2,500.00 margin between dealer cost and a recommended retail price. In 1984 the Commission published the "IMPACT EVALUATIONS OF FEDERAL TRADE COMMISSION VERTICAL RESTRAINTS CASES"at the request of then Senator Kennedy. Among significant criteria, the Commission was most interested in pursuing and gauging the success of pursuit of Resale Price Maintenance (RPM) otherwise known as Vertical Restraint cases brought by the Commission.

Fifteen suits were studied where a manufacturer of a product sold that product to a dealer and that dealer was not allowed to sell the product for less than the manufacturer's mandated retail price to a consumer. The end result was the Commission determined that 33 percent of the time the suits should not have been brought and except for a handful, RPM was a new entrant marketing strategy, slated for abandonment at a predetermined time, when implemented.

In the case of the retail automobile industry a manufacturer sets the selling price to the dealer, publishes the MSRP electronically and on the vehicle WITHOUT RPM, thus controlling the maximum retail price embedded into the information cycle accessed by the consumer. Setting the spread between wholesale and retail price as well as *controlling the cost of a product without RPM support would be considered the exact opposite of Vertical Restraint****. In fact no law exists or agreement inside a New Vehicle Dealer Franchise Agreement that restricts the car manufacturers' ability to reduce the margin or spread between invoice and MSRP to $0.00.*** *Although dealers can charge whatever price they want, neither financial institutions nor the ALG (Automotive Lease Guide) recognizes anything other than the factory printed MSRP as the basis for lending on a retail installment agreement or lease contract in all but a few cases.*

The theory used by the manufacturer was that if people trusted and respected the person selling them the car, then the relationship would be at least as important as the car, its style or reliability. They piggybacked so to speak on the integrity of a man or woman they knew and trusted. In many cases these first dealers did not understand this until it was too late. Once businessmen discovered that their reputation was on the line in their community right along with the quality of the car, the relationship with the factories started to change. This change from being "one of our local distributors" to our "exclusive franchisee" was born. In the pre protected territory or exclusive market area franchise model, the factory would appoint as many dealers as they could get to buy vehicles and parts from them. This is the basis for the first examination the Commission seeks to address; **Dealer Location**. To further clarify, the manufacturers' ability to establish sales locations at their discretion.

When the quality of the cars created credibility issues with the local distributor often the dealer would simply stop selling the car, often asking the manufacturer of the car to fix, replace or repurchase the car from the dealer's customer(s). The issue of taking care of the customer is the second topic the Commission will cover which is **Warranty Services and Reimbursement.** And why is this activity for the most part restricted to an authorized dealer?

In the pre franchise, distributor system the factory representative would simply tell the dealer if he didn't sell the cars that they would appoint a new dealer in the same town. Sometimes the dealer capitulated and sometimes they didn't and a new dealer was appointed, often literally next door or across the street. To this day many manufacturers own and maintain the brand signs located at dealerships. In the event of a dispute, the manufacture simply goes to the sales location and takes down ***<u>their</u>*** sign. The current Franchise laws preclude this arbitrary disassociation without a protracted legal battle, but in the end, the sign belongs to the factory and they have significant rights and retaining their property.

Direct distribution to consumers is not a new discussion and is clearly not a new idea. To the contrary as I write this letter, **Mercedes Benz** is in the process of *privatizing* its franchises in Europe owned by Mercedes. All over the whole of Europe, Mercedes has been under a direct distribution model. Each dealership is managed by a high level reporting general manager, highly educated and extraordinarily well versed in understanding Mercedes Benz and Mercedes Benz products. The dealerships are all being turned over to private ownership. Clearly the next question is why. The reason is simple: lack of profitability. Clearly the bigger question for the Commission will be why the producer of the car can't sell it to the end user profitably. Like **GE** leaving the finance business and all other non-core businesses, big manufacturers come to know what they are good at and what they are not good at. Car manufacturers are not good at selling their products to a retail customer and they have all come to understand this.

"Why are car manufacturers not good at selling their products directly to consumers? Consumers are not their customers, dealers are their customers".

Arguably one of the largest and most disciplined manufacturers of automobiles has come to understand that the interface between a salesperson, a customer service expert and a buyer of their products is the most effective form of getting their products into the hands of the end user *and* creating an experience that keeps that customer coming back to the dealership long term. This is ***Brand Loyalty*** and is the <u>most coveted</u> goal of ALL manufacturers.

Progression of the Distribution system to the Franchise system.

The true change from the distribution model where the factory would put competitors in the market together versus the franchise system with protected territories started when their over dealering started to defeat the manufacturers' goals. In the early years of the system car companies just wanted to sell as many cars as possible as the race for market share took hold in the US. As dealerships started to make real money, dealers started to trust that the factories would not abuse the distributor relationship and became comfortable with investing significant capital in their dealerships.

This relationship of trust was for the dealer to spend significant amounts of money on facilities, inventory, employees, advertising, etc.; in exchange for the manufacturer “keeping their word” that they would not appoint another dealer in the market. In many cases the local managers were good to their word, but in some remote cases new management came in on the car company side and would appoint another dealer, depriving the current, highly invested dealer an opportunity to earn a return on their investment -- the investment their manufacturer required. This informal relationship now required formality due to an evolving market and thus was born the true franchise system.

Dealers that were made promises, often backed up by purposely vague agreements, were abused by the factory management. A factory representative would develop a relationship with a dealer, often a good dealer who lived by his word. That dealer would then rely on the factory person’s word that he would get plenty of product and that they wouldn’t put another dealer in the market. In exchange for that promise, the dealer would buy property and build a building or convert a building that really had no purpose other than as a car dealership. The manager from the car company would then leave the company or be promoted and the new local manager would come in and tell the dealer that just built the building that “I didn’t promise you anything” and appoint another dealer. The newly appointed dealer would simply find a gas station or other location with virtually no overhead and begin competing with the dealer that was coaxed into building the building the manufacturer wanted. Literally thousands of legal cases exist between retailers and manufacturers regarding predominantly two issues. 1. A dealer who built buildings and a business only to have the manufacturer appoint

another dealer in their market, putting both of them out of business. 2. A dealer not performing and living up to the standard that was either promised verbally or in writing and the factory looking to get a new dealer that would represent their interests.

When expenses between competitors create such a lack of parity, the dealer with the lowest overhead will be the survivor. Sometimes the factory would sell more cars given the lower price offered by the low-overhead dealer but the theory of selling out of a gas station was not a sustainable business plan and neither was a loosely written agreement designed to get a dealer to invest significant amounts of capital but to create as little commitment legally on the part of the car maker as possible.

The introduction of the protected market agreement or Franchise Agreement

"The unique advantage of franchising for the manufacturer lies in the considerable control over the process of distribution he may exercise without exposure to the burdens and responsibilities of an agency relationship. Ideally the dealers are carefully chosen from among those of proven ability. Selected dealers, experience has shown, tend to be more aggressive in cultivating a market and servicing the product. They are generally 'co-operative' in carrying out the manufacturer's suggested program of selling. And the franchises of dealers who do not prove their worth may be eliminated by cancellation or non-renewal."

Automobile Dealer Franchises; Vertical Integration by Contract.
Yale Law Review Volume 66, 1957, Professor Friedrich Kessler
Page 1, Paragraph 1, Opening Statement.

Over time dealers and manufacturers were forced to bring lawsuits against each other for their broken promises to one another and to litigate the distribution document. Car makers were often vindicated by their decisions to appoint other dealers to compete with their current dealer or to discontinue their relationship with their current dealer. Case law followed the suits. Some settlements among dealers and manufacturers included performance criteria that are still used today to make sure the factories' sales and service goals are met while also protecting the dealer's investment.   Without some form of market protection, dealers were not willing to build buildings or invest in representing a manufacturer's products. Through case law and different legislation the factories and the dealer wrangled over the years until the franchise system was fairly set up in the 60's to 70's and for the most part completely fleshed out in the past few years. To be sure, the franchise system like any other rules governing trade has certain features that are not desirable for either party.

Dealership Location 2016 to 2026

The Commission will be holding discussions regarding the relevance of the franchise system which is what dealer location means. A car manufacturer's ability to locate dealerships at will is at the heart of the franchise laws. As I stated and concluded earlier, for the manufacturer to affect a customer experience that will make that manufacturer competitive, a specific dealership experience must occur. Without sufficient opportunity to make a profit, business people would be unwilling to invest and therefore unwilling to put in place a system that guarantees this competitive customer experience.

The Commission should be mindful that every manufacturer currently has the opportunity to locate dealerships at will.

Manufacturers can purchase dealerships from dealers and reappoint new dealers in areas where they would like dealerships to be located. They simply need to be willing to purchase the business the dealer has built. Also during the process of a dealer selling his dealership, the manufacturer can assign that document to a buyer of their choice or purchase the dealership on the contract's terms and do with it what they would like. Although some states preclude this right of first refusal, most dealers are not opposed to the manufacturer exercising a right of first refusal as long as the terms of the transaction don't change. The only purpose that a change in the franchise laws would serve would be to keep the costs down for the manufacturer in exercising its will over the dealers. All the dealers together don't have the net worth of a single manufacturer. Changing or altering the rules that govern fair market value exchanges between the dealers and the manufacturers would simply be giving Goliath a bigger rock to crush David.

Does the current franchise system make cars more or less expensive?

As a practical matter dealers in business today have invested capital based on the protections given to them by the franchise laws. Relaxing those regulations would simply be a taking from the current dealers and end up in lifetime-long lawsuits. The buildings are built, the land is purchased, and there is no going back in the current system. Regarding new manufacturers, dealers can agree on any document they choose to agree on and a new manufacturer can make the rules up for their network.

In going back to my summary of the franchise system and the core question from the Commission regarding cost to the consumer, simple extrapolation is necessary. If so few dealers exist that they are able to effectively control price, then this would likely result in the consumers being damaged. In most states the radius law for new dealers is onerous. Typically the law allows a new dealer to be no closer than between 8 and 12 miles. As is the case in Florida, if a dealer can prove that for a prescribed period of time they have sold 25 percent of the cars between 12 and 25 miles from their dealership, a new dealer cannot be appointed.

None of the distances above create an opportunity for the dealer to be usurious on pricing. In Las Vegas few luxury dealerships have more than one or 2 dealerships. The city is remote, requiring the customers to drive approximately six hours to an adjoining dealer. If the dealerships are owned by the same dealer, it is likely that this could be a situation where the customer could be abused. It does not mean that a third dealer should be allowed into the market or that a dealer would want to be the third dealer in the market. These anomalies do exist and no amount of legislation can fix every problem. The customer can still drive or fly to get a car at a better price if the difference so warrants.

Factory Control over Dealers; Incentive Payment Process

The commission needs to be aware of how dealers actually earn money on new vehicles to fully understand and appreciate how the franchise system really works. In many franchises there exists a payment system between the manufacturer and the dealer known as “terms of trade” or “below the line.” These are payments the manufacturer makes to the dealers under specific, negotiated conditions. In the current world of automotive retail not being paid these monies can be the difference between whether the dealer makes money or loses money. These payments are all goal driven and are used as a tool to force a dealer to conform to the policies and desires of the car maker or risk losses.

For a dealer to earn all of the incentive money they will need to score very highly on surveys filled out by the buyers. These surveys question the customer about their experiences with the dealer in both sales and service. They also are paid incentive money critical to profitability related to the current status of their dealership buildings. Dealers must conform to very expensive facility enhancements, facelifts and other capacity requirements to earn these incentive payments. Also dealers are required to have certain levels of training for sales staff and service technician staff. The factory retains the sole right to change the levels of satisfaction percentages and in some cases have made it clear that their goal is to only pay **seventy percent of the dealers** the incentive money and continue to raise the bar so to speak until only seventy percent of the dealers can achieve the standards. Many dealers and their attorneys consider this a less than honorable respect of the dealer's sales and service agreement and in most cases it likely would not be upheld on the manufacturer's behalf if a dealer or group of dealers were to challenge it under the two-tier pricing law.

Summary on Dealership Location

It is unlikely that a wholesale change in the franchise system can or will occur. I think it is important to note that if the factories had more latitude regarding dealership location, they would not use it to add dealers. The factory folks have come to realize that a dealer who is not profitable cannot and will not take care of customers and that without an ever more positive customer experience,

Factories are susceptible to losing customers. It is well known in the automobile industry that everyone is now making very high-quality cars. The difference is price and customer experience. Dealers operate at an overall 2.5 percent margin and as national economies become global economies and as manufacturing is moved around the world the cost to build a car will be identical worldwide by 2026.

That being the case, by 2026 dealers will likely be able to offer only customer experience. Dealers are already addressing the relevance of a brick and mortar experience. Human nature will likely modify even more over the years and customers will come to dealerships and experience a thirty-minute retail experience involving a single person. The cost of being in the business of retailing cars and the expertise and scale necessary will likely make smaller one-off dealers unviable. Every institutional retailer knows that scale will be required to be successful as a retailer. Consolidation will continue. For a customer to go to a place where they can trade in a vehicle, obtain financing (likely completed online ahead of going to the dealership) and buy a new vehicle, dealers will need to increase training expense, personnel and IT. It is also firmly believed that retail dealerships will be split into retail centers and driving centers.

A dealer with multiple brands in a common market or group of dealers will place inventory at a center where the customer and can drive many makes and models in a non selling venue. The people on site will be product geniuses but will not be in the business of selling. The customer will know what they want and order from the dealership and will take delivery at the dealership and drop off their trade-in vehicle if one exists. This is currently happening where real estate is at a premium. In some cases customers will be able to go to the dealership to drive cars and the driving center also. It is simply part of the inevitable revolution of the industry.

New manufacturers will likely embrace the current system and current factories will simply try to get their dealers to invest in technology as quickly as the consumers want to use it. Any changes to the franchise system will likely come from the industry out, not legislation in.

Warranty Services and Reimbursement

Warranty services and reimbursement is fairly straightforward. The commission needs to understand that the factory sets the time allowed to perform warranty work and for the most part, these times are unrealistic. In many dealerships warranty work is parceled out and no technician is given too much warranty work as it is difficult to hit the times allowed by the factory regarding reimbursement. By way of example, for a 2014 BMW M5 it may take thirteen hours to replace an automatic transmission that has failed. BMW pays the dealership 9 hours. The technician may be capable of doing the job in 11 hours. In a customer pay situation the technician can normally complete a job in 80 percent of the allotted time but get paid for the entire time the job takes. In the warranty scenario, the technician will work two additional hours with no pay. Since almost all shops are flat rate and not hourly, when the technician gets allocated this warranty job, he knows over the next 13 hours he works he will be paid for 11.

This is a proficient Master Tech capable of doing every job quickly as that is all he or she does. Imagine a shop that performs warranty work on every new vehicle covered under a factory warranty. As a consumer I would not want someone putting a new transmission in my new M5 that has done only one in the past three years. Techs are like a doctor; you want one that performs the same operation over and over again. In an independent shop scenario, the factory is paying to KEEP THE CUSTOMER HAPPY. It is a common misnomer that dealerships want to keep the lucrative warranty work for themselves. In fact dealership have been moving to customer pay for years as quality has risen and warrant work has dropped of precipitously. Except for the sake of convenience, no consumer is willing to take a new vehicle to a non dealership shop when the factory is paying the warranty claim. Also the factory would make the training rigor required by non dealership techs so expensive that few shops would likely authentically comply.

In conclusion on this topic it is my expert opinion that any change to the warranty and warranty reimbursement process delivers less to the consumer, not more. Dealers have spent decades fighting their factory partners over getting adequate warranty reimbursement. It certainly is not something that requires a legislative solution.

Direct Sales

Tesla and their objection to and test of the franchise system along with others before them have created a lot of dialogue in the industry about manufacturers selling directly to the consumer and where it all leads. Clearly everyone at Tesla understands that given the automotive retail atmosphere, putting together a top notch retail network or distributor in charge of a top notch dealer network would be quite simple. Tesla has little interest in making sure the consumer gets the best possible deal. The entire Tesla experiment in direct sales is about brand control not about delivering the car(s) to consumers for the least amount of money. Tesla clearly understands that they would be further along with their car company had they aligned initially with the billions of dollars dealers have behind them selling vehicles, building dealerships, servicing cars and taking customer cars in trade and providing financial services. As with Tesla and Mercedes and the FRN Ford Retail Network before them, people buy cars from other people in person in a professional, engaged atmosphere. This person-to-person, interpersonal human response that is DNA encoded will change over time but not anytime soon. The automotive retail purchasing processes continuously evolve but the human response of touch, feel, smell and face-to-face exchange is an essential and desired element, basic to the human experience. Tesla is a luxury vehicle for the most part. Every manufacturer of luxury vehicles has developed a process where their products are represented and sold to retail customers at the hands of engaged, professional dealership personnel. Tesla, O' Connell and Musk have discounted the success of Lexus, BMW, Audi, Mercedes, Porsche etc at executing a Luxury experience through their dealer networks, a world class luxury experience according their manufacturers. In fact if you were to ask these manufacturer's if they felt they could protect their brands better than ***Kuni, Qvale, O' Brien, Cantanucci, Pohlad, Stahl, Penske, Catena, Chambers, Swickard, Braman, Myers, Schumacher, Blue, Fields, Jones, Emery, Van Tuyl, De Boer*** etc, it would be an emphatic ***<u>NO</u>***. The statement or implication that **Direct Sales** to the consumer creates a better experience, a lower price, brand protection, 1 or all three is fundamentally disingenuous on the part of any manufacturer. To date, *<u>only Tesla</u>* has made this claim.

It is my expert opinion that a manufacturer should be able to take any path they want to retail their products as long as they obey the law. Tesla sells some of the most expensive cars available today. All electrified vehicles are a thin slice of the market and without a well trained professional educating you on the features and benefits coupled with a hands on, acclimating driving experience; it may be difficult for the main stream consumer to make a good decision. An expensive decision to reverse. If nothing else Tesla is able to control the price of the car as you have no other way to buy the car.

No competition on price, no ability to negotiate. The Commission has made it clear that they intend to discuss and discover the effect of the current system on the consumer. I can see no better example of price control (RPM), and the ability to provide whatever customer experience they want to give than a manufacturer that requires you to purchase your car from them and get your car serviced by them-and only them. This is the exact opposite of the free-market model that is currently in place today with the terms of trade or below the line money model. The Commission cannot legislate price or customer satisfaction. Without the financial incentive model in place between dealers' and manufacturers, there is nothing that keeps a direct retailer from price fixing their product, their service costs and the level of or lack of satisfaction a car buyer will receive or experience. Tesla is in the trough of the "diffusion of innovations" theory where early adopters and ardent fans are willing to overlook score killing experiences and problems not overlooked by the non niche buyer. Tesla has clearly stated their productions goals which are clearly much higher than the typical "niche buyer" production numbers. As non niche buyers become Tesla buyers, brand damage will begin to occur without the one on one hand holding that exists today as an integral part of the luxury experience. Many in the automotive sector can't understand why Tesla has chosen to put off the inevitable alignment with a dealer network, necessary to sustain a brands image as the production numbers move from niche to mainstream. Either they believe they will never achieve non niche status or have decided to approach a more tried model after the damage to their brand has been done.

True Cost to a Consumer of an Unhealthy Retail Network.

It is important to consider the financial cost of a less than healthy dealer network in terms of the cyclic recessions that plague the automobile industry. During the recession dealers that were thinly capitalized and did not survive the recession either through attrition or the GM and Chrysler bankruptcy is an excellent example of costs shifted to consumers as a result of over dealering.

In many cases financially unhealthy dealers were unable to survive the cash flow needs experienced during the recession. Customers were often given back trade-in vehicles that dealers failed to pay off and in some cases the vehicles were sold to another consumer with the loan still in place and owed by the customer that traded in the vehicle. States were deprived of millions and millions of dollars of sales taxes collected by dealers but unable to remit to the state. In addition failing dealers were unable to remit payroll taxes or pay other obligations due to the cash requirements required of a franchised new vehicle dealer. The reduction of the overall dealer count and the increase in new vehicle sales has left the dealer body financially healthy and more viable than ever, if facing a downturn. Changes to the existing structure that would allow a manufacturer to add dealers simply would undermine this progress and expose customers, banks, the federal government and unsecured creditors to future potential losses when the next downturn occurs. The Commission should consider the fact that a healthy, profitable business is better for a consumer than one that cannot meet its obligations, legally or morally.

Access to Retail Installment Loans

As I stated in the first page of this document it is my opinion that the Commission should also consider the topic of ***Access to Automotive Retail Installment Loans.*** In discussing this topic a basic understanding of consumer automotive credit is essential along with the process executed in providing consumer credit to retail automotive customers.

> **"Four years ago, if you got approved with a 620 credit score, you got the same rate as someone with a 750 credit score," he explained. "That's no longer the case."**
>
> **In the fallout from the recession, Bingham said that credit scores have decreased approximately 12 points during the past five years.**
>
> **Last year, about 46 percent of all FICO scores were below 700, according to Fair Isaac Corp. — *with nearly 25 percent of all scores below 600.***
>
> ***"That's huge — one in four Americans," Bingham said. "If you've got a score below 600, you're out of the (credit) market."***

Al Bingham, Author
"The Road to 850: Proven Strategies for Improving your Credit Score."

The typical retail customer has a loan on their vehicle which when traded in or sold must be paid off as part of obtaining a new retail installment contract on their new purchase. A new loan must also be arranged with the proper documents being recorded (all in a highly regulated legal environment) showing the new lien all while obtaining license places and a new registration. Many dealers also have insurance offices on site allowing the consumer to obtain a new rider or policy as required in their new loans documentation.

The Commission can read from the quote listed above that 25% of consumers are considered out of the credit market given their credit scores. Dealers give these "out of the credit market "consumer's access to credit through the dealerships banking relationships. In fact many consumers obtaining car credit they cannot get from their own banks from the dealership. Given the cap on loan spreads, New Franchised Vehicle Dealerships not only put customers into or back into the standard credit markets but they do it at an interest rate the consumer has no possible way of obtaining without riding on the relationship that the dealers have with their lenders.

Dealers maintain a book of business with their primary lenders. Dealers are mindful of making sure that their portfolio losses are minimized so that they are able to obtain financing for financially disadvantaged consumers. The very consumers the Commission seeks to protect.

Summary

In respectfully approaching the Commission regarding the topic at hand, market forces have formed what we have today in the US in a free market. The true equalizer is the consumer who votes with their checkbook. Factories are free to do whatever they would like with their network by purchasing dealerships and dealership real estate and by adding dealerships where they are free to compensate those most affected. A change to the franchise system simply helps Goliath unfairly defeat David. The courts have spoken all over the US about this topic.

Franchise dealers also provide essential services that as a condition of obtaining and maintaining their dealers licenses and Franchise agreements must be completed in a timely and ethical manner, including the following;

- Pay off traded in vehicles.
- Dispose of trade ins either through auction or retail and protect consumers from potential wrongful acts of a subsequent owner.
- Complete all documentation necessary to register vehicles, obtain license plates and transfer titles accurately and in a timely manner.
- Complete all documentation necessary to secure leases and retail installment loans for Dealership customers.
- Complete and register all financial products including service agreements, GAP insurance and in some cases write liability and collision policies.

- Prepare new vehicles coming from the factory in anticipation of delivery to a retail customer.
- Provide a safe, secure and efficient atmosphere and experience for consumers to perform maintenance and repairs to their vehicles.

These are few of the services consumers receive as part of the margin paid to dealers in the retail process. Absent the dealer network, consumer would be required to execute a complex legal, financial and regulatory process few understand or have access to.

In the bankruptcy of Chrysler and the ensuing reallocation of dealerships, it was proven that the free market served the customer and that deciding who should or should not be in business was not effectively legislated nor could it be. In fact those business people willing to invest vast sums of money in support of their business and the sale of a specific brand were and continue to be highly motivated to take care of customers. Coupling their investment with the current terms of trade system in place, the consumer has experienced an aggressive dealer body that will stop at nothing to hit their sales targets, their customer satisfaction targets and their facilities and training targets. The car companies that complain the most about the franchise system have clearly figured out how to exercise their will without any changes to the system through the *terms of trade* payment process.

As I have indicated throughout this document, a vigorous review of public policy is essential in maintaining a healthy and free market. The recent recession among other outcomes purified the retail automotive franchise system and has put consumers in an excellent position to achieve value for their dollar -- all while having a business behind their purchase that is willing, able and motivated to successfully execute the business of providing valuable services to the consumer.

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MD JOHNSON, INC.

About Mark D Johnson and MD Johnson Inc.

Mark Johnson is the President of MD Johnson Inc. A financial services firm that buys, sells and values automobile dealerships and dealership properties for the firm's clients. The firm's clients include private and publicly owned groups and individual dealers.

MD Johnson Inc has advised on approximately 4 billion dollars of transactions during the past 16 years all over entire US. The company has purchased and sold some of the largest dealership groups in the US and has a significant track record in the sale and purchase of luxury dealerships and luxury dealership groups.

Mark Johnson has 34 years of experience in the automotive business including as a Franchised New Vehicle Dealer. Mark Johnson is recognized as an expert in Federal, State and Family court and specializes in supporting auto dealers in assessing damages regarding the value of open, closed, appointed and non appointed franchises and sales under factory duress.

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