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Possible Anticompetitive Efforts to Restrict Competition on the Internet
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Mr. John Delacourt
Office of Policy Planning
Federal Trade Commission

Dear Mr. Delacourt:

I am honored that I have been asked to contribute and hope that I can help the process. As I am sure you are aware you have touched on a very delicate and emotional topic that, as it relates to the automotive industry, traverses the direct economic interests of some of the most powerful businesses in the world (car manufacturers/OEMs) with what are most often some of the most powerful local businesses (car dealers). As such, I would like to focus my remarks on objective and factual information wherever possible. It has been my experience that much of the traditional thinking on the issue of internet auto sales is based on misinformation, a lack of understanding, and/or the desire to protect specific business interests.

For the past 12 years I have been an entrepreneur and business builder having launched over 14 companies. I am the founder or a founding member of 5 different automotive distribution related companies. As the founder and original CEO of CarsDirect.com I learned firsthand about the needs and desires of consumers while navigating an increasingly complex legal and regulatory environment. In many ways I have been on the forefront of the very issue that you are examining. As part of building these companies I have developed strong personal relationships with many of the nation's most prominent franchised automobile dealers and some of my companies have dealers as investors, board members, and partners. As a result of these business interests I have spent tens of millions of dollars understanding and conforming to the laws that govern the sale and distribution of automobiles. Finally, I should also note that I am a licensed car dealer in the state of California. The distinction being that I am not a *franchised new car dealer*. Nevertheless, the same rules and regulations apply and I am required to follow all of the same policies and procedures relating to the sale and the processing of a transaction as a new car franchised dealer. As a result I have a very strong understanding of the issues.

The sale of automobiles is a heavily regulated activity. One component of regulation is focused on protecting the consumer while another is focused on taxation and administration. There are few, if any, national laws governing the sale and distribution of automobiles. National regulation tends to focus on the importation, safety, and fuel economy of vehicles and is traditionally something that only affects manufacturers (OEMs). Although compliance is sometimes prohibitive and often costly, the objective is safer cars and less damage to the environment.

Each state regulates itself and has its own laws which govern the sale and distribution of automobiles. This means that there are 50 completely different sets of rules and regulations. This is particularly challenging to any business that operates in a multistate environment. These laws are generally broken down into two main categories – administrative regulation and franchise law.

Administrative regulations govern the process of selling automobiles. Specifically, this provides for the licensing of “dealers”, both new and used, as a group in order to establish accountability. The two objectives behind the regulation of dealers are consumer protection and the enforcement of specified standards, protocols and requirements. As a result dealers are charged with a very serious responsibility which is the administrative processing of a sale that, in most states, accounts for the single largest sector of tax revenue. Preventing fraud in this area is extremely important and dealers play a vital role.

Outside of any laws or regulatory considerations, dealers (new and used) provide an invaluable service to consumers. Consumers also benefit from the strict regulation and licensing in that they can remain confident and assured regarding one of the biggest purchases that many people make outside of their home. Although many dealerships would have to provide these types of services regardless of any laws in order to win customers, there is a clear place for the regulation and enforcement of specified guidelines. The result is consumer protection and efficient administration. That said every state should be wary of making these laws too onerous or burdensome for the dealer or the consumer. Each new regulation adds administrative costs and complication that is ultimately passed on to the consumer in the form of higher prices and a more frustrating experience.

Franchise laws and how franchise laws affect the retailing of new automobiles is an important legal differentiation to understand. In my experience most people do not fully understand the difference between regulatory issues and franchise issues. Franchise law is the result of franchise agreements between OEMs and their dealer franchisees being violated over the last century and then litigated – hence the name. Franchisees enter into binding legal contracts with OEMs for the geographic exclusivity to distribute an OEMs vehicles.

The franchise fees normally run into the millions. The fundamental nature of franchise law is to protect these franchisees from unfair competition from the OEM with which they have a contract, after all the franchisee has paid for this right. In the past, OEMs have been sued over actual or perceived transgressions of franchise contracts. As a result, there is a growing body of law that pertains strictly to the enforcement and protection of franchise obligations. Franchise dealers and dealer associations that represent franchise dealers are the sponsors of franchise law. Over the years this has been a very successful endeavor in that franchise law now prohibits any OEM (franchisor) from distributing vehicles directly in a manner that would transgress their dealers (franchisees). Oddly enough this only affects the sale of new cars as there is no legal foundation, such as a violated franchise contract, to enforce. As a result, there is robust competition for the sale and distribution of used cars. And although franchise laws have little or nothing to do with the consumer the consumer is ultimately affected as it relates to new automobiles.

Again, franchise law is different from state to state which results in a very inconsistent experience for consumers depending on where they buy their vehicle. Franchise law is the fundamental body of law that is being used to fight any competitive efforts relating to the internet that would benefit consumers. And, although franchise law was never intended to protect franchisees from competition from 3rd parties it is now being interpreted in just this manner. It is natural to assume that these protected businesses will vigorously protect these legal barriers to change. And, it is natural to assume that any change to these laws will require significant effort as dealers are well funded, well organized, and extremely important to the state and local governments in the areas that they do business. Most importantly, it would be unfair to assume that all dealers would act similarly if given the chance. Many dealers, in fact, most dealers that I know would be successful if not more successful in an open competitive environment.

There will always be difficulty for businesses that trade on the basis of geographic nexus as every new method of communication will allow competitors to reach into new market areas in order to conquest customers. This has been the case in the automotive community with the introduction of the newspaper and the radio. An advertisement that promotes anything to customers in a geographic area larger than the nexus of the business itself presumably attracts customers from other areas. This type of litigation defending the right of one franchisee to exclusivity has failed in the past. Customers are essentially free to choose where and from whom they want to buy anything. Yet, this is exactly what is being prevented by the current interpretation of franchise law.

I can personally attest to the fact that the majority of franchised dealers are exceptional businesspeople that are committed to running their businesses by delivering value to their customers. As a result of my dealer relationships I have had the pleasure of working with some of the most innovative and customer focused retailers in business today. Most are committed to exceeding the expectations of their customers at every turn. These dealers offer many ways to buy including the internet.

The "internet" is a new and quickly evolving technology. Although the personal computer revolution began in the late 1980's many experts agree that the IPO of Netscape in August of 1995 marked the rise of the internet as a mainstream means of communication and commerce. To put this in context, eCommerce has only existed for approximately 65,000 hours. In many ways the internet is no different than the newspaper or the radio when they were first introduced. It marks a fundamental shift in how we as a society communicate. However, the internet, like the newspaper and the radio simply represents a technological milestone in this journey, not the end of that journey.

The internet has introduced an important new concept that significantly benefits consumers. Pricing transparency has forever changed the process of buying a new car. After all a more informed consumer with accurate pricing and cost information will always negotiate a better price. This development also comes at a time when it is clear that consumers feel that automobiles have become a commodity in that every make model of a particular brand is predictably similar to other vehicles of the same make model. The customer who pays thousands different from another customer who buys an automobile from a competing dealership or simply

negotiates a different price at the same dealer is not necessarily getting greater value. These customers are paying the price of a closed distribution system. Better information and increased competition is the only way to ensure that this market reality of unpredictable pricing for relatively the same product goes away.

The fundamental question should be focused on what kind of regulation will be required in the future in order to protect the interests of consumers? The only way to answer this question competently is to have a framework of what this future environment will be like. One thing is certain, technology will continue to make access to information more robust, more immediate, and totally transparent. Whether the communications and information platforms available 50 years in the future are based on the internet or some new technology it is irrelevant. Whatever the technology it will completely transform the way that we live our lives, communicate with others, and conduct business. In the same way that the newspaper and the radio expanded the reach and impact of any message the internet and whatever technology comes next will further enhance that capability.

As a business builder I only have one focus – the customer. If consumers do not want my product or service because it is better than the alternative or a significantly better value then I would not win any business. The only way to ensure that consumers are ultimately provided with the best services at the best prices is to enable a truly competitive environment. This is not to say that dealers or businesses that are working outside of the franchise system should be exempt from the administrative laws, regulations, and licensing requirements that each state deems are necessary to protect consumers and administrate the transactions. Rather, these businesses should be allowed to compete on equal ground.

Many of the concerns regarding laws and regulations and how they negatively affect eCommerce and subsequently the consumer should be squarely focused on the effect of franchise law on the true competitive nature of the retail environment. Simply put, does franchise law provide for a more or less competitive retail environment for the purchase of new cars? Every other issue is a subset of this question because franchise law dictates whether or not any competition can exist outside of the closed franchise system. Franchise law was never contemplated to protect franchise dealers from genuine competition. Rather, franchise law was established to protect franchisees from violations by their franchisors and unfair competition between them. Any interpretation that extends beyond that framework has no foundation in law. The specific question of eCommerce and the internet will most likely be irrelevant in the coming years and these tools will evolve and any laws drafted as a result of the internet will probably be obsolete in a relatively short period of time. Furthermore, any restrictive laws established in this area can only have a negative impact on the application of future technologies that may benefit consumers.