HOUSE BILL REPORT
ESSB 6272

As Passed House:
March 6, 2014

Title: An act relating to manufacturer and new motor vehicle dealer franchise agreements.

Brief Description: Concerning manufacturer and new motor vehicle dealer franchise agreements.

Sponsors: Senate Committee on Commerce & Labor (originally sponsored by Senators Hewitt, Conway, Holmquist Newbry, King, Fain, Hobbs, Hasegawa, Cleveland, Rolfes, Hill, Rivers, Dammeier, Keiser, Kohl-Welles and Angel).

Brief History:
Committee Activity:
Business & Financial Services: 2/25/14 [DP].
Floor Activity:
Passed House: 3/6/14, 94-2.

Brief Summary of Engrossed Substitute Bill

- Provides additional authority for the Department of Licensing to deny a license for a new motor vehicle manufacturer or new motor vehicle dealer.
- Modifies the provisions under which a new motor vehicle manufacturer may terminate a franchise agreement and the provisions governing obligations of the manufacturer upon termination.
- Modifies the time frame in which new motor vehicle dealers may make claims for warranty work and the time frame in which a manufacturer may audit those claims.
- Modifies provisions regarding the rates that new motor vehicle manufacturers must pay new motor vehicle dealers for non-warranty customer repairs.
- Adds additional prohibited practices by new motor vehicle manufacturers.
- Provides that a manufacturer with a new motor vehicle dealer license as of January 1, 2014 may own a dealership that sells only vehicles made by the manufacturer when there is no independent franchise dealer.
- Adds provisions regarding access to new motor vehicle dealer data systems and liability for damages for security breaches.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: Do pass. Signed by 13 members: Representatives Kirby, Chair; Ryu, Vice Chair; Parker, Ranking Minority Member; Vick, Assistant Ranking Minority Member; Blake, Fagan, Habib, Hudgins, Hurst, Kochmar, MacEwen, Santos and Stanford.

Minority Report: Do not pass. Signed by 2 members: Representatives Hawkins and G. Hunt.

Staff: Linda Merelle (786-7092).

Background:

The Department of Licensing (Department) regulates persons who engage in businesses as new motor vehicle dealers (dealers) and motor vehicle manufacturers (manufacturers). The Director of the Department (Director) has the authority to issue and deny licenses. Manufacturers maintain a franchise relationship with their dealers, and the responsibilities of each party are delineated in state law and the franchise agreement of the parties. State statutes generally dictate when a manufacturer may own or terminate a dealer's franchise and the compensation a manufacturer must pay a dealer for warranty work and customer-paid service repair. The statutes also spell out prohibited practices.

Denial of Licenses.

The Director may deny a license for a manufacturer or a dealer when the application is made under deceptive terms that conceal the real person in interest whose license has been denied, suspended, or revoked for cause and where the terms of the application have not been fulfilled or a civil penalty has not been paid.

Termination of Franchise Agreements.

A manufacturer may for good cause terminate, cancel, or decline to renew a franchise agreement with a dealer when the new dealer fails to comply with a provision of the agreement that is both reasonable and materially significant to the franchise relationship. The manufacturer must have notified the dealer within 180 days after the manufacturer learned of the failure, and the dealer must have failed to make a correction after a request to do so.

Good cause to terminate an agreement may also exist if the failure of the dealer relates to the dealer's performance in sales, service, or level of customer satisfaction. Good cause is established if the dealer fails to meet reasonable performance standards determined by the manufacturer based upon uniformly applied criteria, where: (1) the manufacturer provided the dealer notice of the failure in writing; (2) the manufacturer provided the dealer with specific, reasonable goals or performance standards to be met within a suggested timetable, not less than 180 days; and (3) the dealer did not substantially comply with the manufacturer's performance standards during the suggested time period, and the failure was not due to factors that were beyond the dealer's control.

Upon termination, cancellation, or nonrenewal of a franchise, the manufacturer must pay the dealer for unsold new motor vehicles and associated costs for distribution, delivery, and taxes. The manufacturer must pay for: unused, undamaged, and unsold supplies, parts, accessories, and inventory; signs bearing the trade name of the manufacturer; equipment; and other related costs. The manufacturer must also pay the cost of transporting new motor vehicles, supplies, parts, accessories, signs, special tools, equipment, and furnishings.

The manufacturer must pay any required sums to the dealer within 90 days after the termination, cancellation, or nonrenewal of the franchise if the dealer has clear title to the property or can provide clear title upon payment by the manufacturer and is in a position to convey that title to the manufacturer.

Except in certain cases, in the event of termination, cancellation, or nonrenewal, the manufacturer must also pay the dealer for costs for any relocation, substantial alteration, or remodeling of a dealer's facilities completed within three years of the termination if they were required by the manufacturer for the continuance or renewal of the franchise agreement.

Rates for Warranty and Non-Warranty Work.

Warranty Work.

Each manufacturer must provide each of its dealers with a schedule of compensation for warranty work or service required by the manufacturer, including parts, labor, and diagnostic work. All claims for warranty work for parts and labor must be submitted to the manufacturer within one year of the date the work was performed. The manufacturer has the right to audit claims for warranty work and to charge the dealer for any unsubstantiated, incorrect, or false claims for a period of one year following the payment.

Non-Warranty Work.

The rates charged by a dealer for non-warranty service or "work for parts" is the price paid by the dealer for those parts, including shipping and other charges, increased by the dealer's average percentage markup. The dealer must establish its average percentage markup by submitting either: (1) repair orders received over 90 days; or (2) 100 sequential customer-paid service repair orders, whichever number is smaller. The change in the dealer's established average percentage markup takes effect 30 days following the submission. The dealer may not be granted an increase in the average percentage markup more than twice in a calendar year.

A manufacturer may not require information that the dealer believes is unduly burdensome or time consuming to provide, including part-by-part or transaction-by-transaction calculations.

A manufacturer must compensate a dealer for labor and diagnostic work at the rates charged by the dealer to its retail customers. If a manufacturer can demonstrate that the rates unreasonably exceed those of all other franchised dealers in the same market area, the manufacturer is not required to honor the proposed rate increase, and the dealer is entitled to resubmit a new proposed rate.

Unfair Practices.

Notwithstanding the terms of the franchise agreement, manufacturers, distributors, and other factory representatives are prohibited from certain unfair practices. Some of those prohibited practices include:

- discriminating between dealers by selling or offering to sell parts, accessories, or like vehicles to one dealer at a lower price than the prices offered to another dealer;
- giving preferential treatment to one dealer over another by refusing or failing to deliver inventory in reasonable quantities and within a reasonable time;
- competing with a dealer by owning, operating, or controlling a service facility in the state for repair or maintenance of vehicles under the manufacturer's new car warranty and extended warranty;
- using confidential or proprietary information obtained from a dealer to unfairly compete with the dealer;
- terminating, cancelling, or failing to renew a franchise with a new dealer based upon any of the following, which do not constitute good cause: (1) the fact that the dealer owns, has an investment in, participates in the management of, or holds a franchise agreement for the sale or service of another make or line of new motor vehicles; (2) the fact that the dealer has established another make or line of new motor vehicles or service in the same dealership facilities as those of the manufacturer or distributor; (3) that the new dealer has relocated or intends to relocate the manufacturer's make or line of new motor vehicles or service to an existing dealership facility that is within the relevant market area; in any nonemergency circumstances, the dealer must give the manufacturer or distributor at least 60 days notice of his or her intent to relocate; or (4) the failure of a franchisee to change the location of the dealership or to make substantial alterations to use the number of franchises on the dealership premises or facilities; and
- requiring a dealer to make a material alteration, expansion, or addition to the dealership facility, unless it is uniformly required of other similarly situated dealers of the same make or line, and the request is reasonable.

Summary of Bill:

Denial of Licenses.

In addition to the existing statutory authority to deny a license, the Director may deny a license if the issuance of the license would cause a manufacturer, distributor, or other factory representative to be in violation of the statutory provisions governing franchise agreements between manufacturers and dealers.

Termination of Franchise Agreements.

Insufficient Allocation.

If a manufacturer terminates a dealer's agreement based upon the dealer's performance and the new motor vehicle dealer claims insufficient allocation, the manufacturer does not have good cause for termination, cancellation, or nonrenewal unless: (1) the manufacturer has allocated sufficient inventory in the dealer's primary allocation, in quantity and product mix,

for the dealer's assigned market area. The inventory must have been delivered in a manner that allowed the dealer to reasonably meet the manufacturer's performance standards; and (2) the manufacturer provides, upon the dealer's request, documentation sufficient to develop a market analysis. The documentation must include, but is not limited to, the allocation of inventory to the dealer and other dealers in the same zone during the period established by the manufacturer. The documentation must not be shared by the dealer with any party not involved in preparing a market analysis or otherwise engaged in the termination proceeding.

Transportation, Relocation, Alteration, or Remodeling.

Upon termination, cancellation, or renewal of a franchise, the manufacturer must pay the dealer for the cost of transporting, handling, packing, and loading of new motor vehicles, supplies, parts, accessories, signs, special tools, equipment, and furnishings purchased from the manufacturer or the manufacturer-approved vendor. These costs must be paid within 90 days after termination, cancellation, or nonrenewal or on the date of delivery of the assets to the manufacturer, whichever is earlier.

If a manufacturer terminates an agreement or the termination is voluntary by the dealer, the manufacturer must pay, at the request and option of the dealer, costs for any relocation, substantial alteration, or remodeling of a dealer's facilities required by the manufacturer for *granting* a franchise, in addition to any requirements for the continuance or renewal of a franchise agreement. The relocation, alteration, or remodeling must have taken place within three years of the termination, cancellation, or nonrenewal.

<u>Rates for Warranty and Non-Warranty Work</u>.

Warranty Work.

All claims for warranty work for parts and labor must be made within 90 days of the date the work was performed, instead of one year. Upon audit of a dealer's claims for warranty work, the manufacturer may charge the dealer for any unsubstantiated, incorrect, or false claims for a period of nine months following the payment, rather than a period of one year.

Non-Warranty Work.

The average percentage markup must be computed by averaging the individual markup rates of each sequential invoice submitted to the manufacturer. In calculating the retail rate customarily charged by the dealer for parts and labor, the following work must not be included in the calculation:

- repairs for manufacturer or distributor special events, specials, or promotional discounts for retail customer repairs;
- parts sold at wholesale or at reduced or specially negotiated rates for insurance repairs;
- routine maintenance not covered under warranty;
- nuts, bolts, fasteners, and similar items that do not have an individual part number;
- tires, batteries, and light bulbs; and
- vehicle reconditioning.

A dealer must be compensated for labor and diagnostic work at the rates charged to customers and for any required documentation to authorize or verify the work, including photographs, paperwork, and electronic data entry.

A dealer may be granted an increase in the average percentage markup of labor once per calendar year, rather than twice.

Unfair Practices.

The following additional practices are added to the list of prohibited practices:

Relocation. A manufacturer may not terminate, cancel, or fail to renew a franchise because the dealer has relocated or intends to relocate a make of vehicle to an existing dealership facility. If a dealer relocates its facility, the relocation must be in a relevant market area, and the manufacturer has an administrative right to protest the location.

Location. The manufacturer must not require, coerce, or attempt to coerce a dealer to change the location of the dealership or construct, replace, renovate, or make substantial changes, alterations, or remodeling to a dealer's sales or service facilities, except as necessary to comply with health or safety laws or to comply with technology requirements necessary for vehicle service before the tenth anniversary of the date of issuance of the Certificate of Occupancy or of the manufacturer's approval.

Improvements. The manufacturer is prohibited from failing to provide to the dealer the right to purchase signs, building materials, or other franchisor image elements of like kind and quality from an alternative vendor selected by the dealer if the manufacturer has designated or selected a vendor to supply goods or services. If the vendor selected by the manufacturer or distributor is the only available vendor, the dealer must be given the opportunity to purchase the signs or other elements at a price substantially similar to the capitalized lease costs of the signs or elements. Nonetheless, a dealer is not allowed to impair or eliminate the intellectual property rights of the manufacturer.

Adverse Action. The manufacturer is prohibited from taking any adverse action against a dealer, including charge backs or reducing vehicle allocations, for sales and service performance within a designated area of primary responsibility.

Equipment. The manufacturer is prohibited from requiring or coercing a dealer to order or accept delivery of any service or repair appliances, equipment, parts, or other commodities not required by law and not requested by the dealer, if the dealer does not have the right to return the unused items for a full refund within 90 days or a longer period mutually agreed upon by the dealer and manufacturer.

Final Stage Manufacturer. A manufacturer is prohibited from competing with a dealer by owning, operating, or controlling a service facility in the state for repair or maintenance of vehicles under the manufacturer's new car warranty and extended warranty; but it is not a violation for a final stage manufacturer to own, operate, or control a new motor vehicle dealership.

A "final stage manufacturer" is "a person who purchases an incomplete vehicle from a licensed motor vehicle dealer and performs such manufacturing operations that the incomplete vehicle becomes a completed vehicle."

A "completed vehicle" is "a vehicle that requires no further manufacturing operations to perform its intended function."

An "incomplete vehicle" is "an assemblage consisting of, at a minimum, a chassis, power train, steering system, suspension system, and braking system in the state that those systems are to be as part of the completed vehicle, but requires further manufacturing operations to become a completed vehicle."

Manufacturer with Vehicle Dealer License. A manufacturer with a vehicle dealer license in Washington on January 1, 2014 may own, operate, or control a new motor vehicle dealership that sells only new vehicles of the manufacturer's make or vehicles that are not sold new by a licensed independent franchise dealer. A manufacturer with a vehicle dealer license may own, operate, or control or contract with companies that provide finance, leasing, or service for vehicles of the manufacturer's make or line.

<u>Access to Dealer's Customer Data</u>.

Definitions.

New terms are defined in the statutory provisions governing franchise agreements between manufacturers and dealers.

A "dealer management computer system" is "a computer hardware and software system that is owned or leased by a new dealer, including the dealer's use of Internet applications, software, or hardware, whether located at an existing dealership facility or provided at a remote location, that provides access to customer records and transactions by a dealer located in this state, and that allows the new dealer timely information in order to sell vehicles, parts, or services through the existing dealership."

A "dealer management computer system vendor" is "a seller or reseller of dealer management computer systems, to the extent that the seller or reseller is engaged in such activities."

A "security breach" is "an incident of unauthorized access to and acquisition of records or data containing new dealer or dealer customer information where unauthorized use of the dealer or dealer's customer information has occurred or is reasonably likely to occur or that creates a material risk of harm to the dealer or dealer's customer. Any incident of unauthorized access to and acquisition of records or data containing dealer or dealer customer information, or any incident of disclosure of dealer customer information to one or more third parties that has not been specifically authorized by the dealer or dealer's customer."

Voidable Agreement.

A dealer may not be required to provide consumer or customer data or information to a second dealer through direct access to the first dealer's management computer system. The dealer may provide consumer or customer data or information to a second dealer upon receipt of a specified request. The dealer providing the information may be charged a reasonable initial set-up fee and reasonable processing fee based on the costs incurred by the requesting party for establishing and implementing the process for the dealer. Any agreement with a manufacturer that requires the dealer to consent to direct access to the dealer's management computer system is voidable by the dealer.

Indemnification.

The manufacturer or dealer management computer system vendor that has electronic access to consumer or customer data or other information in a dealer's computer system, or an entity to whom the dealer has provided consumer or customer data, shall fully indemnify and hold harmless the dealer from all damages, costs, and attorneys' fees incurred by the dealer related to the disclosure of security breaches. The manufacturer and the vendor must indemnify the dealer for damages to the extent that any harm is caused by either or both.

Implementation.

This act applies to all franchises and contracts between the manufacturers and dealers that are amended, renewed, or entered into after the effective date of this act. An agreement between the manufacturer and the dealer entered into after the effective date of the act addressing the issues covered under the chapter of the Revised Code of Washington that governs manufacturer and dealer franchise agreements is considered an amendment to an existing franchise.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony:

(In support) This bill represents a long series of discussions and negotiations between manufacturers and auto dealers. It provides standards for the relationship between a dealer and manufacturer. Even though there may still be disagreement, the bill is a reasonable compromise that benefits all parties, in particular, the rights of consumers. In its original form, the bill would have prevented automobile manufacturers who sell directly to customers from providing services in Washington. The bill does not impact other manufacturers and their relationships with their dealers.

(In support with concerns) The amendment to the bill, which grandfathers in a manufacturer, is a good step, but there are still road blocks for innovative new start-ups. One potential solution could be to exempt manufacturers with low sales from the franchise requirements and impose those requirements once they reach a certain threshold based upon the number of

vehicles registered in the state. The bill provides protections for dealers. Getting new technology into a decades-old business model is difficult, but this bill as it is currently written, only helps one manufacturer.

(Opposed) This is a complex piece of legislation to accomplish in a short session. Under this bill, the voice of the consumer has been lost. It will be more expensive for consumers to have their vehicles serviced in Washington. This bill makes Washington an outlier, specifically regarding facilities and warranty repair. It is critically important that all manufacturers be treated the same, but this bill treats one manufacturer differently than all others. The state should not arbitrarily create more favorable rules for one manufacturer. All companies should have to play by the same rules.

Persons Testifying: (In support) Scott Hazlegrove, Washington State Auto Dealers Association; and Roman Daniels-Brown and Daniel Witt, Tesla.

(In support with concerns) Chad Schwitters, Plug in America; and Jeff Finn, Seattle Electric Vehicle Association.

(Opposed) Trent House, Global Automakers; Sandi Swarthout, Alliance of Automobile Manufacturers; and Cliff Webster, General Motors.

Persons Signed In To Testify But Not Testifying: None.