Date of Hearing: April 22, 2019

ASSEMBLY COMMITTEE ON TRANSPORTATION
Jim Frazier, Chair
AB 179 (Reyes) – As Introduced January 9, 2019

SUBJECT: New Motor Vehicle Board

SUMMARY: Requires car manufacturers to reimburse franchised new car dealers for warranty repairs based on specified formula instead of using the existing practice of determining a reasonable rate and recasts other existing provisions on the relationship between manufacturers and dealerships. Specifically, **this bill**:

1) Establishes the following rules for manufacturers to compensate dealers for fulfilling warranty obligations:

    a) Requires manufacturers to set the parts and labor rates by accepting a rate calculated by the dealers by determining the total charges from qualified repair orders submitted and dividing that amount by the dealer's total costs of the purchase of those parts;

    b) Requires dealers to submit to manufacturers either one hundred sequential qualified repair orders, including any nonqualified repair orders completed in the same period, or all repair orders completed during any period of 90 consecutive days prior to the date of submission, whichever is fewer;

    c) Defines a "qualified repair order" as a repair order, closed at the time of submission, for work that was performed outside of the period of the manufacturer's warranty and paid for by the customer, but that would have been covered by the warranty if the work had been required and performed during the period of the warranty.

    d) Allows dealers to omit certain charges included in repair orders, including: manufacturer, manufacturer branch, distributor, or distributor branch special events, specials or promotional discounts for retail customer repairs; parts sold, or repairs performed, at wholesale, among other things.

    e) Permits a manufacturer to contest the material accuracy of the dealer's retail labor rate or retail parts rate that was calculated by the dealer within 30 days after receiving notice from the dealer.

    f) Requires a manufacturer, if the dealer disagrees with the manufacturers contested rate, to pay the dealers rate until a decision is rendered by the New Motor Vehicle Board (NMVB), or a mutual resolution is made.

    g) Requires the retail labor rate and parts rate to take effect 30 days after the manufacturer receives the rate.

    h) Prohibits the manufacturer from taking any retaliatory or adverse actions because of the rates.

i) Allows a dealer to petition NMVB for failing to accept the rates, and places the burden of proof on the manufacturer to show they did not violate the rate provisions.
j) Allows NMVB to order the manufacturer to reimburse the franchisee for the difference between the amount the dealer actually received and the amount that the dealer would have received if the manufacturer compensated the dealer at the retail labor rate and retail parts.

k) Defines "parts" to include, but not be limited to, engine, transmission and other part assemblies.

l) Defines "warranty" to include certified preowned warranty, a technical service bulletin, a customer service campaign, and a federal recall.

m) Places a 10% cap on the annual increase in the dealership's baseline warranty labor rate.

n) Defines "baseline warranty labor rate" to mean the warranty labor rate that is in effect immediately prior to the dealer's most current submission to establish or modify its warranty reimbursement schedule.

2) Places the following restrictions on manufacturers:

a) Clarifies that it is unlawful for a manufacturer to refuse or fail to deliver in reasonable quantities and within a reasonable time a new vehicle sold or distributed by the manufacturer, a new vehicle or parts or accessories to new vehicles that are of a model offered by the manufacturer or distributor to other franchisees in the state of the same line-make**,** if the vehicle, parts, or accessories are publicly advertised as being available for delivery or actually being delivered in this state.

b) Prohibits a manufacturer from requiring a dealer to perform service repair or warranty work on any vehicle model that is not currently or previously available to the franchisee for sale or lease as a new vehicle.

3) Defines "adverse action" as any activity that imposes, either expressly or implicitly, a burden, responsibility, or penalty on a dealer, including, but not limited to, any audits, withholding of incentives, or monetary chargebacks related to provisions protecting dealers from punitive measures taken to enforce a provision of existing law providing protections to dealers on exports; and removes the sunset clause for this provision.

4) Prohibits a manufacturer from requiring a facility alteration, expansion or addition if the facility has been modified within the last 10 years at a cost of $250,000 or more and the modification was required, or was made, for the purposes of complying with a franchisor's brand image program.

5) Specifies that the $250,000 cap on facility alterations does not apply for the following:

a) Facility alterations made involving the exercise of the franchisor's trademark rights that is necessary to erect or maintain signs or to the use of any trade mark.
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b) Facility alterations made that are necessary for the sale or service of zero-emission or near-zero-emission vehicles.

c) Facility alterations made to comply with health or safety laws.

d) The installation of specialized equipment necessary to service a vehicle offered by a manufacturer and available for sale by the dealer.

6) Authorizes franchisees to file protests with NMVB related to performance standards, and places the burden of proof on the manufacturer to show they did not use prohibited performance standards, until January 1, 2025.

7) Prohibits a manufacturer from preventing a dealer from selecting a digital service of a dealer's choice that is offered by a vendor of the dealer's choice, provided that the service offered by the vendor is approved by the manufacturer.

8) Defines digital service to include internet web site and data management services, but to not include warranty repair processes for a vehicle.

9) Reinstates a provision of law that sunset last year that prohibits a vehicle manufacturer, manufacturer branch, distributor, or distributor branch from taking an adverse action against a dealer relative to an export or sale-for-resale prohibition if the dealer causes the vehicle to be registered in a state and collects or causes to be collected any applicable sale or use tax due to the state until January 1, 2025.

EXISTING LAW:

1) Charges the California Department of Motor Vehicles (DMV) with licensing and regulating dealers, manufacturers, and distributors of motor vehicles who conduct business in California.

2) Establishes NMVB within DMV, and requires it to hear and decide certain protests presented by a motor vehicle franchisee.

3) Prescribes procedures to be followed by franchisors, franchisees, and NMVB regarding claims for warranty reimbursement or incentive compensation. Requires every manufacturer to fulfill every warranty agreement and adequately and fairly compensate each franchisee dealer for labor and parts used to fulfill the warranty. A copy of the warranty reimbursement schedule or formula must be filed with NMVB, and the schedule or formula is required to be reasonable with respect to the time and compensation. Requires all claims made by franchisees to be either approved or disapproved within 30 days after receipt by the franchiser. When any claim is disapproved, the franchisee who submits it shall be notified in writing, and, each notice shall state the specific grounds upon which the disapproval is based.

4) Makes it unlawful for a manufacturer or distributor to require, by contract or otherwise, a dealer to make a material alteration, expansion, or addition to any dealership facility, unless the required alteration, expansion, or addition is reasonable in light of all existing circumstances. In any proceeding in which a required facility alteration, expansion, or addition is an issue, the manufacturer or distributor would have the burden of proving the reasonableness of the requirement.

5) Prohibits a manufacturer from competing with a dealer in the same line-make operating under an agreement or franchise from a manufacturer or distributor in the relevant market area.

6) Establishes that manufacturers have a right of first refusal for the sale of a dealership if certain conditions are met.

7) Prohibits a manufacturer from establishing or maintaining a performance standard, sales objective or program for measuring a dealer's sales, service or customer service performance that may materially affect the dealer, unless the manufacturer has laid out a standard that is reasonable in light of the market characteristics, availability and allocation of vehicles and parts inventory, economic circumstances, and historical sales.

FISCAL EFFECT: Unknown

COMMENTS: NMVB is a board within DMV with oversight provided by the California State Transportation Agency. It was created in 1967 as the New Car Dealers Policy and Appeals Board, with functions limited to hearing appeals from final decisions which were adverse to the occupational license of a new motor vehicle dealer, manufacturer, distributor or representative. After the passage of the Automobile Franchise Act in 1973, NMVB was given its current name and given quasi-judicial capacity to resolve disputes between franchised dealers and manufacturers of new motor vehicles. The board consists of 9 members, four of which are required to be dealers.

Primary Goals: Right now the board has jurisdiction over franchise terminations, new dealership locations, vehicle allocations, warranty reimbursements and incentive reimbursements. This bill recasts franchise agreements between dealers and manufacturers in several different ways, including requiring warranty reimbursement rates to be based on a formula.

The other changes in this bill are aimed toward protecting car dealerships from what they believe are unnecessary costs, including requirements to upgrade their facilities beyond $250,000 in a 10-year time period, or restricting a dealer from selecting a digital service of a dealer's choice.

Others restore provisions of law that sunset last year that would have been extended had Governor Brown signed AB 2107 (Reyes, 2018), including a provision to prevent retaliation against a dealer if someone purchased a vehicle at their dealership and then exported the vehicle.

Finally, several provisions of this bill are meant to clarify or expedite areas of existing law, including definitions of what an adverse action taken against a dealer is, while allowing dealers to protest already prohibited performance standards.

Last year, some manufacturers expressed an interest to continue to work with the dealers to address various issues in this bill, and have been able to work out many of these issues in other state's franchise laws. Other manufacturers had expressed to the committee an unwillingness to negotiate, and that AB 2107 was far more expansive than any other franchise-related bill in recent memory and undoes previous negotiations. This is the sixth bill since 2009 addressing the Automotive Franchise Law, and previous efforts have all generally ended with compromise with the exception of last year.

Multiple amendments were made to AB 2107 last year in an effort of good faith from the sponsors to address the opponents concerns. This bill reflects the final product of those amendments. The bill was ultimately vetoed by the Governor, for reasons to be discussed below.

Both parties have indicated a willingness to continue negotiations this year and to continue to make additional changes to the bill to address the manufacturers' concerns regarding warranty reimbursement rates established in this bill. As of the writing of this analysis, those discussions are ongoing.

A Reasonable Proposition: Much of the debate on the retail reimbursement rate for warranty work hinges on one word: reasonable. Currently, parts and labor rates for warranty reimbursements are generally set by manufacturers, and are required by law to be reasonable. A dealer can file a protest with the NMVB if they believe the rate offered by the manufacturers are unreasonable.

To date, NMVB has never made a determination that a rate provided to a dealer was unreasonable.

This bill reverses the existing power dynamic between dealers and manufacturers by allowing dealers to set the labor and parts rates through an established formula outlined in this bill instead of having those rates dictated by the manufacturers and judged on a "reasonableness" standard by NMVB. Rates would be calculated by looking at either 100 sequential repair orders, or all repair orders completed during any period of 90 consecutive days prior to the date of submission. Dealers are granted permission to omit certain charges that they believe would artificially lower the retail labor and parts reimbursement because manufacturers would include non-warranty repairs in the calculation.

The dealers are concerned that by having a "reasonableness" standard, every retail rate can and will be challenged at NMVB. The sponsors contend that having a mathematical formula to establish the rates will result in a more accurate reflection of the costs to dealerships to provide warranty repairs. The dealers contend that inserting the word "reasonable" into this bill, even with the formula described above, would eliminate the purpose of this bill, which is to create a standardized formula for reimbursement rates.

Governor Brown vetoed AB 2107 (Reyes, 2018), which was identical to this bill, because of this provision in the bill. In his veto message, Governor Brown argued that "Under current law, manufacturers are required to reimburse dealers for warranty and recall repairs at a "reasonable" rate negotiated between the two parties. This framework appears to be working reasonably well and I see no reason to adopt the rather complicated formula authorized in this bill – with perhaps unintended consequences."

The Alliance for Automobile Manufacturers, who are opposing this bill, argue that "The language of the bill clearly encourages car dealers to increase consumer retail repair rates and prices as a method to inflate compensation on warranty work from automobile manufacturers. In addition, the proposed prohibition on cost recovery surcharges would ensure that individual dealers cannot be held accountable for their independent pricing decisions, resulting in reduced competition and higher prices for all consumers."

As part of the negotiations last year, the author took amendments to cap any increase in retail reimbursement rates at 10% per year. They also took amendments to require both qualified and unqualified repair orders to be sent to manufacturers in order to ensure the dealers were not selectively choosing repair orders that may reduce their reimbursement rate. Both sides have discussed with this committee ways to address how this formula should be calculated, and have indicated to the committee that they will continue to discuss these terms.

The Global Automakers contend that some of the provisions of this bill may lead to an artificial increase in costs. For example, they contend that, "The bill would allow a dealer to be compensated for a parts markup for parts used in performing warranty work even if the manufacturer provided the parts to the dealer at no cost. These types of parts are typically provided to address recall or similar issues and allow customers to have their vehicles repaired more quickly and efficiently than traditional warranty repairs without injecting unnecessary costs into the distribution system." The Global Automakers also contend that the formula in this bill allows dealers to charge them for the costs of a part at its highest price, not the current market rate for that part.

Manufacturers are concerned that they will be left with little recourse to contest the rates set by this bill. Manufacturers are only allowed to contest that the rate is materially inaccurate or fraudulent. They are required to pay the rate sent to them by the dealers until NMVB reverses the rate or the two parties come to an agreement to change the rate. Auto manufacturers are prohibited from amending their notification to dealerships, so if new information arises that the rate was fraudulent, the manufacturers will have no recourse to amend their complaint. The Global Automakers contend that "Manufacturers should be able to challenge a submission on any ground, including general economic conditions and if the submission is unreasonable. Moreover, a manufacturer should only have the burden of proof to demonstrate that it complied with this subsection." Further, there is no provision for NMVB to award damages to a manufacturer even if such a rate is determined to be fraudulent. Manufacturers may be forced to pay artificially inflated rates for months with no recourse for reimbursement without filing a separate civil lawsuit after NMVB determination.

The Genesis of This Proposition: Several of the provisions of this bill stem from a dispute between dealers and a new line of car, Genesis, formerly Hyundai Genesis. Hyundai, seeking to break into the luxury car market, decided to spin off its Genesis car into a new brand of automobiles. Manufacturers have told dealers that sold Hyundai Genesis cars that they can no longer service the cars they sold for warranty reimbursements. Manufacturers are also preventing dealers that sold Hyundai Genesis cars from selling the new Genesis brand. Other dealerships are being told that even though they cannot sell the Genesis, they are required to service them for warranty reimbursements.

In response, this bill makes it unlawful for a manufacturer to refuse to deliver any new vehicles that are of a make or model offered by the manufacturer to other dealers in the state of the same line make. Further, a manufacturer would be prohibited from requiring a dealer to provide service repairs on a vehicle model that is currently not available to the dealer to sell. As a result of a provision in last year's bill that was later removed, the car dealers were able to successfully negotiate a deal to make sure dealers that sold the vehicle can still service them.

Build it, and They Will Come: Another requirement dealers have found unfair include requirements to update their facilities for brand imaging. For example, manufacturers may come in and require hardwood floors for certain cars to highlight how luxurious they are. This bill seeks to limit these requirements by deeming facility alterations, expansions, or additions as unreasonable if the facility has been modified in the last 10 years and the modifications were required or made for the purposes of complying with a manufacturer's brand image program.

Last year, amendments were made that are reflected in this bill to place a $250,000 cap on how much money a manufacturer can require a dealer to spend to comply with their brand image program over the course of a decade.

Further amendments were made to clarify that the $250,000 cap did not include payments made for the installation of zero-emission and near zero-emission vehicles, repairs made to comply with health and safety requirements, or upgrades made for the installation of specialized equipment necessary to service a vehicle offered by a manufacturer and available for sale by the dealer.

Up To Standard: Dealers are contending that manufacturer's current performance and incentive programs are unfair. Existing law makes it a violation for a manufacturer to establish or maintain a performance standard, sales objective or program for measuring a dealer's sales, or service or customer service performance standard that may materially affect the dealer, unless the manufacturer has laid out a standard that is reasonable in light of the market characteristics, availability and allocation of vehicles and parts inventory, economic circumstances, and historical sales. However, dealers cannot protest these performance standards to the NMVB unless they are either bringing a protest as a result of a termination. This bill allows for these protests to be made at any time, not just when the failure to meet a prohibited performance standard costs them their business. Last year's negotiations resulted in a sunset clause being inserted for this provision.

Off Into The Sunset: In 2015, the Legislature passed and Governor Brown signed AB 1178 (Achadjian), Chapter 526, Statutes of 2015, which prevented manufacturers from taking adverse actions against a dealer relative to an export or sale for resale prohibition if the dealer registers the vehicle in the state and collects or causes to be collected any applicable sale or use tax due the state. The legislature passed AB 1178 because of actions being taken against dealers who were being punished by manufacturers for individuals buying their cars and then trying to sell them on the international market. These provisions sunset in 2019, but would have been extended had AB 2107 been signed into law. This bill restores the previous law and sunsets the provision by January 1, 2025, and based on some interpretation issues with the NMVB, more clearly defines what should be considered an adverse action.

Committee concerns: Last year when this bill passed out of this committee there was a belief that further negotiations would continue around how the retail reimbursement rate were calculated. While that bill was amended later in the Senate to place a 10% annual cap on retail reimbursement rates and to require dealer's to provide both qualified and unqualified repair orders, no changes were made to the way the reimbursement rate was calculated.

While 34 other states provide a formula for reimbursement rates, this bill uses a model for calculating reimbursement rates only used by one state: Wisconsin. The opponents of the bill have contended that the Wisconsin rate calculation provides a perverse incentive for dealerships to increase their non-warranty repair work in order to increase their warranty reimbursement rates.

This bill may result in car dealerships receiving more adequate reimbursements for the work they have to do as a result of a manufacturing error and are required to provide because of a warranty agreement between the manufacturer and the customer. However, it could also could result in dealerships manipulating the system by increasing the costs of non-warranty repair work in order to increase their warranty reimbursement rates.

Previous Legislation: AB 2107 (Reyes, 2018) was nearly identical to this bill. That bill was vetoed by the Governor.

AB 1178 (Achadjian), Chapter 526, Statutes of 2015, provided that a vehicle manufacturer, manufacturer branch, distributor, or distributor branch cannot take any adverse action against a dealer relative to an export or sale-for-resale prohibition if the dealer causes the vehicle to be registered in a state and collects or causes to be collected any applicable sale or use tax due to the state, as specified.

SB 155 (Padilla), Chapter 512, Statutes of 2013, modified the relationship between motor vehicle dealers and manufacturers by, among other things, making changes regarding the use of flat-rate time schedules for warranty reimbursement, warranty and incentive claims, audits, protest rights, export policies, performance standards, and facility improvements.

SB 642 (Padilla), Chapter 342, Statutes of 2011, modified and expanded the existing statutory framework regulating the relationship between vehicle manufacturers and their franchised dealers.

SB 424 (Padilla), Chapter 12, Statutes of 2009, regulates actions that vehicle manufacturers may take with regard to their franchised dealers, and allows franchisees that have contracts terminated because of a manufacturer's or distributor's bankruptcy to continue to sell new cars in their inventory for up to six months.

REGISTERED SUPPORT / OPPOSITION:

Support

California New Car Dealers Association (Sponsor)
California Conference of Machinists
California Motorcycle Dealers Association

Oppose

Alliance of Automobile Manufacturers
Association of Global Automakers
Civil Justice Association of California
Honda North America, Inc.

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