Date of Hearing: April 23, 2018

ASSEMBLY COMMITTEE ON TRANSPORTATION
Jim Frazier, Chair
AB 2107 (Reyes) – As Amended April 16, 2018

SUBJECT: New Motor Vehicle Board

SUMMARY: Removes the sunset clause on a provision granting the New Motor Vehicle Board (NMVB) the authority to hear protests by an association challenging the legality of an export policy of a manufacturer and recasts the relationship in existing law between new motor vehicle franchisors and franchisees. Specifically, **this bill**:

1) Allows NMVB to consider past franchisor (manufacturers), but not past franchisee (dealers), violations when hearing a protest by a dealer.

2) Restricts any claims made pursuant to a violation of the existing law regarding franchisor-franchisee relations to be commenced in California, with California law governing the claim, unless the claim is being brought in federal court.

3) Prohibits a claim from being brought in state court if a claim has already been commenced with the NMVB, unless the claim is being brought in federal court.

4) 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 dealers total costs of the purchase of those parts.

    b) Requires dealers to submit to manufacturers either one hundred sequential qualified repair orders, or all qualified 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) Requires dealers to omit certain charges included in a 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 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.

5) 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 make or model offered by the manufacturer or distributor to other franchisees in the state of the same line-make**.**

b) 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 state.

c) Prohibits a manufacturer that is also operating as a franchisor, or an affiliate of a franchisor, from competing with any dealer by directly or indirectly offering vehicles for sale, lease, or subscription, or offering branded parts of the same line-make for sale, unless these vehicles or branded parts are offered exclusively by dealers, or unless they are acting as vehicle rentals regulated under the civil code.

d) Prohibits a manufacturer from restricting a dealer to service any vehicle that was sold or leased by the franchisee as a new vehicle offered by the franchisor at the time the vehicle was sold or leased.

e) 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.

6) Removes a manufacturer's right of first refusal for a transfer of a dealership and places the following restrictions on future franchise agreements:

   a) Removes the authority of a manufacturer to enforce a right of first refusal or option to purchase the dealer's business.

   b) Removes the authority of a manufacturer to directly or indirectly condition the awarding of a franchise to a prospective new dealer, on the addition of a line-make or franchise to an existing dealer, the renewal of an existing dealer, the approval of the relocation of an existing motor vehicle dealership, the termination of the franchise, or the approval of the sale or transfer of the ownership of a franchise on the willingness of a dealer, proposed new dealer, or owner of an interest in the dealership premises to enter into a site control or exclusive use agreement.

   c) Defines "site control agreement" and "exclusive use agreement" to include an agreement that:

      i) Requires the dealer to establish or maintain exclusive dealership facilities.

      ii) Requires a "right of first refusal" clause.

7) Defines "adverse action" to 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.

8) Prohibits a manufacturer from requiring a dealer to purchase signage at actual cost or restrict the dealer from erecting or maintaining signs from a specific vendor.

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

10) Prohibits performance standards on the basis of the number of customer repair orders or ones that fail to take into account the brand or type of parts used in retail customer repair orders.

11) Restricts manufacturers from requiring the advancement of money to participate in incentive programs.

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 the 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) Provides 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 sales or use tax due to the state. These provisions are set to expire on January 1, 2019.

8) 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:

Author's Statement: According to the author, "The sale and service of motor vehicles is important to California's economy. California motor vehicle franchises employ over 140,000 people and in 2017, motor vehicle sales and services resulted in over $121.1 billion in direct economic activity. California motor vehicle franchises make up 13 percent of the total statewide sales tax revenue collected. To ensure the orderly sales and service of new vehicles, California, like every other state, has enacted motor vehicle franchise laws.

In addition to preserving a well-organized and cost-effective distribution system of motor vehicles, franchise laws seek to address the disparity in bargaining power between multi-national auto manufacturers and California's local motor vehicle franchises that are primarily owned and operated as family businesses.

By helping to ensure the fair and equitable treatment by auto manufacturers when interacting with their franchised dealers, AB 2107 seeks to address some of the most inappropriate treatment of dealers by manufacturers and finally provides parity for California dealers with regard to warranty reimbursement."

Primary Goals: This bill recasts franchise agreements between dealers and manufacturers in several different ways. The two biggest changes to the state's franchise law include requiring warranty reimbursement rates to be based on the retail value of providing parts and labor and an anti-competition measure to ensure manufacturers cannot shift to a different business model that may undermine car dealerships. 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 for image purposes. Other provisions stem from how certain auto manufacturers have handled the creation of new brands. Many of the provisions in this bill expand the authority of NMVB, and may very well result in significantly more protests being brought to the board.

Some manufacturers have 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 have expressed to the committee an unwillingness to negotiate, and that this bill is far more expansive than any other franchise-related bill in recent memory and undoes previous negotiations. This is the fifth bill since 2009 addressing the Automotive Franchise Law, and previous efforts have all generally ended with compromise.

As a show of willingness to negotiate, the author took amendments on April 16, 2018, addressing several concerns of some of the opposition. These amendments included the removal of a provision allowing NMVB to award triple damages in a protest brought for warranty reimbursements. Further amendments are discussed below.

Enhancing The Power Of NMVB: NMVB is a board within the 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.

Right now the board has jurisdiction over franchise termination, new dealership locations, vehicle allocation, warranty reimbursement and incentive reimbursement. This bill expands the power of NMVB in several ways. The bill grants NMVB the authority to hear relevant alleged violations by a manufacturer of specific franchise laws. The bill also grants NMVB the authority to hear protests over performance standards, manufacturer competition against dealers, and manufacturer discrimination amongst franchisees. NMVB will be granted the ability to award damages in warranty, parts and labor rates disputes. If a protest is made to NMVB, manufacturers will be restricted from filing claims in state court. They can still appeal board decisions to the superior court.

The bill further requires any claim brought to originate in California. This change stems from a case currently being litigated in Tennessee by Nissan against three dealerships in West Covina. In that case the West Covina dealers asserted that NMVB had an exclusive right to handle franchisor-franchisee disputes. The Tennessee court asserted California law granted them the authority to hear the case, as it grants a party the right to file a lawsuit in a court for common law and statutory claims.

Further, unlike a claim brought in state court, many of the provisions in this bill reverse the ordinary jurisprudence of who has the burden of proof. While in civil court a dealer bringing a claim against a manufacturer would have to prove the manufacturer violated the franchise agreement, a case brought before NMVB would place the burden on the manufacturers to show they did not violate the franchise agreement.

CMTA contends this bill denies auto manufacturers due process by improperly favoring dealers and gives too much authority to a board that is mandated to have four of its nine members be dealers.

Nickeled and Dimed: The most substantive change this bill brings is creating a statutory scheme for how dealers should be reimbursed for labor and parts of warranty work and granting authority to the NMVB to enforce these provisions. Currently, parts and labor rates for warranty reimbursements are generally set by manufacturers, and disputes about reimbursement rates are generally handled in state courts. Existing law 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. The sponsors of this measure assert that they are unaware of any manufacturer actually adjusting their schedules to reflect the true retail rate.

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. Rates would be calculated by looking at either 100 sequential qualified repair orders, or all qualified 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 Global Automakers, writing in opposition, contend that these omissions would result in higher warranty labor and parts reimbursements rates to the detriment of manufacturers and California consumers.

The Global Automakers, while arguing that California's current law requiring that manufacturers adequately and fairly compensate each of its franchisees for labor and parts used to fulfill warranty agreements is sufficient, they also recognize that if the legislature wants to specify how these rates are calculated they should be redrafted. They contend that the section of the bill allowing omissions is vague and may artificially inflate a dealer's warranty labor rate. For reimbursements on warranty parts, they believe the calculation is incorrect and needs to be redrafted.

The California Manufacturers and Technology Association (CMTA) are less nuanced. They argue that this bill, if enacted, "would prohibit manufacturers from validating that a dealer's rates charged to consumers are fair and reasonable. It encourages dealers to increase consumer retail repair rates and prices to inflate compensation on warranty work from manufacturers. Additionally, AB 2107 utilizes fabricated and erroneous formulas and processes to calculate

warranty reimbursement rates, allowing dealers to manipulate data and significantly exaggerate rates."

The other major issue in this bill involving rates stems from how it would be enforced. Manufacturers are required to begin paying the labor and parts rate as calculated under this bill within 30 days. Manufacturers are allowed to challenge this rate with NMVB, but the only challenge they can bring is for material accuracy. Opponents contend they should be able to challenge the rates on other grounds as well.

Until the issue is settled by the NMVB, manufacturers are required to pay the rate they are contesting. If the manufacturer fails to do so, the dealer can protest the lack of payment with NMVB. NMVB is then granted the authority to force the manufacturers to reimburse dealers for the difference between the amount the dealer received and the amount the dealer would have received if the manufacturer compensated them at the requested rate.

While dealers can be awarded damages under this bill, there are no reverse provisions for manufacturers to be reimbursed if they have to pay rates NMVB later deems to be materially inaccurate. The opponents contend that damages should be determined by a civil court, not NMVB.

Stay Out Of My Lane: Dealers have contended that manufacturers have taken several steps to circumvent their franchises and are directly competing for the same customers. In order to reduce this competition, they have proposed several changes to restore the franchise relationship between dealers and automobile manufacturers.

Current law 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. This bill expands that provision to cover the entire state, and then restricts manufacturers from directly or indirectly offering vehicles or parts for sale, lease, or subscription, unless such vehicles are offered exclusively by franchisees.

In particular, dealers are concerned about a new business model being rolled out by some manufacturers called vehicle subscription services. These services provide an alternative to a lease or car ownership. Instead of having any sort of ownership stake in a car, you pay a monthly fee to a manufacturer for access to several vehicle models in its lineup. The fee covers the cost of insurance, maintenance and roadside assistance. Users can order the vehicles through an app, and can swap vehicles out if they want to use a different type of vehicle.

This bill would require subscription services to be offered only through dealerships. Opponents contend that the section is overly broad, as it fails to define what was a subscription service is, and is concerned the bill could foreclose any number of potential business models that may change the way consumers use cars. CMTA believes that these provisions will stifle innovation and interfere with the ability of manufacturers by developing innovative new mobility products and services to adapt and evolve with a changing marketplace.

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 may still be 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, it would prohibit manufacturers from restricting a dealer from servicing any vehicle they sold or leased.

Opponents state that they believe this section of this bill is overly broad and vague.

That Special Shade Of Green-Gold Color: Dealers contend that manufacturers too often require dealers to perform facility improvements on dealerships and require the purchase and use of goods or services from a specific vender for dealership signs. They have contended that they are required to even lease these signs instead of purchasing them, increasing their own costs. To address this issue, this bill restricts manufacturers from requiring a dealer to acquire signage at actual cost or restrict the ability of a dealer to erect or maintain signs from a specific vendor.

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 manufacturers brand image program.

Opponents contend that brand is important, and such signage restrictions and facility adjustments are established to make sure dealerships are properly advertising their brand. After all, companies go to great lengths to protect their brand and trademarks, and every line and color in a logo is important to them. Even a shade of color can be important, as evidenced in Qualitex Co. v. Jacobson Products Co., 514 U.S. 159 when the Supreme Court recognized Qualitex ability to trademark its special shade of green-gold color.

One of the amendments taken on April 16, 2018, was to reduce the time limit for the modifications from 15 years to 10 years and to eliminate a dollar amount on the amount of modifications that would be considered reasonable. It is unclear, however, what effect eliminating the dollar amount would have, as the bill could be interpreted to essentially make any request for modification unreasonable if one request had already been made. The Author has also clarified that modifications made for the purposes of enabling the sale or service of zero emission and near zero emission vehicles are not included in this provision.

Location, Location, Location: This bill prohibits manufacturers from making a site control agreement as a condition for purchasing or renewing a franchise. In essence, this prohibits a manufacturer from having input on the location of where their product is sold. Dealers have contended that these provisions have been used to stop dealers from relocating their businesses or making multi-dealership sales. Manufacturers contend this prohibition limits their ability to control their brand.

The Right To Refuse: Current law allows manufacturers the right of first refusal in the purchase of their dealerships in limited circumstances. They are allowed to block the sale of a dealership by purchasing the dealership for the offering price, and reimbursing the dealer for any expenses paid or incurred by the dealer in evaluating, investigating and negotiating the proposed transfer.

They cannot exercise this right if the proposed transferee is a family member of the owner of the dealership, nor a managerial employee owning 15% or more of the franchise.

Dealers have contended that manufacturers have used this right to leverage both the selling dealer and the buying dealer, delaying the sale of the dealership, splitting dual dealerships, and eliminating a multi-dealership deal. They argue some manufacturers force them to sign agreements restricting the dealer's property such as the ability to relocate the dealership.

To deal with these issues, dealers are proposing to eliminate a manufacturer's ability to exercise the right of first refusal altogether, while still keeping intact the requirement that they give consent to the new dealer as a franchisee.

Opponents contend the right of first refusal is extremely important market development right that allows manufacturers to select dealers who will provide the highest quality of service to California customers and who will promote the manufacturer's brand, reputation, and image.

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.

Dealers contend these standards fail to take into account crucial differences in local market conditions and can lead to several negative consequences ranging from disqualification for incentives to franchise termination. To address these issues, this bill would also prohibit performance standards on the basis of the number of customer repair orders or ones that fail to take into account the brand or type of parts used in retail customer repair orders. It further restricts manufacturers from requiring the advancement of money to participate in incentive programs.

Manufacturers contend that they must be able to review and consider a dealer's repair orders to calculate any type of service performance standard, and that the proposed language is too vague and ambiguous.

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. This provision is set to sunset in 2019. This bill removes the sunset, and based on some interpretation issues with the NMVB, more clearly defines an adverse action.

Committee Amendments: In light of the fact that some parties are still negotiating this bill, the committee recognizes that many of the provisions will change over the course of the legislative process. However, there are several provisions in this bill that focus on areas that have been previously negotiated in past bills recasting the Automotive Franchise Law, while other

provisions restrict the manufacturer from controlling their own trademark. As such, the committee recommends the following amendments:

1) Remove the provision that takes away an auto manufacturer's right of refusal and require future franchise agreements to not include provisions that give them a right of first refusal. [These amendments would restore the original Vehicle Code Section 11713.3(t) and strike the new 11713.3(t)]

2) Strike amendments made to 11713.13(c)1 that restricts a manufacturer from requiring a specific vendor for their signs. Specifically, remove the following language: Notwithstanding the foregoing, a manufacturer, manufacturer branch, distributor, distributor branch, or affiliate may not restrict the ability of a dealer to acquire signage at actual cost or restrict the ability of a dealer to erect or maintain signs by requiring the use of any specific vendor.

3) Strike the additional language placing restrictions on performance standards as outlined in 11713(g)1(B)(C)(D), as the existing law on performance standards was negotiated in past legislation.

4) The Global Automakers contend that data security is important and want a say in what vendor is used, but recognizes that the dealers should have a say. The committee recommends striking 11713.13(h) and replacing it with "a dealer has the option to select a vendor chosen by a dealer and approved by a manufacturer for the provision of digital services."

Previous Legislation: 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)

Opposition

Alliance of Automobile Manufacturers
California Manufacturers and Technology Association
Global Automakers
Technet

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