HOUSE BILL REPORT
HB 2524

As Reported by House Committee On:
Business & Financial Services

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: Representatives Kirby, Vick, Ryu, Chandler, Blake, Santos, Stanford, Zeiger, Hurst, Fagan, Takko, Habib, Harris, Sullivan, Kretz, MacEwen, Wylie, Moeller, Morrell, Haigh, Freeman, Springer and Stonier.

Brief History:

Committee Activity:

Business & Financial Services: 1/29/14, 1/31/14 [DPS].

Brief Summary of 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 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.
- Adds provisions regarding access to new motor vehicle dealer data systems and liability for damages for security breaches.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Kirby, Chair; Ryu, Vice Chair; Parker, Ranking Minority Member; Vick, Assistant Ranking Minority Member; Blake, Fagan, Habib, Hawkins, Hudgins, G. Hunt, Kochmar and MacEwen.

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.

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.

<u>Denial of Licenses</u>.

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.

<u>Termination of Franchise Agreements</u>.

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.

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 Substitute Bill:

<u>Denial of Licenses</u>.

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.

<u>Termination of Franchise Agreements</u>.

Sufficient Inventory.

If a manufacturer terminates a dealer's agreement based upon the dealer's performance, 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; (2) none of the dealer's primary allocations of any vehicle during the performance period was more than 120 percent of any other primary allocation during another period established by the manufacturer; and (3) the manufacturer provides, upon the dealer's request, documentation sufficient to develop a market analysis. The documentation must include the allocation of inventory to the dealer and other dealers in the same zone during the period established by the manufacturer.

Transportation, Relocation, Alteration, or Remodeling.

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 only pay the cost of transporting new motor vehicles, supplies, parts, and accessories purchased from the manufacturer or a 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 the dealer for 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.

<u>Unfair Practices</u>.

Relocation.

If a dealer relocates its facility, as permitted under statute, the relocation must be in a relevant market area, and the manufacturer has an administrative right to protest the location.

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

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 before the fifteenth 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 items for a full refund within 90 days.

Second 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 second stage manufacturer to own, operate, or control a new motor vehicle dealership.

A "second stage manufacturer" is "a manufacturer who permanently installs structure and equipment upon the engine, chassis, and drivetrain of a vehicle to produce a tow truck, ambulance, or fire truck." A second stage manufacturer does not include the manufacturer who produces the engine, chassis, or drivetrain.

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

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. 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 related to the disclosure of security breaches.

<u>Retroactivity</u>.

This act applies to all franchises and contracts between the manufacturers and dealers in existence on the effective date, or those amended, renewed, or entered into after the effective date.

Substitute Bill Compared to Original Bill:

Circumstances under which good cause exists for termination, cancellation, or nonrenewal of a dealer's agreement for performance are clarified. Upon termination, cancellation, or nonrenewal of a franchise, the manufacturer must only pay the cost of transporting new motor vehicles, supplies, parts, accessories, and furnishings purchased from the manufacturer or a manufacturer-approved vendor.

The methodology for calculating the dealer's average percentage markup is modified and engine assemblies and transmission assemblies are to be included in that calculation. The number of times that a dealer may be granted an increase in the average percentage markup or labor and diagnostic work rate is reduced from twice per calendar year to once per calendar year.

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. The time period during which the manufacturer has the right to audit claims for warranty work is increased from six months to nine months.

Notwithstanding the prohibition against a manufacturer competing with a dealer, a second stage manufacturer is permitted to own, operate, or control a new motor vehicle dealership and a definition for the term "second stage manufacturer" is added.

A manufacturer may require a dealer to accept delivery of service or repair appliances, equipment, parts, or other commodities that are not requested by law and not requested by the dealer if the dealer has the right to return the items for a full refund within 90 days.

The provisions of the bill apply retroactively to all franchises and contracts between manufacturers and dealers in existence on the effective date of the act and to the contracts that are amended, renewed, or entered into after the effective date of the act.

Appropriation: None.

Fiscal Note: Requested on January 28, 2014.

Effective Date of Substitute Bill: 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 addresses a host of challenges, and dealers share support for all provisions of the bill. Dealers want to take care of customers. Manufacturers try to keep their payment of warranty costs low. Several years ago, the dealers agreed on how to determine the average mark-up, and the manufacturers tried to get around that agreement by including items that are not normally repaired under warranty and that have a very small mark-up. This bill addresses some of the dealer's privacy concerns. Dealers use their internal computer systems to help manage their customer relationships. Some manufacturers are demanding the right to unlimited access to individual customer's information.

(Opposed) There have been conversations and some exchanges of language, but there is not much agreement on the bill. While there have been minor improvements in the substitute bill, there are many issues that remain. A new provision states that good cause termination for dealers does not exist unless the dealer's allocation is sufficient. Generally, allocation does not trigger a termination; so including this provision is problematic. Facility modification is a hot issue across the states, and the manufacturers want to make it difficult for a dealer to say no to a request that they remodel. If an image program is important, then the manufacturer will try to induce a dealer to participate in that program. Warranty reimbursement has been the subject of litigation. The provision in the bill that allows dealers to claim reimbursement for documentation is "double-dipping" because the reimbursement already includes administrative costs. Manufacturers do not object to an opportunity to locally source goods or services, but they want to make sure that the integrity of the brand is maintained.

Persons Testifying: (In support) Bryan Imai, Washington State Auto Dealers Association; John Creedon, Vancouver Ford, Honda, and Suzuki; Gary Gilchrist, Gilchrist Chevrolet; and Bill McCurly, McCurly Integrity Dealerships.

(Opposed) Amy Brink, Alliance of Automobile Manufacturers.

Persons Signed In To Testify But Not Testifying: None.