



BUREAU OF COMPETITION

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

V8200-1

February 19, 1988

The Honorable William P. Te Winkle
State Senate
136 South, State Capitol
P.O. Box 7882
Madison, Wisconsin 53707-7882

Dear Mr. Te Winkle:

The staff of the Federal Trade Commission is pleased to provide these comments on Senate Bill No. 466, An Act Relating to Various Changes to the Fair Dealership law. ^{2/} The proposed legislation, if enacted, would amend Wisconsin's fair dealership law, which prohibits "grantors" of dealerships ^{1/} from terminating any dealer without good cause. Under the bill, the good cause requirement for terminations would not be satisfied even when a grantor withdraws from a product or geographical market, changes its distribution system, sells real estate occupied by the dealer, or discontinues business in whole or in part.

We believe that enactment of S.B. 466 could harm consumers by increasing the costs associated with terminations that are made for sound business reasons. These cost increases may deter suppliers from establishing additional dealerships in Wisconsin or from entering into any dealership agreements with Wisconsin

^{*}/ These comments represent the views of the Federal Trade Commission's Bureaus of Competition, Consumer Protection, and Economics, and do not necessarily represent the views of the Commission itself or any individual Commissioner. The Commission has voted, however, to authorize us to submit these comments for your consideration.

^{1/} "Grantor" is defined as "a person who grants a dealership." Wisc. Stat. § 135.02(3). "Dealership" is defined in turn as "a contract or agreement . . . by which a person is granted the right to sell or distribute goods or services, or use a trade name, trade mark, service mark, logotype, advertising or other commercial symbol, in which there is a community of interest in the business of offering, selling or distributing goods or services at wholesale, retail, by lease, agreement, or otherwise." Wisc. Stat. § 135.02(2). The statute defines "community of interest" as a "continuing financial interest between the grantor and grantee in either the operation of the business or the marketing of such goods or services." Wisc. Stat. § 135.02(4). See, e.g., Lakefield Telephone Co. v. Northern Telecom, Inc., 656 F. Supp. 813 (E.D. Wisc. 1987).

firms. This state-created entry barrier, in turn, may give existing dealers a degree of market power to increase prices or reduce services to Wisconsin consumers without fear of new entry and increased competition.

Interest and Experience of the Federal Trade Commission

The Federal Trade Commission is charged by statute with preventing unfair methods of competition and unfair or deceptive practices in or affecting commerce. 15 U.S.C. § 45. Under this statutory mandate, the Commission seeks to identify and comment upon restrictions that impede competition or increase costs without offering countervailing benefits to consumers. The Commission and its staff have provided comments to federal, state, and local legislatures and administrative agencies on matters that raise issues of competition or consumer protection policy. In 1987, the Commission's staff provided comments to your legislature concerning a bill to repeal the state's relevant market area law. We have also commented on legislation limiting suppliers' ability to terminate dealers or restricting entry into markets. In 1984, for example, the Commission presented testimony against proposed federal legislation that would have restricted the ability of suppliers of office machines and equipment to terminate dealers. In 1987, the Commission's staff commented to the Georgia and Nevada legislatures on bills to restrict the marketing of gasoline by refiners.

The Proposed Legislation

Under the Wisconsin Fair Dealership Law, Wisc. Stat. §135.01 et seq., grantors are prohibited from terminating, canceling, failing to renew, or substantially changing the competitive circumstances of a dealership without "good cause." Wisc. Stat. §135.03. "Good cause" is defined as the failure of a dealer to comply with "essential, reasonable, and nondiscriminatory requirements" of the grantor or bad faith by the dealer. Wisc. Stat. § 135.02(6). S.B. 466 would amend the statute by providing that the following justifications would not provide good cause for dealer terminations:

1. The grantor's withdrawal from a product or geographical market.
2. A change in the grantor's distribution system.
3. A sale by the grantor of real estate occupied by a dealer.

4. Discontinuation of a grantor's business in whole or in part.

S.B. 466, Section 1.

In addition, the bill would prohibit a grantor from "[s]ubstantially changing the competitive circumstances of a dealer's business without good cause." S.B. 466, Section 3. Under this provision, grantors may be prohibited from establishing new dealerships or integrating forward into retail distribution. The bill also would prohibit grantors from preventing a dealer from transferring or assigning all or part of the property that constitutes the dealer's business, or from changing its capital structure. S.B. 466, Section 4.

Effects of S.B. 466 on Competition and Consumer Welfare

Enactment of S.B. 466 could freeze certain business relationships for long periods of time, without any regard to changes in market or other economic conditions. 2/ The bill could be read to prohibit suppliers from terminating the supply of unsuccessful or obsolete products to dealers who insist on the continuation of the supply relationship. 3/ For example, a supplier who wished to stop selling home movie cameras because of the success of video recorders, could be compelled to continue marketing this obsolete product. The bill also would prohibit suppliers from withdrawing from geographical markets. Thus, a supplier who wished to stop marketing a poorly-selling product in the Midwest would be prohibited from withdrawing from the Wisconsin market. Indeed, the bill could be read to prohibit a supplier who wished to go out of business from doing so.

The conduct that S.B. 466 seeks to prohibit is the very essence of a market economy. In a market economy, market forces continually reshape the composition of goods and services that are available to consumers. As consumer demand for buggy whips

2/ Dealers currently possess other legal remedies for wrongful terminations. In the first place, dealers may enter into contracts that protect their businesses from termination. In addition, common law and the existing Fair Dealership Law give dealers protection from terminations, even in instances in which dealers have failed to negotiate contract provisions guaranteeing a long-term supply relationship.

3/ We use the term "supplier" rather than "grantor" because the term has a more readily understood meaning. We recognize that not every supply relationship will render the supplier a "grantor" of a "dealership" for purposes of the statute.

sags and demand for automobile headlights rises, a market economy shifts investment away from buggy whip manufacture and toward headlight manufacture. This adjustment process produces the types of goods and services that consumers desire. State interference with this process can thwart the realignment of investment necessary for the production of the goods and services that consumers wish to buy.

Under S.B. 466, suppliers could be required to invest in the production or distribution of goods and services that consumers do not wish to buy. This distortion of business investment decisions likely would result in the overallocation of resources to products or markets with declining demand and the underallocation of resources to products or markets with rising demand. The market's ability to respond quickly to shifts in consumer preferences consequently would be undermined.

In addition, enactment of S.B. 466 could injure Wisconsin consumers by discouraging the establishment of new dealerships and thereby giving some dealers market power to charge supracompetitive prices. The bill would discourage the establishment of new dealerships in Wisconsin in two ways. First, the bill would require suppliers to maintain every supply relationship that a dealer wishes to continue unless they can prove dealer misconduct. The knowledge that it will be difficult or extremely costly to terminate dealerships is likely to deter suppliers from granting new dealerships in the first place. Second, proposed section 135.03(1)(b) appears to prohibit suppliers from establishing new dealerships or integrating forward into retail distribution if such action would "[s]ubstantially change the competitive circumstances of a dealer's business without good cause." By erecting these artificial entry barriers, the proposed legislation may enable existing dealers to charge higher prices to Wisconsin consumers. ^{4/} In addition, Wisconsin citizens might find it difficult to enter business in growing retail markets because suppliers may be reluctant to grant dealerships in the state.

^{4/} A recent study by a Commission economist showed that relevant market area laws, which restrict entry into the automobile dealership business, increased the price paid by consumers for new automobiles by an average of 6.14 percent. R. Rogers, *The Effect of State Entry Regulation on Retail Automobile Markets* 7 (1986). Under relevant market area laws, existing dealers may be able to prevent a manufacturer from granting additional dealerships in their geographical market areas. Similar effects could be expected in other product markets in which restrictions on the granting of new dealerships are imposed.

To avoid the costs imposed by the proposed legislation, suppliers may grant additional dealerships in neighboring states that have not enacted the restrictions of S.B. 466. Some suppliers may choose to sell to Wisconsin consumers through out-of-state dealers, even where this form of distribution is less efficient than establishing additional dealers in Wisconsin. As a result, Wisconsin consumers may have to travel farther and pay more for products.

Conclusion

The enactment of S.B. 466 is likely to harm Wisconsin consumers by reducing the number of dealers with whom suppliers will deal. The legislation may lead to higher prices for Wisconsin consumers and could reduce the availability of new products within the state.

Sincerely,

Barbara C. Clark, Acting
for Jeffrey I. Zuckerman
Director