

Florida's Dealer Franchising Laws: Tesla Innovation Highlights the Forgotten Consumer

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Tesla's vow to sell its vehicles directly to consumers has forced the electric automaker to contend with a powerful network of dealerships and a century's worth of regulations designed to protect their business model. Laws once intended to shield dealerships and their customers from coercive manufacturers are now denounced by economists, policy analysts, and Tesla itself as harmful to consumers. Numerous states have already taken sides in this battle, some by implementing bans on Tesla's sales model and others by lifting existing restrictions. Florida, despite an active dealer lobby and dealer franchising laws that are among the most comprehensive in the nation, has silently become one of Tesla's largest markets. Florida's unique regulatory and economic environments provide valuable insight into the legitimacy of arguments being presented by either side in this ongoing debate.

Introduction

Before electric automobile manufacturer Tesla was founded in 2003, the most recent successful American carmaker to be founded was Chrysler in 1925. Before Tesla went public in 2010, the most recent American carmaker to do so was Ford in 1956. Tesla's 2008 release of the Roadster, an all-electric sports car, made it the first electric production car to travel over 200 miles per charge. The launch of the Model S in 2012 and the Model X in 2015 established Tesla as a household name and an unprecedented entrepreneurial success story in the mature automotive industry.

Fast forward to 2017, and the Model S is the best-selling luxury sedan in America¹ and the recipient of countless accolades, including Motor Trend's "Car of the Year," Consumer Reports' "Best Car Ever Tested," and the National Highway Traffic Safety Administration's "Highest Safety Rating in America." Over 400,000 interested consumers have placed deposit-backed reservations for Tesla's upcoming Model 3 sedan.² Tesla has captured the attention of the American public and has been heralded as the Apple of the automobile industry,³ with CEO Elon Musk as its Steve Jobs.⁴

Amidst a flurry of awards and media coverage, another industry first has given Tesla the title of regulatory entrepreneur, a company whose business plan hinges on resolving key legal issues.⁵ Tesla is the first automobile manufacturer to entirely circumvent the established dealer franchising system. Every other manufacturer distributes its vehicles in the United States through independent, licensed dealerships, but Tesla has instead chosen to sell directly to the consumer online and through storefronts. In doing so, it has been forced to contend with a powerful national network of franchised dealers and a century's worth of regulations designed to protect their business model. Policy arguments

have begun taking place in various state legislatures over whether or not to allow Tesla to sidestep the dealer franchising system, and numerous states have taken either side in the debate.

Florida, a noteworthy exception, stands in contrast to the tooth-and-nail battles unfolding in many states. The state has silently allowed Tesla to establish and grow its operations without intervention from lawmakers or dealers. Only Florida Senator Marco Rubio has commented publicly on the matter, siding in favor of Tesla and against regulations as a "defensive weapon" for the established members of the automobile industry.⁶ Using Florida and its regulatory environment as a platform for comparative analysis will provide greater depth and clarity for an issue that varies across all 50 states.

Modern Disruptions of Automotive Franchising

The modern hegemony of dealership franchising came to exist largely because manufacturers historically found that distribution model to be the most preferable. However, changes to the automotive industry and to society at large have issued numerous challenges to the entrenched model of automobile sales.⁷ Innovation in e-commerce, changing economic conditions, and advancements in new automotive technologies have been cited as reasons to question the need to maintain exclusive distribution for dealerships.

The rise of the Internet has dramatically altered consumers' car-buying experiences,⁸ but in spite of the Internet's positive effects on consumers, it has fallen short of the revolutionary visions of the 1990s, which predicted custom-built direct-to-consumer automobile sales that minimized inefficiencies in distribution.⁹ Such a system could have eliminated part of the existing costs created by the traditional dealer system—approximately \$6,245 to the average vehicle's gross cost—in the form of transport, dealer overhead, manufacturer sales support, and "phantom

costs” caused by imperfect anticipations of consumer demand for particular vehicle models and configurations.¹

Supported by the protectionist legislation that they lobbied for, dealerships have successfully resisted online efforts to circumvent their established role in automobile sales.¹¹ In 1999, the Texas Department of Transportation found that Ford’s newly-established website for selling used cars violated the Texas Motor Vehicle Commission Code, which prohibited manufacturer-direct sales.¹² Though Ford’s online system directed buyers to dealerships to complete their purchase, it was determined to have overstepped the strict statutory boundaries by assuming a sales role reserved for dealers. In 2001, Ford and General Motors launched websites to provide online shoppers inventory data and haggle-free pricing, but ran afoul of state legislation and disgruntled dealerships.¹³ NADA is strongly opposed to manufacturer involvement and champions the benefits that consumers derive from the franchise model, namely the degree of market competition, franchisees’ knowledge and involvement in the local community, and post-purchase support.¹⁴

Modern economic developments call into question some of these claims. Dealerships have seen a steady decrease in the number of market competitors nationwide—from a peak of 53,125 dealers in 1927,¹⁵ to 16,545 in 2015.¹⁶ Government restructuring of General Motors and Chrysler during the 2008 recession forced them to terminate numerous underperforming dealerships,¹⁷ though Congressional pressure inevitably prevented many of these dealerships from being closed.¹⁸ Moreover, the number of small dealerships has fallen and ownership has consolidated, with 5% of dealer principles representing 31% of new vehicle sales by 1998.¹⁹

Franchising operations in other industries demonstrate that company-owned and franchisee-owned outlets can coexist within a single brand. Economists Roger D. Blair and Francine Lafontaine conclude that dual distribution is an equilibrium strategy in franchising, with a vast majority of franchisors choosing to directly own less than 20 percent of their outlets.²⁰ Moreover, they failed to observe opportunistic behavior by franchisors²¹—company buybacks are infrequent and franchised outlets that were terminated had below-average performance.²² NADA asserts that small, locally-owned dealerships are better able to respond to market conditions and customer preferences,²³ but this argument is diminished to some extent by the considerable consolidation of automotive dealerships.²⁴ However, the franchising analysis notes that smaller and more rural outlets that are further away from company headquarters are more likely than others to be franchised,²⁵ which supports the validity of NADA’s claim, but not in the context of a prohibition against dual distribution in the automotive industry.

The value of franchised dealerships in post-purchase vehicle support such as maintenance and warranty work is a seemingly more tenable argument. If competition from

alternative distribution methods resulted in widespread dealership closure, consumers could lose an important and accessible venue for these services.²⁶ However, even if dealers lost some new cars sales to competing modes of distribution, this kind of extreme outcome seems unlikely—dealers’ average profits from the service and parts departments, as well as the used-vehicle departments, far exceed those from new-vehicle departments.²⁷

The strongest challenge to the dominance of dealer franchising has come from Tesla. Elon Musk, Tesla’s founder and CEO, has emphasized a commitment to a distribution model of company-owned stores and service centers that circumvent franchised dealerships.²⁸ Currently, Tesla lawfully owns and operates stores in 23 states and the District of Columbia, and service centers in 24 states.²⁹ However, Tesla is working within a political framework where dealers and their organizations command a significant degree of political influence—36 bills for auto industry regulations were introduced in 22 states in 2015.³⁰

Florida’s Extensive Dealer Franchising Laws

Florida’s history of regulating the manufacturer-dealer franchising arrangement parallels the national currents of the twentieth century. The state first began to regulate this relationship with legislation passed in 1941, establishing a licensing system for manufacturers and addressing coercion of dealers to accept unwanted inventory and wrongful franchise termination.³¹ A more extensive set of regulations replaced prior legislation in 1970, forming the current legislative framework. The revised legislation offered protection from wrongful franchise termination,³² created territorial exclusivity for dealerships,³³ and set requirements for manufacturers to reimburse dealers for warranty work.³⁴

Various additions and amendments adding clarification and additional protection for dealerships were passed in the following decades. In 1980, an addition established guidelines for transfer or sale of dealership franchises and barred unreasonable interference by manufacturers in this process.³⁵ In 1984, a new section restricted manufacturers from owning dealerships, though it provided some exemptions in specific circumstances such as temporary ownership or where the manufacturer has not licensed any franchises within the state.³⁶ An extensive rewriting of these laws occurred in 1988.³⁷ This revision largely focused on clarification and textual improvements, though it did notably expand the regulations providing established dealerships with territorial exclusivity. Numerous revisions have been passed since then, mostly minor amendments focused on changes in language and administrative issues. Legislation passed in 2001 expanded the procedures and remedies for wrongful termination of franchises and established a state advisory board of automotive dealership representatives.³⁸ Changes made over the next decade involved clarifications

and minor revisions chiefly concerned with territorial exclusivity, wrongful termination, manufacturer incentives, and transfer and sale of dealerships.³⁹ The most recent revision occurred in 2016 and included a prohibition against manufacturers coercing dealers from purchasing goods or services from a designated vendor.⁴⁰

Presently, sections 320.60-.70 govern the relationships between manufacturers and dealers. The Florida Legislature has codified that the intent of these laws is “to protect the public health, safety, and welfare of the citizens of the state by regulating the licensing of motor vehicle dealers and manufacturers, maintaining competition, providing consumer protection and fair trade and providing minorities with opportunities for full participation as motor vehicle dealers.”⁴¹

These laws have been described as “among the most dealer-friendly franchise laws in the nation” and have been credited with the growth of Florida-based AutoNation, Inc.,⁴² the nation’s largest dealership group by sales.⁴³ Florida law goes as far as providing established dealers with territorial exclusivity by allowing them to block new dealerships of the same line-make from opening in a nearby area that the established dealer is adequately serving.⁴⁴ Dealers can even block new competitors from opening in neighboring counties. Attempts in the 1980s by the Motor Vehicle Manufacturers Association of the United States to oppose Florida’s regulations, though unsuccessful, drew attention to how the policy underserved customers—Florida dealers at the time served an average of 13,362 people each, well above the national average of 9,517.⁴⁵

A review of manufacturer-dealer regulations by Florida’s Office of Program Policy Analysis and Government Accountability found that Florida has the most extensive and stringent laws of any state. It deemed Florida to have comparatively equal or greater degrees of regulation in five areas—franchise termination, new dealership establishment, changes in control of dealerships’ executive management, franchise sale and transfer, and availability of civil damages against manufacturers.⁴⁶ It asserted that consumer interests and free trade were undermined by these regulatory programs, and recommended reducing their restrictiveness.

Economists and policy analysts have generally denounced the type of dealer protectionism seen in Florida as being detrimental to consumers. A report from 1972, before many states had even imposed rigorous franchising laws, estimated that economic inefficiencies caused by these laws added 9.3 percent to the cost of a vehicle, or \$3.9 billion per year.⁴⁷ In 1986, the Federal Trade Commission concluded that state restrictions to competitive market entry by new dealerships raised car prices an average of six percent and cost buyers over \$3 billion per year.⁴⁸ The FTC has continued to advocate against restrictive regulations and bans on direct-to-consumer sales.⁴⁹ The Consumer Federation of America has compiled thirteen different analyses of these laws, all of which concluded that they had a negative impact on consumers.⁵⁰

Nonetheless, dealerships in Florida continue to advocate for additional protection. Proposed legislation in 2015 and 2016 was anticipated to have a positive fiscal benefit for dealerships.⁵¹ There is a close, formal relationship between dealerships and the State of Florida, as showcased by the Automobile Dealers Industry Advisory Board, a committee of industry representatives established under the Department of Highway Safety and Motor Vehicles that makes recommendations on legislation and aspects of the industry in general.⁵² Four Florida organizations represent the interests of new car dealers—the Florida Automobile Dealers Association, the Central Florida Auto Dealers Association, the Jacksonville Automobile Dealers Association, and the South Florida Automobile Dealers Association. However, unlike dealer organizations in many other states, those in Florida have remained silent on Tesla’s business model and statewide expansion.

Florida As A National Benchmark

In spite of strict and comprehensive legislation, obstructions to Tesla’s market entry into Florida have been essentially nonexistent. Manufacturers with established dealer franchises within the state are prohibited from conducting direct-to-consumer sales or operating a dealership, but a manufacturer without any franchisees licensed in Florida is exempt from this provision.⁵³ Thus, Tesla is lawfully able to operate its 11 stores in Florida.⁵⁴ These Florida stores are registered to the state as Franchised Motor Vehicle Dealers,⁵⁵ which the governing statute broadly defines as any dealer with an agreement to sell a manufacturer’s line of vehicles.⁵⁶ Under Florida’s regulatory scheme, Tesla is also authorized to establish service centers independent from their sales facilities. Florida is the nation’s third largest market for automobiles, surpassed only by California as the largest and Texas as the second largest.⁵⁷ A share of 11.2 percent of all new and 7.8 percent of all used Model S cars makes Florida the second largest market for Tesla, while California claims first place and Texas claims fourth (behind Washington).⁵⁸ Those two states provide an excellent platform for a comparative analysis of regulatory environments and Tesla’s market penetration.

Comparative Analysis: Texas. Texas is the largest state, both in terms of population and automobile sales, to restrict Tesla from conducting direct-to-consumer sales within the state. The Texas Motor Vehicle Commission Code, which forced Ford to shut down its online used car sales experiment, prevents Tesla from operating under its sales model within the state. The law reads that a manufacturer may not, “(1) own an interest in a franchised or nonfranchised dealership; (2) operate or control a franchised or nonfranchised dealership; or (3) act in the capacity of a franchised or nonfranchised dealership.”⁵⁹ Tesla invested over \$625,000 and hired 21 lobbyists during Texas’s 2015 legislative session to amend the law, but failed to make any

progress in the face of opposition from a strong dealership lobby and an unreceptive governor.⁶⁰

Yet, Tesla still operates in nine different locations across Texas, with a tenth scheduled to open soon. The distinction between its Texas “galleries” and the “stores” it operates in less restrictive states is represented by the difference in name—Tesla’s galleries do not conduct sales, offer test drives, or discuss pricing and purchasing. Instead, they promote brand awareness through a presentation of Tesla vehicle technology. Texans still have the ability to customize and purchase a vehicle online, but they must register it in California, have it shipped, and re-register it in Texas.⁶¹

Despite this extra burden and the ban on direct sales, Texas has become one of Tesla’s largest markets. As of 2015, Texans purchased 7.3 percent of all new and 8.3 percent of all used Model S cars in America.⁶² And while Tesla has been unsuccessful in its legislative battle, it has won in the court of public opinion—a Texas poll showed 85 percent in favor of allowing Tesla to bypass dealership regulations.⁶³

Comparative Analysis: California. Like Florida, California broadly regulates the manufacturer-dealer relationship. The California Vehicle Code establishes requirements for dealer coercion, franchise termination, and establishment of new dealerships.⁶⁴ Though California does restrict manufacturer-owned dealerships, it is far less strict than Florida or Texas and does not categorically limit manufacturers from pursuing direct distribution or online sales. Manufacturers are allowed to operate dealerships at least 10 miles from any of their own established franchises.⁶⁵

California is the national leader in Tesla sales by a vast margin, claiming 45.2 percent of all new and 30.5 percent of all used Model S sales.⁶⁶ Besides a slight lead on population size, there are a variety of likely reasons for the California’s market dominance. California purchases far more luxury cars than any other state, at 15.9 percent of all cars sold.⁶⁷ The California Clean Vehicle Rebate Project offers Tesla buyers a \$2,500 rebate, as well as access to carpool lanes and free municipal parking.⁶⁸ Perhaps the most significant aspect is the home-field advantage, as Tesla began in California and manufactures its vehicles there. Consequently, California has far more Tesla stores than any other state—28 in total.

Conclusion

Inferences made in the Tesla sales debate from information regarding sales and regulations in different states should be taken with a grain of salt. It is next to impossible to analyze all of the socioeconomic factors effecting sales in each state, and the scarcity of official Tesla sales data by region adds to that difficulty. Tesla’s current operations and prior manufacturer attempts at direct distribution have been insufficient to provide one side with an irrefutable argument for the long-term effects of

competition to dealer franchising, leaving states with the difficult decision of how to handle Tesla’s growing market presence and increased dealership opposition.

As debates over the “Tesla Approach” continue to unfold in state legislatures and both sides present their arguments, one particularly important group should not be forgotten—the consumer. Fortunately for Tesla, this aspect of the debate swings in its favor. The FTC, economists, and policy analysts have been decrying adverse effects of dealer protectionism on consumers in near-harmony for decades before Tesla brought this matter into the national spotlight. And, as Elon Musk himself noted, not one consumer poll has reported anything but overwhelming support from consumers for the direct-to-consumer model.⁶⁹

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