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Fully Loaded: Oklahoma's Car Dealer Licensing Cartel

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Oklahoma has two executive agencies dedicated to the regulation of car sales - not including the Corporation Commission, the Tax Commission, and the Department of Public Safety. The Oklahoma Motor Vehicle Commission (OMVC) regulates new car dealers, distributors, and manufacturers. The Oklahoma Used Motor Vehicle and Parts Commission oversees used car dealers, dismantlers, manufactured home dealers, manufactured home manufacturers, and manufactured home installers, and will be the topic of a forthcoming 1889 Institute paper.

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The current regulatory scheme for new car dealers includes numerous onerous and anticompetitive provisions that harm consumers. These include sections that: make it illegal for brokers to negotiate on behalf of buyers; prevent manufacturers from selling directly to consumers; give dealers enormous leverage over the placement of new dealerships as well as keeping manufacturers entangled with existing dealers, their heirs, or whomever a dealer decides to sell the franchise to; and mandatory licensing of dealers. Since these laws prop up dealerships at the expense of consumers, they should be eliminated. In fact there is little to justify the existence of a dealer licensing scheme at all, much less one as burdensome as Oklahoma's.

Commission

The Motor Vehicle Commission has nine members who are selected by the governor, with the advice and consent of the Senate. Seven members must be 10-year veterans of the new car

industry (manufacturer, distributor or dealer), while the other two must be lay members. One member must be appointed from each of six geographic regions, the other two come from the state at large.¹

The Commission is charged with ensuring compliance with all regulations and licensure related to the manufacture, distribution and sale of new cars. This includes the power to hear disputes over negative actions taken by the OMVC such as denial or revocation of a license or a fine. These dispute resolution responsibilities come fully loaded with quasi-judicial authority such as subpoena power and "the power to compel the production of all records, papers and other documents."²

History

Auto dealerships began as voluntary agreements between a manufacturer and a franchisee or dealer, calculated to be to the benefit of both parties. Manufacturers in the early days sold directly to consumers, or through non-exclusive channels such as retail or catalogue.³ Franchising made sense. Car manufacturing was a relatively new industry, and it's easy to imagine the nascent companies had a comparative advantage in making cars, not in selling them.

As manufacturers concentrated in Michigan, dealers spread throughout the country in order to meet customers where they lived. These dealers became powerful in their home states, and convinced their state legislatures to force manufacturers (who, being from out of state, played little role in state politics) to give advantageous terms to all dealers regardless of what their franchise agreement might say and regardless of whether or not the dealers quality merited such terms.⁴

A study by Mercatus Center looked at three aspects of dealer regulation: mandatory dealerships, exclusive territories, and good cause provisions for dealer termination. In 1979, only 24 states regulated all three of aspects of the dealer-manufacturer

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relationship, with several states regulating only one, and Alaska imposing none of these restrictions.⁵ By 2014, 49 states regulated all three. Oklahoma was one of the 24 early-adopters of overregulation.

Oklahoma began regulating car dealerships in 1953, ostensibly to protect consumers. But that laudable goal was either misguided or a facade from the start. Economists understand that government-created monopolies are the ones likely to stick around and harm consumers.⁶ Whatever the true intent of the law in 1953, even a cursory glance at today's laws reveals that car dealers enjoy enormous protections from both ends of the supply chain; they are insulated against both the manufacturers who supply them, and the consumers who buy from them.

Current Laws

An exhaustive catalog of the entire regulatory regime concerned with new vehicle sales would be neither practicable nor useful. The state of car dealer licensing is so deeply flawed that only extraordinary regulations are worth noting.

Illegality of Brokering

It is illegal in Oklahoma to be a broker of new cars. Here, broker means "a person who, for a fee, commission or other valuable consideration, arranges or offers to arrange a transaction involving the sale of a new motor vehicle," and excludes dealers, their employees, auctioneers, or the owner of the vehicle.⁷ A first offense is a misdemeanor, but someone caught brokering for a second time is guilty of a felony. It is unclear whether paying a lawyer or other professional negotiator to go to the dealership with you to negotiate on your behalf would run afoul of this law. It seems likely, based on the text of the law, that having a lawyer do the negotiation ahead of time, and having the buyer attend only the signing of papers would constitute brokering. Whether a dealer would engage with a buyer's agent when the buyer is present is also unclear.

Documents dating back to 2015 (the last date available on the attorney general's website) do not show any enforcement actions for violations of the anti-brokering section of the law.⁸ This could be due to many factors, including the difficulty in detecting such offenses, the great deterrent of felony charges for what is likely a small financial gain, or the commission taking a lax stance on the statute.

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This law appears to make it illegal to negotiate on behalf of a buyer, unless someone does it for free. Whether it reaches all the way to being paid to go car shopping with someone and help negotiate is not entirely clear. But even this lack of clarity is likely to chill these activities. Who would risk it? And who would risk it often enough, under the threat of a felony prosecution, to become as proficient in negotiation as the professional salesmen across the table? More to the point, why should car dealers enjoy a monopoly on the services of professional negotiators?

Anti-brokering laws are hardly ubiquitous. Several states allow the practice, though most require the same license as a car dealer. New York State currently allows brokers, but there is an effort by car dealers, Teamsters, and the United Auto Workers to install a law similar to Oklahoma's.⁹ While it is easy to see what the auto industry has to gain from such a practice - higher profit margins mean unions get a bigger piece from a bigger pie. It is less clear what, besides higher prices, consumers get out of the bargain.

Dealerships: Mandatory, Powerful, and Perpetual

Carmakers are required to use an intermediary dealer to sell their cars to consumers.¹⁰ Even a new car manufacturer with no current franchisees could not choose to sell new vehicles directly to consumers in Oklahoma. They must franchise with dealers, who must hire professional salespeople. However, factory-owned dealers that existed prior to 2000 are grandfathered in. A grandfather clause is a sure sign that the real purpose of a law is something other than consumer protection. After all, why would a factory-owned dealer that has been in business for 20 years be any less dangerous to the public than one that opened last week? If, on the other hand, the law is about creating a special class of middlemen and it is the dealers who benefit from reduced competition, they may be willing to accept a compromise wherein the existing factory-owned dealers can stay, so long as they are not allowed spread. The law is structured to accomplish just such a goal.¹¹

Oklahoma law makes it quite difficult for a manufacturer to get rid of a troublesome dealer. Dealers enjoy a presumption that they are entitled to maintain their franchise - notwithstanding the terms of the contract. That means that a manufacturer who wants to oust a franchisee must demonstrate "good cause" to the OMVC, a body loaded in favor of dealers.¹² This applies not only to terminating a dealer in the middle of the agreed contract, but also if a manufacturer does not wish to renew the contract after the agreed time period has ended. The presumption that the franchise agreement should continue in perpetuity extends not only to the party the manufacturer originally chose to be their representative, but also to that person's heirs, and to any potential buyer.¹³ In other words, once a dealer receives his franchise, Oklahoma law dictates that manufacturers are at that dealer's mercy in determining who is fit to continue the dealership, regardless of how negatively this might affect Oklahomans.

Barriers to Entry: Licensing and Exclusive Territories

The primary thrust of the law is clearly to limit the number of new car dealers in the state. This begins with the licensing of new dealers. No dealer can open without the OMVC's approval. If they propose to open near another dealer of the same line-make, they can, in effect, be vetoed by the entrenched competitor.

Car manufacturers must get permission from an existing dealer before granting another dealer franchise in the same geographic area (15 mile radius).¹⁴ More precisely, the manufacturer must provide notice to their affiliated dealers of their intent to grant a new franchise, and the dealers have an opportunity to express their opposition. If the dealers do so, the burden of proof is on the proposed dealer to show "that good cause exists for permitting the proposed establishment of a new motor vehicle dealer..." Factors to be considered include: whether the proposed

dealership will be permanent; the effect on the retail new motor vehicle business and the consuming public; whether it harms the public welfare for an additional dealership to be established; whether current dealers are providing adequate competition and convenient consumer care; and whether the establishment of an additional new motor vehicle dealership would increase competition, and therefore be in the public interest.¹⁵ The OMVC, composed of existing dealers, is the arbiter of whether a new dealership meets this burden.

Dealers must apply to the OMVC before displaying their vehicles off-site (for example, displaying vehicles in a mall or in the parking lots of other retail establishments). The off-site location must be within the dealer's "factory-approved area of sales and service responsibility" (on which the OMVC will have already signed off), and "no selling activities shall be conducted."¹⁶ These protections further entrench existing dealers, who have less ground work to do to attract the attention of car buyers. It is much easier to keep an established business running without these off-site events than it is to launch a new one.

It is certainly the case that the state has a duty to uphold legally binding contracts. If a manufacturer has promised a certain exclusive territory to attract the best dealer, the state should enforce such a contract. If the manufacturer has to give favorable termination terms, such as good cause or unfitness to attract the best dealers, these too should be upheld by the courts. But it is both harmful and unseemly for the legislature to foist such terms upon every manufacturer wishing to do business in the state.¹⁷

The Free-rider "Problem"

Those who defend car dealer licensure will be heard to complain of their inability to compete with low-overhead dealers who lack fancy showrooms, access to all models of a particular line-make at all times, factory authorized parts, repairs and maintenance, and all the bells and whistles that come with a fully licensed franchise dealer. The fear is that shoppers will go to a franchise dealer, take a test drive, waste the time of the dealer, and then go buy from a freelancer who can get the same car at the same price, but can cut the dealer's margin in half since he only has a small office with room for a couple of cars to be parked between dealer delivery and the customer driving off the lot.

This may be a valid fear for dealers. But does the fear validate the measures the state has taken to prevent it? One can try on shoes at the mall, find the right style and size, and then order the same pair online for a significant discount. This is the marketplace. It may well be that in 10 years there will be very few malls. They are certainly in decline.¹⁸ So should the state legislature ban the sale of shoes by anyone who doesn't have a retailer's license? Should it require shoe stores to be affiliated with Nike or Adidas?¹⁹ If not, what makes cars different? Why are the laws of supply and demand suddenly suspended when the good sold has four wheels and a stereo? Certainly it's nice to be able to test drive a car. It's also nice to be able to try on a shoe. The car is far less likely to leave you in severe pain if it is less than an ideal fit. Granted, a car is a great deal more complex than a shoe, and manufacturers may want a network of trusted mechanics who can service and repair their vehicles. But there is no reason these mechanics have to be attached to a dealer, and there is certainly no reason the state should compel such an arrangement.

This is not a problem that warrants a governmentally imposed

solution. It may be that the time of brick and mortar car dealerships has reached the end of its usefulness. People may well be willing to buy their cars online, sight unseen, and take delivery at the house. More likely, there are some who will prefer to visit a dealer of some kind. It may be that the concentration of dealers will diminish, that those who want to see several different sub-models of a car will have to drive to major cities to do so. This may lead more potential buyers to turn to the internet. This is the free market at work. Government policies intended to keep dealers in business or to keep more dealers than the free market would dictate in business - are inefficient, and restrict honest competition. This, in turn, raises prices for consumers since competition results in lower prices and higher quality.

Further, manufacturers, who have a vested interest in making sure consumers are confident in their wares, could set up showrooms. These could be actual dealers, or they could simply be a place for people to take test drives, so they know which make and model they would like to purchase elsewhere. Or perhaps people who want to test drive will turn to car rental companies. A long-term rental gives consumers far more information about a vehicle's day-to-day livability than a 30 minute test drive. Will the kids, their instrument or sports equipment and the dog all fit at once? That's not something one is likely to find out with a salesman breathing down one's neck.

Eliminating the outdated and unwarranted dealer licensing scheme could also create an enormous opportunity for innovation and entrepreneurship. Whether it's an app where you sign up to let someone take your car out for a spin when you're not using it, or a dedicated showroom for all models, there is great potential for innovation, and some enterprising entrepreneur is sure to fill the gaps, increasing efficiency and consumer welfare.

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Protectionism

There may not be a clearer example of naked protectionism in the laws of Oklahoma than the protection afforded to car dealers. One of the stated purposes of the law that regulates new car sales is to "prevent bankrupting of motor vehicle dealers, who might otherwise be caused to fail because of such unfair practices."²⁰ That law goes on to instruct the courts that "All provisions in this chapter shall be liberally interpreted to protect the public from fraud in the business of purchasing or selling motor vehicles and to *protect the investments of its citizens in motor vehicles and dealerships* and to protect the transportation system of the state and shall further be interpreted to *affect existing as well as future franchise agreements*."²¹ (Emphasis added.) While the rest of the legislative finding is couched in consumer protection terms, this last sentence is an unusual moment of candor for the legislature. This anticompetitive, protectionist purpose is evident from the way they have structured the law regarding new

car dealers, in a way that is of, by, and for dealers. Oklahoma's consumers and out-of-state manufacturers, on the other hand, are left to be preyed upon.

For instance, the OMVC may fine manufacturers and distributors a maximum of \$10,000 per violation, but may fine dealers no more than \$1,000 for violations of the same sections of law.²² Why this disparity? Perhaps the legislature believed a smaller fine created an equal deterrent for dealers. More likely, dealers can vote in Oklahoma, and are more likely to donate to Oklahoma legislators' campaigns than an out-of-state manufacturer would be.

Manufacturers appear to be the primary intended target of the laws. It is extraordinarily difficult for a manufacturer to cut ties with, or even offer competition to, an underperforming dealer. Even the death of a dealer does not free the manufacturer of the franchise agreement. State law creates a devisable property interest in the franchise agreement, provided the heir provides proper notice to the manufacturer. The dealer may protest the new franchisee; however, the protest will be heard and decided by the OMVC, a body consisting mostly of car dealers.

Bizarrely, in light of the protectionist nature of the licensing scheme, the OMVC is ordered to consider "Whether the establishment of an additional new motor vehicle dealership would increase competition, and therefore be in the public interest," when deciding whether an additional dealership should be permitted to open within the territory of an existing dealer.²³ If this mandate in the law is taken seriously, then every new dealer would be approved since every new dealer would increase competition. The only way a new dealer in a given territory could possibly reduce competition is if that dealer were part of a larger dealership network that was cornering the market for all makes of cars. Manufacturers would know this, and fight it themselves. They do, after all, play a controlling part in authorizing dealerships.

Perhaps manufacturers are indeed the boogeyman that the law portrays. But if dealers need protection from manufacturers, surely they do not need protection from consumers and

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consumer advocates. Nevertheless, that is exactly what we see, for instance, in the outlawing of brokering. It is a criminal violation (and a second offense is a felony) for anyone to act as a broker. Dealers are sophisticated practitioners who wheel and deal on a daily basis. Surely they can stand up to a broker advocating on behalf of his client. Clearly, however, dealers have influenced past legislatures to grant them a significant advantage over the vast majority of Oklahomans who are mere automobile consumers.

Perhaps dealers simply could not survive in a free market. Does this say more about the hostile world of car sales, or does it say more about the value consumers put on car dealers? Perhaps it would be more efficient for Ford and Chevy to have corporate show rooms in major cities, and allow low-overhead sales lots with fewer bells and whistles to serve consumers.

Policy Recommendations

The state-sponsored car dealer cartel should be ended. Car dealers should not be protected from honest competition. This requires repealing the laws that grant geographic territories to one dealer each, instead opening each region up to genuine competition. It requires repealing the predatory anti-brokering law that prevents consumers from engaging an advocate to negotiate in their place. In fact, it requires eliminating dealer licensing in toto.

- 1 47 O.S. § 563 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82887>.
- 2 47 O.S. § 566 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82893>.
- 3 Roger M. Quinland, "Has the Traditional Automobile Franchise System Run Out of Gas?", *American Bar Association Forum on Franchise*, Summer 2013, https://web.archive.org/web/20160514034137/http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html.
- 4 Will Zerhouni, "Tesla Takes On Michigan", Cato Institute, February 27, 2018, <https://www.cato.org/publications/policy-analysis/tesla-takes-michigan>.
- 5 Tara Fitzgerald Urich, "Tesla and the Policy behind Its Long Haul to Selling Cars in the U.S.", *Journal of Business & Economic Policy* Vol. 5, No. 2, June 2018, https://jbepnet.com/journals/Vol_5_No_2_June_2018/2.pdf
- 6 Jerry Ellig and Jesse Martinez, *State Franchise Law Carjacks Auto Buyers*, Mercatus Center, January 20, 2015, <https://www.mercatus.org/publications/regulation/state-franchise-law-carjacks-auto-buyers>.
- 7 Francine Lafontaine and Margaret Slade, "Exclusive Contracts and Vertical Restraints", *Handbook of Antitrust Economics*, MIT Press, 2008, http://masonlec.org/site/rte_uploads/files/GAI/Readings/Economics%20Institute/LaFontaine%20and%20Slade_Exclusive%20Contracts.pdf
- 8 A literature review contained in this chapter examined eleven different studies on state-mandated vertical restraints. Nine found a negative impact on consumer welfare. Two found an ambiguous impact. None found an improvement in consumer welfare.
- 9 47 O.S. § 579.1 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82905>.
- 10 Oklahoma Attorney General, Board Supervising Letters, <http://www.oag.ok.gov/board-supervisory-letters>.
- 11 Matthew Flamm, "End of the Road for Auto Brokers?" *Crain's New York*, June 17, 2018, <https://www.craigslist.com/small-business/end-road-auto-brokers>.
- 12 47 O.S. § 565 (12) (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82890>.
- 13 Robert B. Ahdieh, et al., Letter to Governor Christie, International Center for Law and Economics, March 26, 2014, https://law.wm.edu/documents/Tesla_Letter.pdf.
- 14 "Irrespective of the terms, provisions or conditions of any franchise, or the terms or provisions of any waiver, no manufacturer shall terminate, cancel or fail to renew any franchise with a licensed new motor vehicle dealer unless the manufacturer has satisfied the notice requirements as provided in this section and has good cause for cancellation, termination or nonrenewal."
- 15 47 O.S. § 565.2 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82892>.
- 16 "The manufacturer shall have the burden of proof to show that its disapproval was for a good cause and in good faith. A denial shall not be for good cause and in good faith unless the factory establishes that the legal heir or devisee, or the legal heir or devisee's controlling executive management, is not of good moral character or fails to meet the written, reasonable and uniformly applied requirements of the manufacturer or distributor relating to financial qualifications, general business experience, and other requirements relating to prospective franchisees."
- 17 47 O.S. § 565.1 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82891>.
- 18 "The approval by the manufacturer or distributor of the sale, transfer, or assignment shall not be unreasonably withheld unless the transferee is not of good moral character or fails to meet the written, reasonable, and uniformly applied requirements of the manufacturer or distributor relating to prospective franchisees. Approval of the transfer shall not be made contingent upon the transferee meeting unreasonable facility requirements or performance standards, but may be made contingent upon the transferee meeting reasonable written requirements. The burden of proof shall be upon the manufacturer or distributor to show good cause existed to withhold approval."
- 19 47 O.S. § 565.3 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=104419>.
- 20 47 O.S. § 578.1 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=104830>.
- 21 47 O.S. § 579 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82904>.
- 22 47 O.S. § 564.1 (OSCN 2019) <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82889>
- 23 Jerry Ellig and Jesse Martinez, *State Franchise Law Carjacks Auto Buyers*, Mercatus Center, January 2015, <https://www.mercatus.org/system/files/Ellig-Auto-Franchise-MOP.pdf>.
- 24 Pamela N. Danziger, "The Fall Of The Mall And How To Make Them Rise Again," *Forbes*, October 14, 2018, <https://www.forbes.com/sites/pamdanziger/2018/10/14/the-fall-of-the-mall-and-three-ways-to-make-them-rise-again/#75e650622a26>.
- 25 It should be noted that this is not a serious policy suggestion.
- 26 47 O.S. § 561 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82885>.
- 27 47 O.S. § 573 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82898>.
- 28 47 O.S. § 565 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82890>.
- 29 47 O.S. § 579 (OSCN 2019), <http://www.oscn.net/applications/oscn/DeliverDocument.asp?CiteID=82904>.