

Get a Great Deal on A Car Over the Internet —NOT IN TEXAS!

By Shellie R. Gutman

The Internet has enabled economies across the world to achieve the ideal sales model. It has allowed goods to flow from producers directly to consumers without delays or middlemen; yet, the Internet maintains low costs for marketing and overhead. One of the few remaining market frontiers that the Internet has yet to conquer, however, is the automobile industry. Across the United States, and particularly in Texas, strict automobile franchise laws prohibit Internet companies and manufacturers from competing with dealers for a share of the market.

For example, in *Ford Motor Company v. Texas Department of Transportation*, 264 F3d 493 (5th Cir. 2001), the Federal Appellate Court for the Fifth Circuit affirmed the West Texas District Court's decision holding that it was illegal for Ford to sell pre-owned cars over the Internet in Texas and fined the company 1.7 million dollars.

The court reviewed Ford's plan for selling pre-owned cars on the Internet. In May of 1998, Ford unveiled its pre-owned showroom website, *fordpreowned.com*, on which consumers from Houston, Atlanta, Boston, Newark, Washington D.C. and New York City could purchase low-mileage used cars at "no-haggle" prices. Most of the vehicles sold were either vehicles Ford had previously leased to consumers or national rental car companies, or were used by Ford employees as company service vehicles.

Twenty-four hours after a consumer placed an order and paid a \$300 deposit, Ford shipped the vehicle to a local dealer for the consumer to test drive. The consumer could then decide to purchase the vehicle, at which point Ford would transfer title to the dealer with whom the consumer would complete the transaction. Alternatively the consumer could reject the vehicle, and Ford would either sell the vehicle to the dealer or take it back. Only after the consumer expressed that he was not interested in

the ordered car could the dealer attempt to interest him in a car on the lot.

In November of 1999, the Texas Department of Transportation determined that Ford's website violated provisions of the Texas Motor Vehicle Commission Code which made it unlawful for a vehicle manufacturer or distributor to operate directly or indirectly as a dealer or obtain a license to do so. (TEX. REV. CIV. STAT. art. 4413(36), §§ 4.01,4.06(a)(3), (6) & 5.02C(c) (Vernon 2002); TEX. TRANSP. CODE § 503.021 (Vernon 2002)). The Department of Transportation sent notices to all twenty-two Houston area dealers involved in the program, about 80% of all Ford dealers, warning that they would be fined up to \$10,000 per day for associating with Ford's website.

Ford challenged the constitutionality of these statutes and brought suit against the Texas Department of Transportation claiming, among other things, that the statutes violated the dormant commerce clause of the Constitution and "amounted to nothing more than economic protectionism." The dormant commerce clause restricts a state from discriminating between in-state and out-of-state commerce. Ford alleged that these statutes discriminated against out-of-state interests because it prohibited out-of-state manufacturers from selling vehicles in Texas. See generally, *Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93, 114 S. Ct. 1345 (1994).

The Fifth Circuit rejected Ford's claims citing *Exxon Corp. v. Maryland*, 437 U.S. 117 (1978), which held that a statute

only violates the dormant commerce clause when it discriminates among similarly situated in-state interests or out-of-state interests. The *Ford* court held that the Texas statute is not discriminatory because all vehicle manufacturers or brokers (including motor boat and motorcycle manufacturers), whether in or out of state, are prohibited from acting as dealers.

The court also held that: (1) the statutes did not violate Ford's first amendment rights to put



what it pleases on its website because first amendment rights are not invoked when they are only incidental to an illegal activity, as the sale of automobiles by manufacturers was here; (2) the statutes were not unconstitutionally vague; and (3) Ford's website was unlike GM's website, which the state approved, because GM's site is operated by a local dealer who sets the price for the vehicle by referring to a mutually developed pricing schedule, whereas on Ford's website the manufacturer had exclusive discretion to set the vehicle sale price. Thus, the appellate court affirmed the trial court's decision that Ford's pre-owned showroom would show no more.

Fordpreowned.com is only one of many automobile-purchasing sites whose sales and brokering activities have been curbed by strict Texas laws. Battles between the Texas Department of Transportation and automobile-selling and brokering web sites began in 1999. The site *carsdirect.com* was forced to cease its operations in Texas in the fall of 1999 after threats from the Texas Department of Transportation. See Mark Cooper, *A Roadblock on the Information Superhighway: Anticompetitive Restrictions on Automotive Markets*, at <http://www.consumerfed.org/internetautosales.pdf>. *Autobytel.com*, an automobile referral site (or "broker" according to the Texas Department of Transportation) was required by the Department to charge a flat fee to any car dealer who wished to contract with the site, instead of a per-car referral fee, rendering the service uneconomical to smaller dealers. See Robert Elder Jr. and Jonathan Weil, *To Sell Cars In Texas: Online Firms Are Forced to Enter the Real World*, WALL ST. J., Jan. 26, 2000 at T1. Even *carorders.com*, an Austin based website was restricted from operating in its home state. See Cooper. So, for now, unless and until the Texas Supreme Court gives these websites the green light, *fordpreowned.com*, like the others before it, will remain in park on those long Texas information highways.

Texas and forty other states around the country began enacting laws regulating automobile sales over twenty-five years ago to protect dealers and consumers from manufacturers and fraudulent business practices. In the 1950s, for example, these and other franchise laws discouraged unscrupulous, unlicensed businesses from pocketing people's money and not delivering the cars they promised. Until recently consumer advocates supported these types of laws because they prevented manufacturers from competing with dealers who often sold cars at lower than suggested retail prices. However, the onset of the Internet economy, which has brought producers and consumers together, has eliminated the hassle and expense of middlemen and leaves consumers and their advocates wondering whom these laws are actually protecting and who is bearing the cost.

Consumers and consumer advocates now believe that allowing manufacturers to form vertical relationships with consumers would eliminate the powers that dealers exercise over pricing and would increase efficiency in distribution. Studies show that regulations are currently costing consumers approximately one thousand dollars per vehicle. See Murray Widenbaum, *Auto Dealers Quash Internet Competition*, THE CHRISTIAN SCIENCE MONITOR, Aug. 17, 2000 at 9. Furthermore, without these restrictions, savings of 10% per car are achievable over time. See Mark Cooper, *A Roadblock on the Information Superhighway: Anticompetitive Restrictions on Automotive Markets*, at <http://www.consumerfed.org/internetautosales.pdf>.

While other states are realizing the potential savings garnered by allowing more Internet auto sale companies to

operate, Texas, the nation's second largest automotive market, is pumping the brakes. See Robert Elder Jr. and Jonathan Weil, *To Sell Cars In Texas: Online Firms Are Forced to Enter the Real World*, WALL ST. J., Jan. 26, 2000 at T1. A number of states have allowed Internet-auto sellers and brokers to continue in business, either directly through the language of their statutes, or by allowing them to slip through loopholes in the laws. In California, for example, automobile selling or brokering sites are allowed to operate as long as the Internet company has an office and licensed staff in the state. See Cooper. Additionally, in the Northeast and West dealers and regulators have done little to apprehend Internet companies. See Keith Brasher, *Car Dealers Driveway Blues*, N.Y. Times, Jan. 25, 2000, at C1. Only a small number of states, primarily in the South, have restrictions that parallel or surpass those in Texas. In Arizona, for example, regulators recently prohibited manufacturers from participating with dealers in establishing web sites that enable new car buyers to obtain financing and other sales and services like insurance or extended service plans. See Murray Widenbaum, *Auto Dealers Quash Internet Competition*, THE CHRISTIAN SCIENCE MONITOR, Aug. 17, 2000 at 9.

Texas regulators claim that these strict laws come in response to dealer prompting as well as concern that businesses could use the Internet to commit fraud. The validity of the latter claim is questionable because Texans are susceptible to fraud when making almost any Internet purchase, even on items more expensive than cars like mortgages, which are readily available online. The former claim is more believable, considering that dealers wish to protect the substantial investments they have made in obtaining and developing their franchises. Thus the question becomes whether the laws should protect car dealers from Internet competitors and manufacturers at the consumers' expense.

The Texas Supreme Court may ultimately have the final word on Internet car sales in Texas. If that happens, the court should consider the benefits of Internet automobile sales. Aside from the actual savings to the consumer, the Internet, as a venue for automobile purchases, facilitates comparison shopping, higher quality and less expensive marketing, reduction in inventory costs, and a reduction of storage and transit time. The court might also consider the negative effects that shutting down a website like *fordpreowned.com* has on all parties involved: the manufacturer suffers because he cannot sell cars; the dealer suffers because he does not make a commission on a sale in which he invested little; the consumer loses the good deal on a car; and the state loses because Internet companies that perceive Texas as hostile to e-commerce will take their business elsewhere.

The Internet is here to stay. As a researcher from the Cato Institute has written, "the manufacturer of the buggy whip did not get far by placing restrictions on the sale of automobiles." Solveig Singleton, *Will the Net Turn Car Dealers Into Dinosaurs?*, 58 CATO INST. BRIEFING PAPERS 3 (2000). Texas should join the states that have embraced the Internet and its potential for making car buying a more consumer-friendly experience.

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