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LETTING THE ELECTRICS SLIDE: A CONSTITUTIONAL CHALLENGE TO STATE DEALER-FRANCHISE LAWS PROHIBITING DIRECT-TO-CONSUMER CAR SALES

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Tesla Motors has a business model for its U.S. sales unlike that of all other car manufacturers: Tesla sells cars directly to consumers rather than through a system of independently owned dealers. Most car manufacturers choose not to sell cars this way because most states have dealer laws that ban direct-to-consumer sales. To use this business model, Tesla has had to win narrow exceptions to these dealer franchise laws. It has mostly succeeded with this method and can now sell cars, albeit from a limited number of company stores, in all but six states.

Tesla is now suing the state of Michigan claiming that its dealer franchise law violates Tesla's rights to substantive due process and equal protection. Traditionally, economic regulations facing Fourteenth Amendment challenges are subject only to a low standard of scrutiny that grants great deference to legislative judgment. However, some lower courts have been applying a standard of scrutiny that, while still low, requires some inquiry into the legitimacy of the legislature's justifications of the regulation.

This Note argues that, if Tesla's case reaches the U.S. Supreme Court, the Court should institute a more exacting standard of review for economic regulations that discriminate against one party for the sole purpose of protecting the economic interests of another. The extremely deferential reaction to cases such as Lochner v. New York, *where the right of parties to contract was upheld against all better judgments, has no place in a political system where big money interests can influence state legislatures. To be clear, this Note does not ask the Court to carve out an exception for Tesla but rather to strike down the universal ban on direct-to-consumer car sales. This Note embarks on a thorough review of the Court's application of substantive due process, a study of the current regulatory climate of new car sales, and a recommendation that the Court should consider the compelling policy reasons to rule in favor of Tesla.*

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INTRODUCTION

A Texan who wants to buy a car from the electric automobile manufacturer Tesla accesses Tesla's website to locate the nearest Tesla "gallery" in his state. He finds that there are eight galleries to choose from in Texas[1] and drives to the nearest one. When he arrives, he is greeted by an employee who shows him the various models that Tesla sells. The employee shows the Texan a car he likes, prompting him to ask to test-drive it. Much to the Texan's surprise, the employee says no. Regardless, the Texan is so smitten with the car that he tells the employee he would like to order one anyway, as long as the price is reasonable. The employee explains that not only is he forbidden from taking orders, he cannot even discuss the price of the car.[2]

Although the Texan's experience sounds like something from a comedy sketch, it is a scenario not unlike those experienced by any resident of Texas, Arizona, Connecticut, Michigan, Utah, or West Virginia, where direct sales of automobiles are banned.[3] In these states, a customer must buy a car from an independently owned dealer franchise. This is incongruent with Tesla's business model. Tesla employs a system of company-owned stores and

1. *See US Tesla Stores and Galleries*, TESLA, https://www.tesla.com/findus/list/stores/United+States [https://perma.cc/7DSR-25RZ] (last visited Nov. 19, 2017).

2. *See* Peter Valdes-Dapena, *Tesla's Fight with America's Car Dealers*, CNN (May 20, 2013, 3:04 PM), http://money.cnn.com/2013/05/20/autos/telsa-car-dealers [https://perma.cc/H46B-WNXS].

3. Mike Ramsey, *Tesla Weighs New Challenge to State Direct-Sales Bans*, WALL ST. J. (Mar. 28, 2016), http://www.wsj.com/articles/tesla-weighs-new-challenge-to-state-direct-sales-bans-1459189069 [https://perma.cc/MB7W-26JQ].

outlets from which people buy cars directly.[4] Thus, in states where this practice is banned, Tesla can only direct potential customers to its website or a neighboring state's sales department.

Bans of direct-to-consumer sales of automobiles have their fans and detractors. The National Automobile Dealers Association (NADA), for instance, argues that consumers benefit from the support that independent dealers can provide beyond the actual sale of the car and from the competition between dealers themselves and the multiple car brands that a given dealer sells.[5] The Federal Trade Commission (FTC) argues that the independent-dealer distribution model actually leads to higher car prices with negligible consumer benefit.[6] Whether states are on solid constitutional footing with these statutes could hinge on whose argument is supported by the evidence.

Tesla has succeeded in challenging some of these laws by compromising with dealer associations and legislators. These compromises allow car manufacturers like Tesla to operate limited numbers of direct-sale stores.[7] Willingness to negotiate, however, has not proved to be a comprehensive solution. For example, a bill in Texas, much like those passed in states that carved out exceptions for companies like Tesla, never made it to a vote once the state legislature caved to pressure from dealer associations.[8] Until now, Tesla has only challenged these laws on a state-by-state basis.

In March 2016, the *Wall Street Journal* reported that Tesla General Counsel Todd Maron was considering a constitutional challenge to these laws.[9] His team had been studying *St. Joseph Abbey v. Castille*,[10] a Fifth Circuit decision that struck down a Louisiana statute requiring licensing of coffin manufacturers.[11] Some scholars see this case as a possible indicator that federal courts may be abandoning the post-*Lochner* deference given to a state legislature when a statute is challenged for violating a plaintiff's economic rights.[12] Then, on September 22, 2016, John Bursch, on behalf of

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4. Daniel A. Crane, *Tesla, Dealer Franchise Laws, and the Politics of Crony Capitalism*, 101 IOWA L. REV. 573, 580 (2016).

5. MARYANN KELLER & KENNETH ELIAS, CONSUMER BENEFITS OF THE DEALER FRANCHISE SYSTEM 2 (2014), https://www.nada.org/workarea/DownloadAsset.aspx?id=21474838844 [https://perma.cc/XZP6-VB86].

6. U.S. Fed. Trade Comm'n, Opinion Letter on Proposed Michigan Senate Bill 268 (May 7, 2015), https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-regarding-michigan-senate-bill-268-which-would-create-limited-exception-current/150511michiganautocycle.pdf [https://perma.cc/TF4J-YBEZ].

7. *See* Crane, *supra* note 4, at 584 ("In a number of states, Tesla and the car dealers have reached agreements on compromise legislation allowing Tesla a fixed number of stores in the state: New Jersey (four dealerships), Ohio (three dealerships), and Pennsylvania (five dealerships).").

8. Dylan Baddour, *Tesla v. Texas Dealerships Explained: Are More Luxury Electric Cars Headed Our Way?*, HOUS. CHRON. (May 23, 2016), http://www.houstonchronicle.com/local/explainer/article/texas-law-tesla-franchise-dealership-electric-cars-7940158.php [https://perma.cc/PCG9-Q44X].

9. Ramsey, *supra* note 3.

10. 712 F.3d 215 (5th Cir. 2013).

11. *Id.* at 217.

12. *See, e.g.*, Thomas B. Colby & Peter J. Smith, *The Return of* Lochner, 100 CORNELL L. REV. 527, 577–78 (2015) ("At the very least, [*Castille*] was a marked departure from the approach in *Williamson*, which effectively sent the message . . . [that] judges should not

Tesla Motors, Inc., filed a complaint in the Western District of Michigan for declaratory and injunctive relief against Ruth Johnson (Secretary of State and Chief Motor Vehicle Administrator), Bill Schuette (Attorney General), and Rick Snyder (Governor).[13] Tesla is now seeking constitutional relief from Michigan's dealer statute that categorically bans direct-to-consumer sales.[14] In accordance with Maron's earlier statements, Tesla is claiming a violation of the Due Process Clause of the Fourteenth Amendment.[15] If courts' applications of substantive due process are actually changing, then Tesla may have a chance of persuading courts to invalidate statutes banning direct-to-consumer sales.

This Note, by analyzing the likelihood of Tesla's success, examines substantive due process jurisprudence, a field that, until recently, was well settled. Specifically, this Note attempts to show that Tesla's claim against the State of Michigan presses for the evolution of substantive due process and presents courts with an opportunity to reassess the doctrine, which circuit courts have experimented with in recent years. Ultimately, this Note explores the possibility that states such as Michigan have dealer statutes banning direct-to-consumer sales as a direct result of political lobbying, which, alone, may not be a sufficient legal basis for impinging on car manufacturers' rights. Part I addresses courts' application of substantive due process from the age of *Lochner*, through the post-New Deal era, and into the modern era. Next, Part II outlines the scope of regulation of the automotive industry and examines the viability of Tesla's direct-sales model. Lastly, Part III assesses the challenges that Tesla would face in persuading the U.S. Supreme Court to strike down Michigan's dealer law, and others like it that prohibit direct sales, on the basis of substantive due process.

I. WAS IT THE GHOST OF *LOCHNER* LURKING, OR A MERE [*LEE*] *OPTICAL* ILLUSION?

The Fourteenth Amendment to the Constitution prohibits states from depriving "any person of life, liberty, or property, without due process of law."[16] In the early twentieth century, the Supreme Court understood this Amendment to "extend to the citizens and residents of the States the same protection against arbitrary state legislation, affecting life, liberty and property, as is offered by the Fifth Amendment against similar legislation by Congress."[17] The Court also recognized that states had designated "police powers," used to govern the "safety, health, morals and general welfare of the public" that the Fourteenth Amendment does not affect.[18] In the late

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invoke the Due Process Clauses to second-guess legislative judgements that interfere with economic liberty.").

13. *See generally* Complaint for Declaratory and Injunctive Relief, Tesla Motors, Inc. v. Johnson, No. 16 Civ. 01158 (W.D. Mich. Sept. 22, 2016) [hereinafter Tesla Complaint], 2016 WL 5346201.

14. *Id.* paras. 51–52; *see also* MICH. COMP. LAWS § 445.1574 (2017).

15. Tesla Complaint, *supra* note 13, para. 52.

16. U.S. CONST. amend. XIV, § 1.

17. Hibben v. Smith, 191 U.S. 310, 325 (1903).

18. Lochner v. New York, 198 U.S. 45, 53 (1905).

nineteenth and early twentieth centuries, these police powers allowed states to restrict rights relating to alcohol,[19] sanitation,[20] property safety,[21] and the like. Part I.A highlights the period of the late nineteenth century to the 1930s, when the Court would frequently intervene in legislation that it found to be an unnecessary intrusion on citizens' rights. Part I.B chronicles the period from the 1930s onward, when the courts began to defer to legislative judgment where neither fundamental rights nor protected classes were implicated. Part I.C studies recent lower court decisions that exhibit a more probing review of legislative decisions despite the otherwise deferential regime.

A. Substantive Due Process: Late 19th Century to the 1930s

In *Lochner v. New York*,[22] the Court struck down a state statute that impermissibly abrogated the freedom to contract conferred on individuals by the Due Process Clause of the Fourteenth Amendment.[23] New York State passed legislation limiting the maximum weekly hours of bakery workers to sixty and the maximum daily hours to ten.[24] New York argued that the regulation was a valid exercise of its police powers as it regulated the health of both bakery workers and customers.[25] While recognizing that a state legislates permissibly where it is exercising its police power, the Supreme Court held that the State of New York had gone beyond its police power by opening up nondangerous industries to the state's "all-pervading power."[26] The test became whether the statute was "a fair, reasonable and appropriate exercise of the police power of the State, or [whether] it [was] an unreasonable, unnecessary and arbitrary interference with the right of the individual to his personal liberty."[27]

Although an earlier indication of the Constitution's protection of liberty to contract was present in *Allgeyer v. Louisiana*,[28] *Lochner* was viewed as regressive in the face of the increasingly dangerous conditions of industrial

19. *See* Crowley v. Christensen, 137 U.S. 86, 91 (1890) ("The police power of the State is fully competent to regulate [the sale of liquor] to mitigate its evils or to suppress it entirely.").

20. *See generally* Barbier v. Connolly, 113 U.S. 27 (1884) (allowing the city of San Francisco to require hopeful laundromat operators to conform to certain sanitary guidelines).

21. *See generally* Mo. Pac. Ry. v. Humes, 115 U.S. 512 (1885) (allowing the state of Missouri to require railroad operators to erect and maintain fences along the sides of the tracks).

22. 198 U.S. 45 (1905).

23. *Id.* at 64.

24. *Id.* at 46 n.1.

25. *Id.* at 58–60.

26. *Id.* at 59 (claiming that the trade of baking was no more dangerous than any other trade).

27. *Id.* at 56. Statutes fitting the latter description were, in the Court's view, "mere meddlesome interferences" with the rights of "grown and intelligent men." *Id.* at 61.

28. 165 U.S. 578 (1897); *id.* at 589 ("The liberty mentioned in [the Fourteenth] [A]mendment means not only the right of the citizen to be free from the mere physical restraint of his person . . . but the term is deemed to embrace the right of the citizen . . . to enter into all contracts which may be proper, necessary and essential . . . .").

workplaces.[29] Today, Supreme Court Justices still refer to *Lochner* as an "anti-canon" of due process jurisprudence, an example of "judges usurping legislative authority by basing decisions on policy preferences rather than law."[30] Regardless of the judgment exercised by the Justices as to whether regulating the working hours of bakers was actually within the state's police power, it was also important that the state provide scientific reasoning to justify the law that the Court found insufficient "to justify the claimed right of such interference.'"[31]

B. Substantive Due Process: 1930s to Present

Judicial intervention on statutes that, in the Court's opinion, unjustifiably exceeded the state's police power continued as precedent until the late 1930s. Occasionally, courts would uphold economic regulations so long as the statute was not "arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt."[32] Actual precedential change came by way of the Court's decision in *West Coast Hotel Co. v. Parrish*.[33] The Court held that the state legislature, in working to protect the interests of women in the workplace, had the right to consider which means best furthered such an interest, even where "the wisdom of the policy [would] be regarded as debatable and its effects uncertain."[34] This reasoning informed federal courts' application of the Due Process Clause to economic regulations throughout the twentieth century.[35] This rational basis review has resulted in the retention of state statutes that, so long as they *only* abrogate economic rights, might be unfair or unwise.[36]

Commentators such as Bernard Siegan attribute the ruling in *West Coast Hotel* to President Roosevelt's attempt to "pack" the Court and the resulting "switch in time that saved nine."[37] Justice Owen Roberts, who had voted to strike down a state law regulating employment contracts one year prior to the

29. Its most fervent critics included Theodore Roosevelt and Justice Felix Frankfurter. Colby & Smith, *supra* note 12, at 534–36.

30. *Id.* at 536 (quoting Howard Gillman, *De*-Lochner*izing* Lochner, 85 B.U. L. REV 859, 861 (2005)).

31. *Lochner*, 198 U.S. at 62.

32. Nebbia v. New York, 291 U.S. 502, 539 (1934); *see also* BERNARD H. SIEGAN, ECONOMIC LIBERTIES AND THE CONSTITUTION 107 (2d ed. 2006) (finding that of the fifty-six times that the Court struck down economic regulations between 1890 and 1936, fifteen were decided based on freedom of contract).

33. 300 U.S. 379 (1937).

34. *Id.* at 399 (invalidating a state statute imposing a minimum wage for women and children).

35. *See* Austin Raynor, *Economic Liberty and the Second-Order Rational Basis Test*, 99 VA. L. REV. 1065, 1069–70 (2013).

36. *See* United States v. Carolene Prods. Co., 304 U.S. 144, 152 (1938) ("[T]he existence of facts supporting the legislative judgment is to be presumed, for [economic regulation] is not to be pronounced unconstitutional unless in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis . . . .").

37. SIEGAN, *supra* note 32, at 114.

decision[38] in *West Coast Hotel*, was the deciding vote.[39] The famous footnote four of *United States v. Carolene Products Co.*[40] is also illuminating here. Just one year after the decision in *West Coast Hotel*, the Court drew the distinction that the Fourteenth Amendment does not call for exacting scrutiny where the statute does not abridge fundamental rights[41] or affect a protected class.[42]

Perhaps the most drastic application of the rational basis analysis of economic regulation came in *Williamson v. Lee Optical Co.*[43] The Court upheld a state statute that prohibited an optician from fitting lenses into new frames or duplicating existing lenses without a prescription from an ophthalmologist or optometrist.[44] Despite the Court's admission that the statute may place a "needless, wasteful" burden on opticians and customers, it was "for the legislature, not the courts, to balance the advantages and disadvantages of the new requirement."[45] The Court also used post hoc rationales to justify the statute without scrutiny.[46]

C. Substantive Due Process: The Court's Deference to Deference

The bad taste that *Lochner* left in the mouths of liberal and conservative Justices alike kept the Court from intervening in the legislature's sphere when only economic rights were concerned.[47] To be sure, this Note does not advocate for a revival of *Lochner*. Starting in the 1980s, though, some scholars called for the courts to recognize some legitimate judicial intervention in state actions that abridge economic rights.[48] Richard Epstein argued that the Contracts Clause "extends substantial protection to economic liberties against legislative . . . interference" and that courts should recognize only limited state control over economic activities.[49]

38. *See generally* Morehead v. New York *ex rel.* Tipaldo, 298 U.S. 587 (1936).

39. SIEGAN, *supra* note 32, at 114.

40. 304 U.S. 144 (1938).

41. This included restrictions "upon the right to vote, on restraints upon the dissemination of information, on interferences with political organizations, as to prohibition of peaceable assembly," and on rights granted by the first ten Amendments. *Id.* at 153 n.4 (citations omitted).

42. This protected class included "particular religious, or national, or racial minorities" and other "discrete and insular minorities." *Id.* (citations omitted).

43. 348 U.S. 483 (1955).

44. *Id.* at 486.

45. *Id.* at 487.

46. *Id.* at 491 ("[I]t *may be deemed important* . . . that the eye doctor be restricted to geographical locations that reduce the temptations of commercialism." (emphasis added)).

47. Conservative judges believed that protection of nonenumerated rights was "unjustifiable judicial activism," while liberals decried the protection of the wrong rights and suppression of the important and justiciable rights. Colby & Smith, *supra* note 12, at 556–61.

48. Bernard Siegan and Richard Epstein, for instance, separately argued that the Court had essentially abdicated its duty to the people to check the legislature's potential for abuses. *Id.* at 564–65.

49. Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 705 (1984).

Regardless, state statutes that do not implicate fundamental rights or protected classes are given a "'strong presumption of validity' under rational basis review."[50] That review requires "only that the regulation bear some rational relation to a legitimate state interest."[51] The state earns this deference by offering merely "the government's 'rational speculation' linking the regulation to a legitimate purpose, even 'unsupported by evidence or empirical data.'"[52] Although there is no exhaustive list of legitimate purposes for the sake of due process review, consumer protection is recognized to be a legitimate purpose.[53]

In *Castille*, the Fifth Circuit struck down an economic regulation despite applying rational basis review.[54] A group of Benedictine monks were enjoined from producing and selling caskets in accordance with a state law limiting casket sales to funeral homes.[55] The court concluded, "plaintiffs may . . . negate a seemingly plausible basis for the law by adducing evidence of irrationality."[56] It found that the funeral board's proffered state interest of "restrict[ing] predatory sales practices by third-party sellers" and of general promotion of health and safety was "betrayed by the undisputed facts."[57] This, rather obviously, is a dramatic departure from the blind deference exhibited by the Supreme Court in *Lee Optical Co.*

The Fifth Circuit relied in part on the Sixth Circuit's assertion in *Craigmiles v. Giles*[58] that economic protectionism is not a legitimate state interest for the purposes of due process analysis.[59] *Craigmiles* involved a challenge to a Tennessee law requiring casket sellers to be licensed by the state as funeral directors.[60] There, the Sixth Circuit opined that "[e]ven foolish and misdirected provisions are generally valid if subject only to rational basis review,"[61] but "protecting a discrete interest group from economic competition is not a legitimate governmental purpose."[62]

50. Craigmiles v. Giles, 312 F.3d 220, 224 (6th Cir. 2002) (quoting Walker v. Bain, 257 F.3d 660, 668 (6th Cir. 2001)).

51. *Id.* at 223.

52. *Id.* at 224 (quoting FCC v. Beach Commc'ns, 508 U.S. 307, 313 (1993)).

53. *See* Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 462 (1978) (ruling that protection of the public from "vexatious" solicitation is a legitimate state interest for the purposes of rational basis review).

54. St. Joseph Abbey v. Castille, 712 F.3d 215, 225 (5th Cir. 2013).

55. *Id.* at 218.

56. *Id.* at 223.

57. *Id.*

58. 312 F.3d 220 (6th Cir. 2002).

59. *Castille*, 712 F.3d at 222–23 ("[E]conomic protection, that is favoritism, may well be supported by a post hoc perceived rationale as in *Williamson*—without which it is aptly described as a *naked transfer of wealth*." (emphasis added)). The Fifth Circuit first adopted this reasoning in *Greater Hous. Small Taxicab Co. v. City of Houston*, 660 F.3d 235, 240 (5th Cir. 2011).

60. *Craigmiles*, 312 F.3d at 222.

61. *Id.* at 223–24.

62. *Id.* at 224.

The Ninth Circuit shares this view.[63] Even though the state of Tennessee offered the justifications of public health, safety, and consumer protection, the court found that there existed "no rational relationship to any of the articulated purposes of the state," leading it to conclude that the state was merely protecting licensed funeral directors from competition.[64] The Second and Tenth Circuits, however, have ruled that economic protection is a legitimate stand-alone purpose for the sake of rational basis review.[65] The Supreme Court has yet to address this issue, so the circuits remain split.[66]

It is important to note that *Castille* and *Craigmiles* are *not* revivals of *Lochner*; rather, they are reinterpretations of substantive due process review in the post-*Lochner* landscape. While the *Lochner* Court substituted the legislature's interpretation of the bounds of its police powers for its own, the *Castille* and *Craigmiles* courts examined whether the states' justifications for their laws were legitimate at face value and, if so, whether such bases were stated in good faith. This can be thought of as a two-step inquiry into whether a state's justifications for abridging rights deserve deference under rational basis review: (1) whether the justification is legitimate and, if so, (2) whether the justification is directly contravened by facts indicating that the justification was made in bad faith.

The first part of the inquiry, for the purposes of this Note, largely hinges on the resolution of the circuit split on economic protectionism.[67] The second part of the inquiry is murkier, but the *Castille* and *Craigmiles* courts clearly exercise the authority to examine whether the state's justifications are directly contravened by the available evidence.

This was a new take on how to apply substantive due process analysis to economic regulation. Not new, though, is the idea that rational basis review can require a more probing inquiry into the adequacy of a state's justifications. The landmark case *City of Cleburne v. Cleburne Living Center*[68] struck down a state statute even though the allegedly discriminatory law did not target a protected class.[69] The state action at issue was a denial of a zoning permit for the operation of a group home (referred to in the opinion as "201 Featherston") for the intellectually disabled.[70] Not only did the Supreme Court explicitly rule that intellectual disability does not constitute "a quasi-suspect classification calling for a more exacting standard

63. *See* Merrifield v. Lockyer, 547 F.3d 978, 991 (9th Cir. 2008) (holding that a licensing statute exempting licensure for certain animals but not others fails the rational basis test by "singling out . . . three types of vertebrate pests" to "favor economically certain constituents at the expense of others similarly situated").

64. *Craigmiles*, 312 F.3d at 228.

65. *See* Sensational Smiles, LLC v. Mullen, 793 F.3d 281, 286 (2d Cir. 2015) ("We join the Tenth Circuit and conclude that economic favoritism is rational for purposes of our review of state action under the Fourteenth Amendment."); Powers v. Harris, 379 F.3d 1208, 1222 (10th Cir. 2004) ("[I]ntra-state economic protectionism . . . is a legitimate state interest . . . .").

66. Jarod M. Bona & Luke A. Wake, *The Market-Participant Exception to State-Action Immunity from Antitrust Liability*, COMPETITION, Fall 2014, at 156, 176 n.140.

67. *Id.*

68. 473 U.S. 432 (1985).

69. *See id.* at 442, 450.

70. *See id.* at 435.

of judicial review than is normally accorded economic and social legislation,"[71] but it also spent several pages explaining why the five justifications provided by the city council were irrational.[72] One district court viewed this case as a "departure from the extreme deference accorded legislative bodies in the past" and noted that "it is clear that a court would be shrinking from its most basic duty if it abstained from *both* an analysis of the legislation's *articulated* objective *and* the method that the legislature employed to achieve that objective."[73]

The Supreme Court is well versed in scrutinizing government justifications for discriminatory statutes. In questions of Commerce Clause violations, for example, the Court requires the state to prove that discrimination in a law is "demonstrably justified."[74] Leaving the burden to the legislatures, however, does not preclude the Court from scrutinizing the proffered rationales and *disproving* them. In *Granholm v. Heald*[75] the Court faced a consolidated challenge to New York and Michigan laws banning direct-to-consumer sales of out-of-state wine.[76] As one of the justifications provided for the ban, the states argued that direct shipment of out-of-state wine would make it difficult for the states to prevent underage drinking.[77] The Court found that "[t]he States provide little evidence that the purchase of wine over the Internet by minors is a problem."[78] Though this would likely have been sufficient to discredit the states' justification under the Commerce Clause analysis,[79] the Court proceeded to review a study by the FTC that provided evidence contrary to the states' claim.[80]

While the Supreme Court is not completely reluctant to consider new standards of scrutiny, it does voice concerns about straying from the mold. In *Lingle v. Chevron U.S.A. Inc.*,[81] for instance, the Court doubted the judiciary's ability to adequately review the purposes for which states pass

71. *Id.* at 442.

72. First, "mere negative attitudes, or fear, . . . are not permissible bases for treating a home for the [intellectually disabled] differently from apartment houses, multiple dwellings, and the like," *id.* at 448; second, "denying a permit based on such vague, undifferentiated fears is again permitting some portion of the community to validate what would otherwise be an equal protection violation, " *id.* at 449; third, the concern of the home being built on a flood plain "can hardly be based on a distinction between the Featherston home and, for example, nursing homes," *id.*; fourth, the "record does not clarify how . . . the characteristics of the intended occupants . . . justify denying to those occupants what would be permitted to groups occupying the same site for different purposes," *id.* at 450; and fifth, "the expressed worry . . . fail[s] rationally to justify singling out a home such as 201 Featherston for the special use permit, yet imposing no such restrictions on the many other uses freely permitted in the neighborhood," *id.*

73. Brown v. Barry, 710 F. Supp. 352, 355 (D.D.C. 1989).

74. Chem. Waste Mgmt. v. Hunt, 504 U.S. 334, 344 (1992).

75. 544 U.S. 460 (2005).

76. *Id.* at 465.

77. *Id.* at 489.

78. *Id.* at 490.

79. *See id.* ("Under our [Commerce Clause] precedents, which require the 'clearest showing' to justify discriminatory state regulation, this is not enough." (quoting C & A Carbone, Inc. v. Clarkstown, 511 U.S. 383, 393 (1994))).

80. *Id.*

81. 544 U.S. 528 (2005).

legislation.[82] In disregarding the plaintiff's demand for a heightened scrutiny requiring legislation to "substantially advance" a legitimate state interest, the Court ruled that such a test "would require courts to scrutinize the efficacy of a vast array of state and federal regulations" and might "empower . . . courts to substitute their predictive judgments for those of elected legislatures and expert agencies"—an endeavor the Court found itself to be "not well suited" to.[83]

The opinion in *Lingle* begs a broader question: is the legislature actually best suited to review its own actions for evidence of abuse? Richard Epstein argues that the state commits error in the forms of over- and under-inclusion.[84] He goes on to say that rational basis review sets a court's "thumb too heavily on the side of state power," thus precluding "any serious review of the fit between means and ends."[85] The solution, according to Epstein, is to apply an intermediate review where "the court should defer where it believes that a legislative decision is likely to be more accurate than its own, or more precisely, where it believes the additional costs of its own extended supervision . . . is not justified by an incremental improvement in fitting means to ends."[86]

II. FOSTERING FRANCHISES—DEALING DEALERS A LEG UP

After the first car dealerships emerged in the last decade of the nineteenth century, cars were sold both directly by the manufacturers and indirectly by the franchised and licensed dealerships.[87] It was not until the mid-1920s that the "emphasis in the industry [shifted] from production to distribution," which resulted in manufacturers acting more like wholesalers and leaving the sales to dealerships.[88] The relationship between manufacturers and dealerships most resembles a traditional franchise, where the manufacturer acts as a franchisor that sells finished products to its dealers, or franchisees, who then put the products on the market for general consumption.[89] As of 2010, there were 18,607 car dealerships in the United States, reflecting a

82. *Id.* at 544.

83. *Id.*

84. RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 127–28 (1985).

85. *Id.* at 128.

86. *Id.* at 129; *see also* Bona & Wake, *supra* note 66, at 176 n.140 ("Intermediate scrutiny might be more appropriate in order to deter self-interested regulatory conduct, on the assumption that such conduct cannot enjoy the same presumption of legitimacy.").

87. Francine Lafontaine & Fiona Scott Morton, *State Franchise Laws, Dealer Terminations, and the Auto Crisis*, J. ECON. PERSP., Summer 2010, at 233, 234–35.

88. *Id.* at 235.

89. Traditional franchising contrasts with business-format franchising, where the franchisor sells a brand, business model, and resources to a franchisee, who then produces and sells a finished product to consumers. *Id.* at 237. Classic examples of this business-format franchising model include fast-food chains and rental-car businesses. *Id.*

steady decline since 2003.[90] Despite that decline, car dealerships are doing well; in 2014, car dealership net profits were higher than ever.[91]

This Part explores the industry of automobile sales and the regulatory climate in which it exists. Part II.A discusses how and why most state dealer statutes were passed. Part II.B addresses the history and the present form of the new car sales industry. Part II.C weighs the advantages and disadvantages of a direct-to-consumer sales model. Part II.D reviews the statute at issue in *Tesla*. Lastly, Part II.E outlines past attempts to strike down state dealer laws on constitutional grounds.

A. State Dealer Statutes: Why Were They Passed?

In 1956, Congress passed the Automobile Dealer's Day in Court Act (ADDICA), which was formally called the Federal Automobile Dealer's Franchise Act.[92] This statute requires car manufacturers to act in good faith in their dealings with franchisees or else risk statutory damages.[93] While twenty states had their own franchise regulation statutes prior to ADDICA's enactment, all fifty states have one today; most of them are more dealer friendly than ADDICA itself.[94] Many states prohibit manufacturers from terminating dealership relationships absent "good cause," require them to "demonstrate 'need' to establish a new dealership in a[n existing] dealer's 'Relevant Market Area,'" and require them to buy back unsold vehicles upon termination of a franchise contract.[95]

Although ADDICA never so required, many of the subsequent state dealer statutes included provisions that prevented manufacturers from selling cars directly to consumers.[96] Such statutes do not always prohibit direct sales explicitly, but they at least prohibit manufacturers from having ownership

90. *See id.* at 236.

91. Phil LeBeau, *Auto Dealers Racked Up Record Profits in 2014*, CNBC (Apr. 10, 2015), http://www.cnbc.com/2015/04/10/auto-dealers-racked-up-record-profits-in-2014.html [https://perma.cc/T7GV-LQGC].

92. Pub. L. No. 84-1026, 70 Stat. 125 (1956) (codified at 15 U.S.C. §§ 1221–1225 (2012)); *see* Lafontaine & Morton, *supra* note 87, at 239.

93. 15 U.S.C. § 1222.

94. *See* Lafontaine & Morton, *supra* note 87, at 239. *See generally* Carla Wong McMillian, *What Will It Take to Get You in a New Car Today?: A Proposal for a New Federal Automobile Dealer Act*, 45 GONZ. L. REV. 67 (2009) (proposing a new federal law that would not only replace ADDICA but would preempt state dealership regulation). McMillian argues that state dealer acts, as they stand, "have essentially supplanted the dealer agreement to define the terms of the manufacturer-dealer relationship." *Id.* at 73. She goes on to assert that a new federal act could allow franchisors and franchisees to contract efficiently while still protecting their interests. *Id.* at 101–03.

95. Lafontaine & Morton, *supra* note 87, at 234–41. For an example of a statutory "relevant market area," see WASH. REV. CODE § 46.96.140(1)(a)–(c) (1994).

96. *See* John T. Delacourt, *New Cars and Old Laws: An Examination of Anticompetitive Regulatory Barriers to Internet Auto Sales*, 3 J.L. ECON. & POL'Y 155, 167 (2007).

stakes in their franchisee dealerships.[97] Other dealer statutes, like Michigan's, ban direct-to-consumer sales more explicitly.[98]

B. State Dealer Statutes: Who Do They Protect?

Today, new-car-dealership profits are higher than ever,[99] but they do not derive much of those profits from the sale of new cars.[100] Most dealerships make their money primarily from reimbursements for repairs and from used-car sales.[101] While dealerships have benefitted from the protectionist climate,[102] many scholars and economists believe that this protection—specifically, bans on direct-to-consumer sales—ultimately results in losses to consumers.[103] In a letter referencing the statute that Tesla now challenges, the FTC cited similar studies and urged "the legislature to consider abandoning the direct sales prohibition in Michigan's existing law, and instead permit manufacturers and consumers to reengage the normal

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97. *See, e.g.*, N.Y. VEH. & TRAF. LAW § 463(2) (McKinney 2017) (noting that "[i]t shall be unlawful for any franchisor, not withstanding the terms of any franchise contract . . . to acquire any interest in any additional motor vehicle dealer in this state," excepting where the interest is only temporary).

98. *See, e.g.*, MICH. COMP. LAWS § 445.1574 (2017) ("A manufacturer shall not . . . [d]irectly or indirectly own, operate, or control a new motor vehicle dealer, including, but not limited to, a new motor vehicle dealer engaged primarily in performing warranty repair services on motor vehicles under the manufacturer's warranty, or a used motor vehicle dealer.").

99. *See* LeBeau, *supra* note 91.

100. In 2015, the average net loss per new vehicle retailed was $22. STEVEN SZAKALY & PATRICK MANZI, NADA DATA 2015: ANNUAL FINANCIAL PROFILE OF AMERICA'S FRANCHISED NEW-CAR DEALERSHIPS 2 (2015), https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474839497 [https://perma.cc/8QMR-7VH4].

101. Service, parts, and body-shop departments made, on average, 59.4 percent of the total average gross income in 2015, and 17.6 percent of that figure was warranty work. *Id.* at 3. Although the NADA does not separate financing profit from new-car sales profit, financing and insurance make up a significant portion of that figure. Moneytips.com, *How Car Dealerships Really Make Their Money*, BDN ME. (Aug. 5, 2015, 5:33 PM), http://bangordailynews.com/2015/08/05/business/how-car-dealerships-really-make-their-money [https://perma.cc/426L-M4N8]. In 2015, the average retail net profit per used car sold was $132 versus $22 lost on each new car sold. *See* SZAKALY & MANZI, *supra* note 100, at 2–3.

102. *See* Moneytips.com, *supra* note 101 (citing auto sales growth for five uninterrupted years at an average growth rate of 9 percent); *see also* Eric D. Stolze, *A Billion Dollar Franchise Fee? Tesla Motors' Battle for Direct Sales: State Dealer Franchise Law and Politics*, 34 FRANCHISE L.J. 293, 306 ("Today, the country's largest automotive dealer is a publicly traded company, operating '265 dealerships in 15 states selling 32 different brands,' with a total market capitalization exceeding $7 billion." (quoting Peter Valdes-Dapena, *AutoNation to Become McDonald's of Car Dealers*, CNN (Jan. 31, 2013), http://money.cnn.com/2013/01/31/autos/autonation-car-dealerships [https://perma.cc/R8TB-JJUW])).

103. John Delacourt includes restrictions on manufacturers' ability to advertise, issue referral fees, broker financing, and sell cars or ancillary services as hindrances to efficiency and innovation in car sales. Delacourt, *supra* note 96, at 164–68. He refers to bans on direct-to-consumer sales as "[p]erhaps the most universal, and fundamental, restriction imposed by automotive franchise law," as it "prevent[s] manufacturers from actively taking the same, retail-level financial risks that [state dealer laws] supposedly impos[e] on dealers." *Id.* at 167.

competitive process that prevails in most other industries."[104] In its letter, the FTC characterized the statute as offering "protectionism for independent franchised dealers, to the detriment of Michigan car buyers."[105]

The International Center for Law and Economics (ICLE) also weighed in on this issue when Tesla was battling with the New Jersey legislature.[106] The ICLE characterized New Jersey's ban on direct sales as an unjustified "restraint of commerce."[107] It went on to say that the regulation serves to "reduce competition in New Jersey's automobile market for the benefit of its auto dealers and to the detriment of its consumers."[108] To justify this conclusion, the ICLE argued that dealers and manufacturers have the same ability to exploit their full market power through price markups but that eliminating independent dealer distribution incentivizes the use of the most efficient model.[109] Others argue that state laws regulating the manufacturer-dealer relationship have led to an "over-dealered market," which, in turn, has contributed to the failure, and subsequent bailout, of the "Big Three" American car companies.[110]

There are some, however, who contend that the franchised-dealer model is better for consumers and competition alike. The NADA argues that such laws protect the interests of smaller car dealerships and consumers by forcing local dealers to compete with one another, while still protecting them from the market whims of big manufacturers that could, absent such regulation, open up multiple dealerships next to one another and saturate local markets.[111] The NADA also argues that manufacturers benefit from being spared the burden of selling their own cars because, historically, they have "failed miserably" in their attempts to enter the retail business.[112] The NADA's tendency to support statutes banning direct-to-consumer sales should not come as a surprise.

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104. U.S. Fed. Trade Comm'n, *supra* note 6, at 11.

105. *Id.* at 1.

106. Letter from Int'l Ctr. for Law & Econ. to Chris Christie, Governor of N.J. (Mar. 26, 2014), https://law.wm.edu/documents/Tesla_letter.pdf [https://perma.cc/6W2V-RAEG]; *see also* Hunter Walker, *Tesla Goes to War Against Chris Christie*, BUS. INSIDER (Mar. 22, 2014, 12:25 PM), http://www.businessinsider.com/tesla-motors-vs-chris-christie-2014-3 [https://perma.cc/33X4-L8VQ].

107. *Id.* at 1.

108. *Id.*

109. *Id.* at 3 (arguing that neither the ICLE nor the Motor Vehicle Commission are well suited to comment on which system is best for consumers).

110. McMillian, *supra* note 94, at 68; *see also* Kate Linebaugh, *The Trials of the Auto Dealer*, WALL ST. J. (Jan. 3, 2009), http://www.wsj.com/articles/SB122969965719421799 [https://perma.cc/NK3N-JKHV].

111. *See generally Why Dealer Franchise Laws?*, NADA, https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474838847 [https://perma.cc/X8ZS-FRLC] (last visited Nov. 19, 2017).

112. *Auto Retailing: Why the Franchise System Works Best*, NADA 1, https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474838843 [https://perma.cc/8BHT-ZJ8Z] (arguing that retailing requires skills better suited to individually owned dealerships and that small businesses are better positioned to incur the inherent costs of business).

Some major car manufacturers, General Motors (GM) for example, have also supported retail regulation. In response to a proposed bill allowing Tesla to circumvent Ohio's ban of direct-to-consumer sales, GM wrote a letter addressed to Governor John Kasich arguing that allowing Tesla to eschew the dealership-franchise model would amount to unfair competition.[113] GM also made an official statement in support of the bill that amended Michigan's dealer statute that Tesla now challenges.[114]

While it may be counterintuitive that a major car manufacturer would support legislation that imposes more regulations on the production and distribution of automobiles, GM has its own horse in the electric-car race. Chevrolet, a subsidiary of GM, released the all-new Bolt EV for 2017.[115] Prior to its introduction of the Bolt, electric-car buyers had only one model to choose from if they needed a battery range of anything beyond 150 miles: the Tesla Model S.[116] The Bolt, with its 238 miles of range, as rated by the Environmental Protection Agency (EPA), is the only electric car to challenge Tesla's range supremacy.[117]

C. Does the Direct-to-Consumer Sales Model Make Sense?

The FTC hosted Todd Maron, Tesla's General Counsel, at a conference entitled "Auto Distribution: Current Issues & Future Trends" in January 2016.[118] Maron outlined seven reasons why a traditional franchise-dealership system would not be viable for Tesla: (1) dealership locations,[119]

113. *See* Eric Loveday, *General Motors Sends Anti-Tesla Direct Sales Letter to Ohio Governor*, INSIDEEVS (Mar. 24, 2014), http://insideevs.com/general-motors-sends-anti-tesla-letter-ohio-governor [https://perma.cc/FF8F-EYRZ].

114. *See* Damon Lavrinc, *General Motors Supports Anti-Tesla Motors Bill in Michigan*, JALOPNIK (Oct. 21, 2014, 12:18 PM) http://jalopnik.com/general-motors-supports-anti-tesla-bill-in-michi-1648915169 [https://perma.cc/B36P-452F] ("We believe that House Bill 5606 will help ensure that all automotive manufacturers follow the same rules to operate in the State of Michigan; therefore, we encourage Governor Snyder to sign it."). Michigan House Bill 5606 became section 445.1574 of the Michigan Compiled Laws. *See* MICH. COMP. LAWS § 445.1574 (2017).

115. *Chevrolet Bolt EV*, CHEVROLET, http://media.chevrolet.com/media/us/en/chevrolet/vehicles/bolt-ev/2017.html [https://perma.cc/8UL9-VYGY] (last visited Nov. 19, 2017).

116. A base Tesla Model S is rated by the EPA to have 218 miles of electric range, while the next highest range of 114 miles was found in the BMW i3. Joseph Capparella, *Home on the Range: 2017 Chevrolet Bolt EPA Rated at 238 Miles of Range*, CAR & DRIVER (Sept. 13, 2016, 12:01 AM) http://blog.caranddriver.com/2017-chevy-bolt-ev-epa-rated-at-238-miles-of-range [https://perma.cc/56QF-MRVK].

117. *Id.*

118. Matt Pressman, *Tesla Defends Direct Sales Model at FTC Talks; Cites Unfair Opposition from GM*, EVANNEX (Jan. 23, 2016) https://evannex.com/blogs/news/74602181-tesla-defends-direct-sales-model-at-ftc-talks-cites-unfair-opposition-from-gm [https://perma.cc/UJZ7-6ZV6].

119. *Id.* (explaining that Teslas utilize technology new and foreign enough to necessitate locations in high foot-traffic areas rather than the "out-of-the-way" locations of traditional car dealerships).

(2) inventory differences,[120] (3) longer sales cycles,[121] (4) different profit models,[122] (5) no advertising,[123] (6) dealer price markups,[124] and (7) conflicts of interest.[125] While this Note does not detail every one of these reasons, several of them are supported by the research outlined below.

In 2014, Consumer Reports endeavored to study the ability and willingness of car dealers to sell their electric and hybrid inventory.[126] Of the eighty-five dealerships visited in the survey by "secret shoppers" inquiring about buying a hybrid or electric car, thirty-five recommended buying a gas-powered car instead, and thirteen discouraged the purchase of a hybrid or electric car entirely.[127] More to Maron's point that a dealership cannot effectively sell both gas-powered and electric cars, Consumer Reports found "a strong correlation between the salesperson's knowledge about electric cars and their propensity to encourage people to buy them."[128] While Maron's contention that dealerships earn the bulk of their profits from service and parts is also true,[129] Consumer Reports found the 2015 Tesla Model S to have a "worse-than-average" problem rate, stemming mostly from problems with "the drivetrain, power equipment, charging equipment, giant iPad-like center console, and body and sunroof squeaks, rattles, and leaks."[130]

The Trefis Team, a collection of Massachusetts Institute of Technology engineers and Wall Street analysts,[131] believe that based on the profit margins of the Tesla Model S, the direct-sales model is critical for Tesla's success.[132] Trefis predicts that the gross profit margin for the Tesla Model S will be approximately 27.5 percent, which will increase to 30 percent over the next six years.[133] If those margins were to steadily decline, however, there could

120. *Id.* (noting that Teslas are ordered custom from the factory, so dealerships would not have inventory on-site).

121. *Id.* (speculating that Tesla customers would need more time with salespeople than dealerships can traditionally provide).

122. *Id.* (claiming that, unlike dealerships, Tesla derives all of its profits from new-car sales and none from parts, service, or financing).

123. *Id.* (noting that Tesla does not advertise).

124. *Id.* (positing that for a dealership to make a profit, it would need to sell Teslas at a price marked up from the price available online or only in states that allow direct sales).

125. *Id.* (arguing that a dealership could not effectively sell internal combustion cars and electric cars at the same time).

126. Eric Evarts, *Dealers Not Always Plugged in About Electric Cars,* Consumer Reports' *Study Reveals*, CONSUMER REP. (Apr. 22, 2014, 8:00 AM) http://www.consumerreports.org/cro/news/2014/04/dealers-not-always-plugged-in-about-electric-cars-secret-shopper-study-reveals/index.htm [https://perma.cc/3J2W-7MB5].

127. *Id.*

128. *Id.*

129. *See supra* Part II.B.

130. Mark Rechtin, *Tesla Reliability Doesn't Match Its High Performance*, CONSUMER REP. (Oct. 20, 2015), http://www.consumerreports.org/cars-tesla-reliability-doesnt-match-its-high-performance [https://perma.cc/8KV9-FRHY].

131. *Trefis Team Full Bio*, FORBES, https://www.forbes.com/sites/greatspeculations/people/trefis/#319338154462 [https://perma.cc/EV9R-PRXC] (last visited Nov. 19, 2017).

132. Trefis Team, *Is the Direct Sales Model Critical for Tesla Motors?*, FORBES (Mar. 3, 2016, 8:40 AM) https://www.forbes.com/sites/greatspeculations/2016/03/03/is-the-direct-sales-model-critical-for-tesla-motors/#4706144f23b3 [https://perma.cc/4B9R-CCUW].

133. *Id.*

be a substantial downside.[134] Trefis believes that a dealership model would cut too far into these margins without being able to "prove itself in the mass market to enjoy economies of scale."[135] Furthermore, Tesla's direct sales model is likely to save consumers money. Thirty percent of an average new vehicle's price covers distribution costs, and allowing manufacturers to distribute products themselves could save consumers between $1500 and $2600 per new car sold.[136]

Daniel Crane highlights the electric automotive upstart Fisker Automotive, whose failure is possibly attributable to its decision to pursue a franchise distribution model rather than a direct distribution model.[137] By deciding to sell its cars through franchised dealerships, Fisker used existing dealer networks that had also dedicated themselves to selling other manufacturers' cars.[138] While Fisker had myriad problems that likely contributed to its failure[139] and the car was sold for too short a time for there to be data as to whether its distribution model was flawed,[140] it is not hard to imagine the difficulty in selling a brand-new, foreign electric car alongside gas-powered cars made by manufacturers with household names. Kelley Blue Book analyst Karl Brauer argues that, were the legislature to force Tesla to sell its cars alongside conventional gas-powered cars, they could see their "image and customer experience splinter into thousands of pieces," which a new entrant to the automobile market cannot afford.[141]

Despite the regulatory roadblocks, Tesla's business model appears to be attractive enough to have inspired at least one other automotive upstart to sell directly. Lynk & Co, a newly formed carmaker spun off from China's Geely, is planning to sell cars through a combination of online order processing and company-owned outlets.[142] Believing that distribution costs contribute to 25

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134. Trefis calculated a possible 15 percent loss if the margins were to sink to 25 percent. *Id.*

135. *Id.*

136. Cynthia Barmore, *Tesla Unplugged: Automobile Franchise Laws and the Threat to the Electric Vehicle Market*, 18 VA. J.L. & TECH. 185, 201 (2014).

137. Crane, *supra* note 4, at 581–82.

138. *Id.* at 581.

139. *See generally* Katie Fehrenbacher, *A Look Under the Hood: Why Electric Car Startup Fisker Crashed and Burned*, GIGAOM (Apr. 17, 2013, 5:29 PM), https://gigaom.com/2013/04/17/a-look-under-the-hood-why-electric-car-startup-fisker-crashed-and-burned [https://perma.cc/LEZ9-VQZM] (citing problems such as regulatory delays, reliance on parts suppliers, public relations problems, executive upheaval, and recalls for dangerously defective parts).

140. Crane, *supra* note 4, at 581–82.

141. Brian Fung, *Why Tesla Keeps Fighting for Direct Sales When It Could Just Work with Dealers*, WASH. POST (Oct. 22, 2014), https://www.washingtonpost.com/news/the-switch/wp/2014/10/22/why-tesla-keeps-fighting-for-direct-sales-when-it-could-just-work-with-dealers [https://perma.cc/YN2A-RX75].

142. Mike Duff, *Lynk & Co Brand to Do Without Dealerships, Sell "Smartphones on Wheels,"* CAR & DRIVER (Oct. 24, 2016, 9:16 AM), http://blog.caranddriver.com/lynk-co-brand-to-do-without-dealerships-sell-smartphones-on-wheels [https://perma.cc/E43H-X8MN]. Alain Visser, senior vice president of Lynk & Co, noted, "We're learning from what Tesla has been doing there . . . . It's not easy, and we know that because Tesla is a 'home' brand it has an advantage. . . . [A]t the end of the day—our model will create employment." *Id.*

percent of a car's price, Lynk & Co intends to pass these savings along to the consumer.[143] As of this writing, the company has not publicly addressed the legal hurdles facing direct car sales.

Independent dealerships, though, do provide valuable services to consumers.[144] Dealers can provide maintenance services, regulatory services relating to registration and titling, and social services ensuring that customers' cars are road ready.[145] It is unknown whether Tesla-owned stores could provide these services as effectively as independently owned dealers. The NADA argues that the integration of manufacturing and distribution will rob consumers of these safeguards.[146] Others who believe that the dealership model is effective include business mogul Warren Buffett, who explained, "When a distribution system . . . becomes that firmly established, there's a reason for it."[147]

D. The Michigan Amendment

In May 2014, the Michigan legislature introduced an amendment to Michigan's dealer franchise law. Michigan House Bill 5606[148] was a proposed amendment to Michigan's dealer law that added to the list of prohibitions on car manufacturers.[149] Among the existing prohibitions was subsection (i), which forbade carmakers from selling "any new motor vehicle directly to a retail customer other than through *its* franchised dealers."[150] This particular subsection was left untouched until the legislature introduced an amended bill on October 2, 2014. In this version of Michigan House Bill 5606, subsection (i) had the word "its" removed and provided that a manufacturer could not "[s]ell any new motor vehicle directly to a retail customer other than through franchised dealers."[151]

The amendment was introduced by Republican Representative Aric Nesbitt.[152] Representative Nesbitt was the lead Republican staffer for the

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143. Martin Gurdon, *Geely Confirms Direct Sales for New Lynk & Co Brand*, MOTORTRADER (Oct. 20, 2016), http://www.motortrader.com/motor-trader-news/automotive-news/geely-sell-lynk-co-cars-online-retail-stores-20-10-2016 [https://perma.cc/Q4CJ-45PE].

144. *See* Barmore, *supra* note 136, at 200.

145. *See id.* at 200–01.

146. *See supra* Part II.B.

147. Daron Gifford, *Why Warren Buffett Is Wrong on Car-Dealer Model*, CNBC (Apr. 9, 2015), http://www.cnbc.com/2015/04/09/why-warren-buffett-is-wrong-on-car-dealer-model-commentary.html [https://perma.cc/Q2SP-SLPT]. Gifford also mentioned that one month before his interview with Buffett, Buffett's company, Berkshire Hathaway, acquired the largest privately held dealership group in the United States. *Id.*

148. H.R. 5606, 97th Leg., Reg. Sess. (as introduced in Michigan House of Representatives on May 28, 2014).

149. The bill would amend the statute to add that a manufacturer may not " prevent, attempt to prevent, prohibit, coerce, or attempt to coerce a new motor vehicle dealer from charging any consumer any fee or charge allowed to be charged by the dealer under the laws of this state." H.R. 5606 (as introduced in Michigan House of Representatives on May 28, 2014).

150. *Id.* (emphasis added).

151. H.R. 5606, 97th Leg., Reg. Sess. (as passed by Michigan Senate on Oct. 2, 2014).

152. *Id.*; *see also 2014 Michigan Public Acts Table*, LEGISLATIVE SERVICE BUREAU 36 (Mar. 24, 2015), http://www.legislature.mi.gov/documents/2013-2014/publicacttable/pdf/

Congressional Natural Gas Caucus and wrote the Natural Gas Subcommittee Report on Energy and Job Creation,[153] which highlights "the EPA's continued assault on fossil fuels."[154] Although Representative Nesbitt is listed as the legislator who introduced the amendment, Tesla Motors posted on its blog that it was Republican Senator Joe Hune who struck the word "its" from the amendment.[155] The National Institute on Money in State Politics found that the Michigan Auto Dealers Association (MADA) contributed over $15,000 to Senator Hune's campaign efforts; its contribution during the 2014 election cycle was the biggest yet.[156]

After the amendment passed, GM issued a public statement applauding the State of Michigan for banning direct sales of automobiles.[157] The company stated that the bill "will provide stability and support for our dealers" and will "ensure we compete under the same rules in the marketplace as other automobile manufacturers."[158]

E. Previous Attempts to Strike Down Dealer Statutes

While some lower courts have applied standards of review requiring more scrutiny, no lower court has struck down a state dealer law on constitutional grounds. In *Alliance of Automobile Manufacturers v. Hull*,[159] a collection of carmakers sued the state of Arizona on Commerce Clause and anticompetitive grounds for amending its auto dealer statute[160] to ban manufacturers from selling ancillary services, such as parts, services, accessories, or financing.[161] The court found that the statute did not impermissibly prevent manufacturers from indirectly competing because existing franchise statutes already protected dealers from "competitive business practices by the manufacturers."[162]

2014-PAT.pdf [https://perma.cc/WP2R-44UJ] (indicating that House Bill 5606 was filed and effected on October 21, 2014).

153. *See generally* STATE OF MICH. H.R. SUBCOMM. ON NAT'L GAS, REPORT ON ENERGY AND JOB CREATION, 96th Leg., Reg. Sess. (2012), http://banmichiganfracking.org/wp-content/uploads/2012/11/NaturalGasReport.pdf [https://perma.cc/CRE7-L8MR].

154. *Id.* at 20.

155. The Tesla Motors Team, *A Raw Deal in Michigan*, TESLA (Oct. 16, 2014) https://www.tesla.com/blog/raw-deal-michigan [https://perma.cc/8MHA-LSXH]. Tesla also claimed that the version of the amendment striking the word "its" was introduced on "the last day of the legislative session." *Id.*

156. *Contributions of Michigan Auto Dealers Association to Joe Hune*, FOLLOWTHEMONEY.ORG, http://www.followthemoney.org/show-me?c-t-eid=1393809&d-eid=3185%23%5B%7B4%7C#[{1|gro=c-t-id,d-eid [https://perma.cc/CXU8-LEKC] (last visited Nov. 19, 2017).

157. Press Release, Gen. Motors, Statement on GM Support of Michigan House Bill (Oct. 21, 2014), http://media.gm.com/media/us/en/gm/news.detail.html/content/Pages/news/us/en/2014/Oct/1021-hb-5066.html [https://perma.cc/CQR6-VB4W].

158. *Id.*

159. 137 F. Supp. 2d 1165 (D. Ariz. 2001).

160. ARIZ. REV. STAT. ANN. § 28-4460 (2017).

161. *All. of Auto. Mfrs.*, 137 F. Supp. 2d at 1168–69.

162. *Id.* at 1174. The court also asserted, without apparent support, that "[s]uch franchise laws keep the disparity of power between manufacturers and dealers in check." *Id.* at 1168.

In *Ford Motor Co. v. Texas Department of Transportation*,[163] Ford claimed that a Texas statute that prohibited manufacturers from acting as car dealers deprived Ford of equal protection and due process and sued to enjoin the enforcement of the statute.[164] Ford had developed a system where customers could view preowned cars online and schedule test drives; Ford would then deliver the car to a voluntarily participating dealer who could sell the car on consignment.[165] The court found that the state did not treat Ford dissimilarly to other manufacturers, and, thus, that the enforcement was constitutional.[166]

In *International Truck & Engine Corp. v. Bray*,[167] International challenged the enforcement of a Texas statute[168] that applied to the sale of commercial trucks for violation of the Dormant Commerce Clause.[169] International argued that the statute treated in-state and out-of-state manufacturers differently by creating an exception to the statute[170] that allows a single manufacturer of motorhomes to also act as a dealer, evidencing Texas's arbitrary, if not discriminatory, intent.[171] The court found that the legislature's proffered interests in preventing unfair advantage to vertically integrated companies were legitimate and that barring International from acting as a dealer was a rational furtherance of these interests.[172]

Lastly, in *Alliance of Automobile Manufacturers, Inc. v. Currey*,[173] another conglomeration of car manufacturers brought an antitrust and Contract Clause action against the State of Connecticut over a 2009 amendment to the Connecticut Franchise Act,[174] which revised the proscribed method for calculating dealer compensation for warranty work and barred manufacturers from recouping costs incurred by such reimbursement provisions.[175] The court summarized the plaintiff's argument as follows:

> The provisions were actually motivated by a decrease in the volume of warranty repairs; that the legislature deliberately sought to recapture lost revenue; that the law insulates dealers from competition with independent service shops; and that a growing body of literature undercuts "the well-worn rationale that all motor vehicle franchise laws, no matter how oppressive, overreaching or economically devastating to manufacturers and

163. 264 F.3d 493 (5th Cir. 2001).
164. *Id.* at 498.
165. *See id.* at 498–99.
166. *Id.* at 510–11. Ford pointed to a similar GM website that the court found permissible under the statute, but the Court emphasized that a third-party dealer operated the GM website and, thus, GM was not acting as a dealer through that contract. *Id.*
167. 372 F.3d 717 (5th Cir. 2004).
168. TEX. OCC. CODE ANN. § 2301.476(c) (West 2017).
169. *Int'l Truck & Engine Corp.*, 372 F.3d at 724–25.
170. OCC. § 2301.476(h).
171. *Int'l Truck & Engine Corp.*, 372 F.3d at 726–27.
172. *Id.* at 728.
173. 984 F. Supp. 2d 32 (D. Conn. 2013), *aff'd*, 610 F. App'x 10 (2d Cir. 2015).
174. *Id.* at 39–40.
175. *Id.* at 40.

> consumers, are necessary to protect dealers from abuses by manufacturers or to level the playing field to equalize the parties' bargaining power."[176]

The court dismissed Alliance's complaint, holding that Alliance failed to allege facts sufficient to overcome the "strong presumption of legislative rationality," despite reference to a "body of literature" that undercut the legislature's justifications.[177] The Second Circuit issued a nonprecedential affirmation of the district court's ruling.[178]

III. CAN TESLA TOPPLE THE TRADE-IN TITANS?

If Tesla's case reaches the Supreme Court, Tesla has two substantial hurdles to persuade the Court to rule in its favor. This Part addresses each hurdle in turn. Part III.A explains that Tesla needs to show the Court why its case is unlike every other constitutional challenge that has been brought against dealer statutes. Part III.B then argues that Tesla needs to convince the Court to adopt a more searching review of the legitimacy of the government's interests supporting the amendment, as well as the rationality with which the legislature believes the amendment will further those interests.

A. Why Tesla Is Different

Tesla's case is different from the constitutional challenges outlined in Part II.E. In each of those cases, the court reasoned that protecting the interests of parties dissimilarly situated, such as dealers against manufacturers, does not cause constitutional problems. In *Alliance of Automobile Manufacturers v. Hull*, the manufacturers claimed that the challenged statute granted dealers a competitive edge over manufacturers.[179] Likewise, in *Ford Motor Co. v. Texas Department of Transportation*, Ford claimed that the statute gave an unfair advantage to used-car dealers, not that it gave an unfair advantage to some car manufacturers over others.[180] In *International Truck & Engine Corp. v. Bray*, the plaintiff claimed that one in-state dealer was given an advantage, not that in-state manufacturers were generally treated dissimilarly.[181] Lastly, in *Alliance of Automobile Manufacturers, Inc. v. Currey*, the plaintiffs argued that the state was insulating dealers from competition with independent car-service businesses.[182]

The unwritten common thread throughout these failed attempts to strike down dealer statutes is that each plaintiff alleged that the statutes protected the interests of parties that were not so similarly situated as to be a deprivation of the plaintiffs' constitutional rights. This translates best to the rationality prong of a due process challenge because if a statute does not treat similarly

176. *Id.* at 60 (quoting the plaintiff's allegations in its complaint).
177. *Id.* at 60–61.
178. All. of Auto. Mfrs. v. Currey, 610 F. App'x 10, 11 (2d Cir. 2015).
179. *See supra* note 162 and accompanying text.
180. *See supra* notes 165–66 and accompanying text.
181. *See supra* notes 167–69 and accompanying text.
182. *See supra* notes 175–78 and accompanying text.

situated actors equally, then it should fail to meet the rational relation requirement. Thus, as long as all manufacturers are affected equally, these courts would not necessarily find a violation. In each of the cases above, the dealer statutes affected all similarly situated parties equally.

Tesla's argument is different. In its complaint, Tesla alleges that "the only possible purpose [for the statute] is to protect two discrete Michigan-based interest groups—Michigan's franchised auto dealers and *Michigan-based manufacturers*—from economic competition."[183] Tesla also claims that a franchise model, as exercised by all other car manufacturers who sell cars in the United States, would not be viable for either Tesla or the hypothetical independent Tesla dealers.[184] Tesla's claim is unique from the other car manufacturers' claims because Tesla alleges that Michigan discriminates against it relative to all other car manufacturers. Thus, the discrimination arbitrarily affects parties that are similarly situated. Furthermore, because there are no independent Tesla dealerships, the statute is not protecting any dealership interests against Tesla as a manufacturer, so the rulings by the courts in the previous four cases do not govern here.

Although subjected to the stricter scrutiny applied in Commerce Clause cases, the Supreme Court's consideration of state-proffered justifications in *Granholm v. Heald* is more analogous here than the consideration given to other car manufacturers' claims against state dealer laws. Not only are the underlying restrictions of rights similar in both cases,[185] the sources of evidence contradicting the states' rationales are also similar.[186]

B. Stare Decisis

Even if the Court were to find that Tesla is different from those other car manufacturers that have failed where Tesla hopes to succeed, the Supreme Court would need to settle some thorny due process questions. In that event, Tesla is well situated to force at least one of the two issues highlighted in Part I.C. For instance, it can challenge the Court to solve the circuit split over the legitimacy of economic protectionism as a state interest for purposes of due process review, or it can try to convince the Court to apply a standard of review that, though burgeoning, is not widespread. This means that the Court would need to break with precedent and conduct a more searching investigation into the proffered interests of the Michigan legislature in passing the statute.

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183. Tesla Complaint, *supra* note 13, para. 55.

184. *Id.* paras. 42–43.

185. In *Tesla*, the underlying restrictions are of direct-to-consumer sales of cars, *see supra* note 14 and accompanying text, and in *Granholm* the underlying restrictions were of direct-to-consumer sales of wine, *see supra* notes 75–77 and accompanying text.

186. The FTC cited "[t]he vast majority of existing work by economists," suggesting that allowing companies to make the decision of whether to sell their products themselves results in "better outcomes for consumers." U.S. Fed. Trade Comm'n, *supra* note 6, at 5; *see also* Granholm v. Heald, 544 U.S. 460, 466–68 (2005) (citing the FTC's stance against restrictions on direct sales of wine).

In *Planned Parenthood v. Casey*,[187] the Court opines that overruling precedent requires the Court to consider whether the previous

> rule has proven to be intolerable simply in defying practical workability; whether the rule is subject to a kind of reliance that would lend a special hardship to the consequences of overruling . . . ; whether related principles of law have so far developed as to have left the old rule no more than a remnant of abandoned doctrine; or whether facts have so changed, or come to be seen so differently, as to have robbed the old rule of significant application or justification.[188]

This implicates two different strategies that the State of Michigan could use in defending its law against Tesla. Michigan could argue that the sole justification for abridging Tesla's due process rights is economic protection of a discrete group and that such a justification alone is legitimate for the purposes of rational basis review. Alternatively, it could argue that the statute serves other, more obviously legitimate purposes. In the first case, the Court would only need to settle whether economic protectionism is a legitimate state interest, which is a question the circuits have split on. In the second case, the Court would be forced to decide whether state interests should be taken at face value and, if not, how to test whether such an interest was provided in good faith.

Therefore, if *Tesla Motors Inc. v. Johnson* reaches the Supreme Court, the Court should abandon the rule of unquestioned deference to state legislatures' judgment on questions of economic regulation and rule that economic protectionism is not a legitimate state interest. The Court, when assessing whether the Michigan law bears any rational relation to a legitimate state interest, should not accept as "rational" the argument that barring direct-to-consumer sales of cars is a form of consumer protection from dangers such as higher pricing, inadequate consumer services, or unsafe cars. It should be suspicious of the political currency that Michigan earns by protecting dealers' associations and GM from competition. It should reject "evidentiary" findings relating to the benefits of the independent dealer-franchise system that were published by an organization as self-interested as the NADA, and it should credit only evidence produced by neutral evaluators and organizations. If the Court applies this more searching inquiry into the motivations and justifications of the state rather than the blind deference of *Lee Optical*, it will inevitably find that the statute barring Tesla and others from selling cars directly is related only to the state's interest in protecting the economic interests of major automobile manufacturers and car dealerships. If the Court decides the circuit split in favor of those circuits that have found economic protectionism not to be a legitimate state interest, then Tesla may win its case.

The best argument for declaring economic protectionism an insufficient justification for economic regulation is that, by allowing state governments to statutorily grant protection to certain industry groups, the Court essentially

187. 505 U.S. 833 (1992).
188. *Id.* at 854–55 (internal citations omitted).

allows politicians to pick winners and losers, or, even worse, to put those positions up for sale. New Mexico Governor Gary Johnson, for instance, sees corruption as an inevitable consequence of legislatures' attempts to "bolster one industry, penalize another, or 'stimulate' one sort of economic activity over another."[189] Even where industrial policy was born out of good intentions, the economic effects of such protection are rarely calculated properly by politicians.[190] Assuming that industries needing economic protection lobby governments for it and that governments need these lobbying dollars, industry "losers get most of the protection because losers lobby harder."[191] Often, these arguments are made in opposition to governments' investments in private companies so as to give one party an advantage over others.[192] What makes the protectionism practiced by the Michigan legislature an even more compelling case for judicial action is that it has given well-established economic players an advantage over *one* party—a start-up no less.

In *Nebbia v. New York*,[193] the Court found that "the Legislature is primarily the judge of the necessity of [an economic] enactment, that every possible presumption is in favor of its validity," and that "the courts are both incompetent and unauthorized to deal" in questioning that wisdom.[194] The *Nebbia* Court's concern, however, is not implicated in *Tesla*. The judiciary does not impinge on the domain of the legislature by preventing a "naked attempt to raise a fortress protecting . . . monopoly rents"[195] at the expense of consumers.

When we consider the parameters laid out in *Planned Parenthood* for when overturning precedent is appropriate, it seems clear that the political climate has changed significantly to warrant such a ruling. The fourth justification that Court provided, that the "facts have so changed or come to be seen so differently, as to have robbed the old rule of significant application or justification,"[196] fits well here. The reaction to *Lochner* was an understandable response to the apathetic cowboy-capitalists of the industrial age. State legislatures were thus empowered to defend the rights of their

189. Gary Johnson, *Government Picking Winners and Losers=Corruption*, HUFFINGTON POST (Dec. 20, 2011), http://www.huffingtonpost.com/gary-johnson/solyndra-corruption_b_1022089.html [https://perma.cc/H5HF-85BF].

190. *Picking Winners, Saving Losers*, ECONOMIST (Aug. 5, 2010), http://www.economist.com/node/16741043 [https://perma.cc/2YKW-YN4T].

191. Richard E. Baldwin & Frédéric Robert-Nicoud, *Entry and Asymmetric Lobbying: Why Governments Pick Losers* 45 (London Sch. of Econ., Pol. Sci. & Pol. Econ. Working Paper No. 3/2007, 2007), http://www.lse.ac.uk/government/research/resgroups/PSPE/pdf/PSPE_WP3_07.pdf [https://perma.cc/73JW-M7VS].

192. *See, e.g.*, Eric Lipton & John M. Broder, *In Rush to Assist a Solar Company, U.S. Missed Signs*, N.Y. TIMES (Sept. 22, 2011), http://www.nytimes.com/2011/09/23/us/politics/in-rush-to-assist-solyndra-united-states-missed-warning-signs.html [https://perma.cc/K324-QQRZ] (characterizing the Obama administration's failed backing of solar startup Solyndra as "one of the administration's most costly fumbles").

193. 291 U.S. 502 (1934).

194. *Id.* at 537–38.

195. Craigmiles v. Giles, 312 F.3d 220, 229 (6th Cir. 2002).

196. Planned Parenthood v. Casey, 505 U.S. 833, 855 (1992).

constituents against big money interests. The facts have changed in that those same big money interests have bled into the legislative realm, and the deferential standard has been "robbed . . . of significant application or justification"[197] in that, under the modern regime, the *courts* are the citizens' last line of defense.

CONCLUSION

Gone are the days when any regulation served to promote the health and wellness of the general population. In allowing special interests to creep into politics, the Court has robbed itself of its ability to check the legislature for abuses. The presumption that a state government has passed a law in accordance with good judgment has no place in an arena where an innovative business is barred from selling a product that is environmentally sustainable, cheaper to the consumer, and easier to buy, simply because the local Chrysler-Dodge-Kia dealership would rather not be forced to make car buying competitively pleasant. The Texan from this Note's Introduction should be able to buy the car he wants from whom he wants, especially if consumers, corporations, and the environment will be better off if he can.

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197. *Id.*