

Tesla's War on the State Automotive Franchise Establishment

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Federal mandate for the Automotive Industries future and Innovation:

From the advent of the automobile, the automotive industry has been one of the most important economic driving forces in America. In fact the International Organization of Motor Vehicle Manufacturers states, “The auto industry is the single greatest engine of economic growth in the world”. Automobiles represent freedom and economic growth, OICA, last visited Sept. 27, 2014, <http://www.oica.net/category/economic-contributions/>. The wide gamut of the impact comes from a host of facets that revolve around the automobile from: design, manufacturing, supplies and materials to selling, servicing, maintaining, financing, insuring and parking. The list is almost in in-exhaustible. In 1953, Charles Wilson, the president of General Motors declared before Congress: “what is good for the country is good for General Motors and vice versa”. What's good for the country is good for General Motors, and vice versa definition, Dictionary.com, last visited Sept. 27, 2014, <http://dictionary.reference.com/browse/what's+good+for+the+country+is+good+for+general+motors,+and+vice+versa>. We saw the correlation that Charles Wilson alluded over 50 years prior in the recession of 2008-2011. General Motors, which was once the largest corporation in the world, had a pre-recession market capitalization in 2000 of \$50 billion yet as the great recession took hold, their market capitalization dropped to below \$1billion in February 2009, a level not seen since the Great Depression of the 1920's. Jim Quinn, As General Motors Goes, so Goes the Nation, The Burning Platform, Nov. 10, 2010, <http://www.theburningplatform.com/2010/11/18/as-general-motors-goes-so-goes-the-nation-oldie-but-goodie/>. The recession brought similar fates to Ford,

Chrysler, all their subsidiary brands, most auto suppliers and many auto related companies as demand for automobiles drastically decreased. GM, Ford and Chrysler responded and cut production resulting in huge economic losses including, lost jobs, compensation decline, community collapse, tax bases shrinking and finally leading these economic titans to a position which most thought was certain demise without substantial intervention.

When President Obama took office, the American auto industry was by most accounts either on the brink of collapse or already collapsed. Peter Davidson, [An Update on Fisker Automotive and the Energy Department's Loan Portfolio](http://energy.gov/articles/update-fisker-automotive-and-energy-department-s-loan-portfolio), Energy.gov, Sept. 17, 2013, <http://energy.gov/articles/update-fisker-automotive-and-energy-department-s-loan-portfolio>. The President and the federal government not only had to contend with the disastrous effects of the giant and failing manufacturers but also the countless workers, communities, suppliers, dealers and incalculable peripheral businesses that rely on the automotive industry for their livelihood. The federal government stepped in and bailed out General Motors, Chrysler and Ford (although to a lesser degree) through the United States Treasury Department's Troubled Asset Relief Program (TARP). The massive bailout was not implemented and probably never would have happened solely to protect the corporations but instead the bailout was designed to protect the countless dependents in communities all over this country from the effects of a failed automotive industry. As a result of the bailout and the opportunity to survive, the American automotive manufacturers and their related businesses have emerged with a remarkable comeback resulting in production that has almost doubled during

the years between 2009 and 2013. Derek Thompson, Overdrive: How America's Amazing Car Recovery Explains the U.S. Economy, The Atlantic, Sept. 6, 2013, <http://www.theatlantic.com/business/archive/2013/09/overdrive-how-americas-amazing-car-recovery-explains-the-us-economy/279413/>. The cumulative effects can be seen in every community across America manifested as created or retained jobs, rebounded real estate values, continued and/or rebounded tax revenues and continued increasing automotive based commerce. Davidson, supra. The recovery in the automotive sector accounts for between 15 and 20 percent of the United States entire economic recovery. Thompson, supra.

While the federal government utilized the TARP program to breathe life into these manufacturers, Congress simultaneously strived to spur new ways to revitalize the aging and declining American automobile industry as a needed catalyst to aid in the US economy's emergence from recession and reduce the risk of entering an economic depression. 2009 was the seventh straight year of decline for the failing American automotive manufacturers. When the difficult decision was made to support the American automotive industry there were sacrifices that had to be made but also there was an undoubtable need to turn towards innovation from stagnation to aid America's resurgence in a critical segment of our economic engine.

The Advanced Technology Vehicle Manufacturing Loan Program:

In 2008 the Advanced Technology Vehicles Manufacturing Loan Program (ATVM) was created and funded with \$25Billion. The ATVM program was designed to provide capital to American automobile manufacturers to create vehicles that

would help lessen America's dependence on foreign oil and meet the looming higher mileage requirements set by the EPA. The ATVM executive director put it this way:

"Over the long term, we know that the continued success of America's auto industry depends on whether we keep innovating and adopting next generation technologies that consumers all over the world increasingly demand." Peter Davidson, An Update on Fisker Automotive and the Energy Department's Loan Portfolio, Energy.gov, September 17, 2013, <http://energy.gov/articles/update-fisker-automotive-and-energy-department-s-loan-portfolio>.

In 2009 the US Department of Energy announced that it was loaning \$8 Billion dollars to Ford, Nissan and Tesla motors to fund their quests to create advanced vehicle technologies, which mainly consisted of electric drivetrains.

DOE Awards \$8 Billion in Loans for Advanced Vehicle Technologies, U.S. Dept. of Energy, June 24, 2009, http://apps1.eere.energy.gov/news/news_detail.cfm/news_id=12594. Later that year Fisker Automotive, another American startup automotive manufacturer was conditionally awarded a loan of over \$528 million dollars under the same program with the same mandate. Josh Mitchell, Gore-Backed Car Firm Gets Large U.S. Loan, The Wall Street Journal, September 25, 2009, online.wsj.com/news/articles/SB125383160812639013?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB125383160812639013.html.

Peter Davidson, the director of the loan program commented that the DOE program was "playing a crucial role in helping America's auto industry thrive, innovate and compete. Davidson, *supra*. He further stated what had become a common belief that "This is a race that we simply cannot afford to lose." *Id.*

Although two of the world's largest automotive manufacturers (Ford and Nissan) took part in the ATVM program many of the other players were small innovators with great aspirations or fledging enterprises who had dreams for

creating next generation technology. As example, Tesla was founded in 2003 and started delivering vehicles in 2008. At the time they received the ATVM funding they were selling a few hundred high priced electric two-seat sports cars, which were manufactured in the United Kingdom. With the advent of the ATVM loan program and a desire to provide innovation to the American automotive industry Tesla was quickly memorialized and became one of the poster-children for the ATVM and the new federal mandate. Tesla Motors, Inc. and their founder Elon Musk had a dream to change the automotive industry despite their very small sales numbers. Tesla, with their ambitious dream, clearly captured the ingenuity that Congress sought when they created the programs to help the United States exit the recession and move forward in the automotive industry's race for innovation.

The larger recipients of the ATVM program have been very important to technological advances and made stellar progress yet Tesla and another small start-up, Fisker, became the models for the initiative that was positive or conversely, negative with the ATVM and aspirations for alternative fuel vehicles. Both companies have been heralded by some, scorned by others and ultimately used as political capital or scapegoats depending on the party and the moment in what has often ended up in a bipartisan political war of words.

Tesla, a new player in the highly competitive and capital intensive world of automobile manufacturing was founded on a model and brand with a totally new and innovative drivetrain and electric platform. Fisker Automotive, the other small automotive manufacturer, offering new yet unproven technology, also received ATVM loans and was initially heralded as a promising upstart. Although Fisker

promised huge results in electric cars they ultimately were unable, even with huge ATVM loans, to survive in the extremely fast paced, competitive and capital intensive business of automotive manufacturing, sales and distribution. In addition to the ATVM funds that Fisker received, they also “burned through roughly \$1 billion in private investment money”. China billionaire eyes US market after snatching up taxpayer-backed, Fox News, June 9, 2014, <http://www.foxnews.com/politics/2014/06/09/china-billionaire-buys-fisker-in-bankruptcy-now-poised-to-sell-in-us-auto/>. Fisker filed for bankruptcy in November 2013 falling out of the graces of even their most diehard supporters. A Chinese auto parts supplier, Wanxiang Group, acquired Fisker’s assets in 2014 for \$149.2 million dollars in the bankruptcy action. Id. The Chinese company has plans to reintroduce Fisker and its products. The demise of Fisker has since been used as fodder in the bipartisan war against the ATVM program and alternative fuel vehicles. Aaron Nathans, Fisker Assets headed to public auction, Delaware Online News Journal, Jan 10, 2014, <http://www.delawareonline.com/story/money/2014/01/10/judge-rules-fisker-assets-will-go-to-public-auction/4411145/>.

Tesla on the other hand has not only survived but Tesla’s CEO, Elon Musk, as the CEO of one of the smallest automotive manufacturers in the world has created himself as an opinion leader and gained “an inordinate influence over the entire auto industry”. Musk makes auto industry rethink basic assumptions, Automotive News, June 23, 2014, <http://www.autonews.com/article/20140623/OEM02/306239981/musk-makes-auto-industry-rethink-basic-assumptions>. Musk, the founder of a host of companies including, Zip2, PayPal, SpaceX, SolarCity and Tesla

has used his ingenuity, work ethic, previous success, political power and influence to poise his small-volume but successful sales at Tesla, in a very small premium segment of the auto sales arena to push customer's experiences to new levels all whilst recasting the image of electric powertrains in the public's eye. Elon Musk Biography, Encyclopedia of World Biography, last visit September 27, 2014, <http://www.notablebiographies.com/news/Li-Ou/Musk-Elon.html#b>. As a result, both Musk and Tesla both have garnered a respected voice in boardrooms, legislatures, the stock market, among other automotive manufactures and even in family rooms all around the country. An example of the public persona Tesla enjoys was evident by the remarks of President Obama on May 26, 2010:

“...thanks to loans through the Department of Energy, which helped provide Tesla motors with the financial wherewithal to expand, that shuttered plant is soon going to reopen. (Applause.) And once again -- once again, it will be a symbol of promise, an example of what's possible here in America. Tesla is joining with Toyota in a venture to put a thousand skilled workers back to work manufacturing an all-electric car. (Applause.) And this is only the beginning. We're investing in advanced battery technologies to power plug-in hybrid cars... And it was made possible by loans through the Department of Energy, as well as tax credits and grants to increase demand for these vehicles.” President Barack Obama, Remarks by the President on the Economy, May 26, 2010, <http://www.whitehouse.gov/the-press-office/remarks-president-economy-0>.

Tesla as an Innovator:

On the innovation side, “Despite the huge obstacles and numerous hurdles Tesla has created more than 3,000 American jobs and created a new vehicle that has won much acclaim. Davidson, *supra*. Tesla innovations and remarkable vehicles are bringing advanced manufacturing back to the United States.” *Id.* The Model S is the first electric car to win Motor Trends Car of the year. Why Texas Bans the Sale of Tesla Cars, Yahoo News, August 22, 2013, <http://news.yahoo.com/blogs/nightline-fix/why-texas-bans-sale-tesla-cars-140842349.html>. They have also received a 99 out of 100 rating from Consumer Reports. Additionally, the National Highway Traffic Safety Administration named the Tesla Model S the safest car built. *Id.* In addition to automotive accolades Tesla is boasting that they posted a profit in 2013, only 5 years after introducing their first car. Roger Quinland, Has the Traditional Auto Franchise System Run Out of Gas?, The Franchise Lawyer, last visit September 27, 2014 http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html. Although Tesla’s profitability is at first glance laudable, Tesla adversaries point out that their profitability is not all that it appears to be. They point out that the profits that Tesla posted in 2013 are largely related, not from selling cars to consumers, but from selling emissions credits from its Electric Vehicle’s to traditional automakers in need of those credits to meet government regulations. Musk makes auto industry rethink basic assumptions, Automotive News, June 23, 2014, <http://www.autonews.com/article/20140623/OEM02/306239981/musk-makes-auto-industry-rethink-basic-assumptions>. Without government regulations that allow Tesla to sell EV credits to

large automakers in need, Tesla's profitability would be in great jeopardy and the automaker might have suffered a fate like Fisker. Id.

Ultimately even in light of critic's arguments, Tesla has seen success with their vehicles and with the federal government's mandate to enhance alternative fuel vehicles. This success has enabled Tesla to gain federal support most automotive manufacturers don't have when fighting the automotive establishment. Couple that with Musk's influence and tenacity and Tesla has willingly placed themselves at the center of an age old battle with dealers and state laws and regulations prohibiting consumer-direct manufacturer's sales.

Battle with the Franchise Automotive distribution model:

The main arena where Tesla is now making waves has little or nothing to do with innovation and technology Tesla was founded on, but with changing the way the automotive industry traditionally delivers cars to end-user consumers. Instead of affecting a small group of affluent customers with a technology laden, luxury and pricey car, Tesla is now trying to change the way automobiles are sold to consumers in the United States. Tesla seeks to bypass traditional local dealers and sell directly to their consumers. In fact, Tesla has set out to change the existing automotive retailing model and like their battle to create a new and innovative car company with new technology they face many roadblocks. Instead of utilizing local automotive dealers like other manufacturers, Tesla argues that electric cars cannot be sold in the traditional manner and as such needs to create a network of corporate "galleries". Although a manufacturer claiming that "electric" cars require a different

manufacturer-direct sales model has never been voiced before, the manufacturer-direct sales push has been fought many times. The most recent fight was in 2000 and was initiated by Ford Motor Company (Ford). Historically the fight has been lost by the manufacturers, due in part to the various states desire to protect consumers by maintaining competition and enhance consumer protection and consumer choice. This time Tesla and their proponents argue that consumer choice is what they are fighting for and the debate over the merits of the dealer franchise system are being argued all across America, spurred by this small-volume but successful premium car company – Tesla.

At this point there are 23 states where Tesla operates retail stores and each state has either been engaged by Tesla or has engaged Tesla in the battle. Shiraz Ahmed & Amy Wilson, Tesla's state-by-state battle with dealers, Automotive News, March 1, 2014, file:///Users/jericgregory/Documents/Law%20School%20GSU%20documents/Fall%2014%20Classes/writing%20requirement/Tesla's%20state-by-state%20battle%20with%20dealers.webarchive. The outcome is dynamic and constantly evolving as the battle is waged in legislatures, courtrooms, showrooms and in the media. The outcome has varied and has resulted in Tesla sales being legally allowed with no restrictions in some states, legally allowed with restrictions in other states and totally banned in some states. In still other states Tesla is being challenged in court by legislation and/or regulation.

Economic Impact of Consumer-Direct Sales:

Although Tesla's manufacturing innovation is clear, the potential environmental impact is inspiring the federal government's investment and the company's inroads into automotive manufacturing are commendable. Changing the way vehicles are sold and serviced across America has a potential broad social and economic impact and as a result this particular non-technology based Tesla "innovation" has far reaching effects in communities across this country. The fights over the direct sales model are pitting Tesla against auto dealers with deep community roots and powerful state lobbying operations and the outcomes will have broad effects not only on the dealers but also the communities and the customers the dealers serve.

Automotive dealers and dealer associations argue that the highly capital and labor-intensive automotive retailing franchise model is what's best for consumers. Since automotive consumers, legislation and consumer safety demand virtually immediate service when consumers purchase, trade and service automobiles they need dealers with local roots to serve their needs and protect their interests. Additionally, consumers need protections in their respective states that the local dealers are obligated to abide by and in which the government can enforce locally. For the past 100 years these demands have been fulfilled by tens of thousands of entrepreneurial businesses designed around a host of state franchise laws and manufacturer-to-dealer franchise agreements. The franchise distribution model for automobiles dates back to General Motors' first dealership in 1898 when William E. Metzger established what is believed to be the first car dealership. The First Century of the Detroit Auto Show, Society of Automotive Engineers Inc., January

2000, at 265. Today, over 100 years later the franchise system is backed not only by strong state laws but also an active lobby of well healed constituents. Donald Scarinci, Will Tesla Motors Stay in New Jersey?, NJ.com May 20, 2014, http://blog.nj.com/njv_donald_scarinci/2014/05/will_tesla_motors_stay_in_new.html. Only well-funded political powerhouses have a chance to fight the strong contingency that is behind the traditional franchise automotive model. When Ford tried to fight for consumer-direct sales in 2000 they were swiftly defeated. Over the past several years Tesla has garnered their political capital and put their checkbooks to work to fight the battle again.

Proponents for the franchise model point to the fact that individual “Franchised dealers invest millions of dollars of private capital in their retail outlets to provide top sales and service experiences, allowing auto manufacturers to concentrate their capital in the core areas of designing, building and marketing vehicles”. Auto Retailing: Why the Franchise System Works Best, NADA, last visit September 27, 2014, http://www.nada.org/NR/rdonlyres/DF4863B1-591A-4CA4-917D-45FF870AE3D0/0/Auto_Retailing_Why_the_Franchise_System_Works_Best.pdf. The average dealership requires an investment of \$11.3 million dollars and has annual operating costs of approximately \$4.6 million dollars per dealership. Id. Over 95% of the retail automotive dealers across the country are locally owned and those dealers generate billions of dollars for their communities all while allowing manufacturers to benefit from the high financial returns of capital invested in manufacturing as opposed to the low sales margins gained from retailing automobiles. Local real estate values in every community depend heavily on automotive dealers, state and local

governments rely on dealers for tax revenue and automotive dealers provide significant employment opportunities that are imperative to communities across the country. Dealers bear the expense and the risk of their investments at virtually no cost to the manufacturers and they provide a huge, highly competitive outlet for consumers in every community for their automotive needs. Since the local dealers' investments are so large and since they make up a major portion of the economic engine in their relative communities, every state has created laws to protect dealers' investments and livelihood.

Although the vast majority of automotive dealers and perhaps more importantly all the major automotive manufacturers argue that the franchise model is the most efficient and effective for the automotive industry. However, Tesla contends that the franchise model will not work for them. In a blog post by Tesla's Elon Musk on March 14, 2014 he said:

“Auto dealers have a fundamental conflict of interest between promoting gasoline cars, which constitute virtually all of their revenue, and electric cars, which constitute virtually none. Moreover, it is much harder to sell a new technology car from a new company when people are so used to the old. Inevitably, they revert to selling what's easy and it is game over for the new company”. Elon Musk, To the People of New Jersey, March 14, 2014, <http://www.teslamotors.com/blog/people-new-jersey>.

With this in mind Tesla is fighting for a system that they purport to believe is their most likely path to succeed in selling new technology vehicles. The dealer establishment can point to the fact that almost every major manufacturer either already has or is coming out with an all electric car in the very near future and each of these manufacturers will sell their electric cars side by side with fossil fuel engines. Sales for example of the Nissan Leaf in July 2014 were 3,019 all sold at

franchise Nissan dealers while sales of Telsa were an estimated 1,000. Zachary Shahan, [Nissan Leaf Still King, Ford Fusion Energi Sales Jump 201%](http://cleantechnica.com/2014/08/05/nissan-leaf-still-king-ford-fusion-energi-sales-jump-201/), Clean Technica, August 5th, 2014, <http://cleantechnica.com/2014/08/05/nissan-leaf-still-king-ford-fusion-energi-sales-jump-201/>. Emerging technology is constantly arriving at car dealerships and it is not a new phenomenon even though Telsa brought their cars to market early they will soon be in a very competitive environment selling electric cars against most of the worlds major manufacturers. Today despite Tesla arguing that their electric cars cannot be sold successfully next to fossil fuel cars Nissan, Chevy, Toyota and Ford all are doing just that and in the latest numbers that are available for study these brands sold more electric vehicles than Tesla. Id. New entrants by BMW, Smart, Cadillac, Honda and Mercedes are all coming into the market and are soon to be fighting in the sales arena along side Tesla with their franchised dealers at the forefront.

Consumer Choice Claims:

In addition to Tesla's argument for direct to consumer sales of electric cars and because of a Tesla argument that there is a dealer bias that will lead to their inability to sell EV's along-side traditionally powered vehicles, they join with consumer advocates to propound the view that allowing consumer-direct sales would enhance consumer choice and protection. John Galandak, president of the Commerce and Industry Association a consumer advocate agency against New Jerseys ban on direct-consumer manufacturer retail sales said; "Competition is one of the most powerful market forces that leads to the highest quality goods and services available

at the best price". Terrence Dopp & Mark Clothier, Tesla pushes NJ bill to follow NY lead allowing direct sales, Bloomberg News, June 18, 2014, <http://www.bloomberg.com/news/2014-06-18/tesla-pushes-n-j-direct-sales-bill-to-follow-cuomolead.html>. Traditionally, consumer protection is what state legislatures and courts have argued in favor of the franchise system. They made this argument because under the franchise model consumers can choose not only between a host of different offerings by divergent automotive manufacturers but also between the community centric dealers who operate in each state, representing the same brands and vying for the same customers business. The reasoning that this distribution model is best for competition stems from the belief that if all the manufacturers sold direct to consumers the ability for consumers to shop the same brand against itself would be eliminated. Additionally, the consumer would ultimately be negotiating with one entity that was controlling the price of the specific brand thereby limiting consumer choice and realistically keeping prices higher than with the dealer to dealer competition. Along these lines "some dealers have sought to block Tesla retail operations, expressing that laws requiring consumers to purchase new cars from dealerships instead of manufacturers selling consumer-direct, encourages competition and gives consumers an advocate and in many cases better prices through enhanced competition". Dopp & Clothier, *supra*. If all automotive manufacturers were to sell direct per the Tesla design, consumer choice at least under the traditional thought process would be constrained to cross-brand shopping not inner-brand shopping and as a result consumer choice would be

eroded and transaction prices would increase thereby hurting consumers, not helping them.

Musk has made Tesla's pricing plan clear and it has worked well to this point as all Tesla's are pre-sold. Musk has stated that he wants to have "uniform prices at every store". ABC New Nightline, Why Texas Bans the Sale of Tesla cars, Yahoo News, August 22, 2013, <http://news.yahoo.com/blogs/nightline-fix/why-texas-bans-sale-tesla-cars-140842349.html>. This uniform pricing concept is only possible without distinct franchisees competing with one another and thereby limiting the competitive pricing inherent in the franchise sales model. Ultimately if Tesla controls all the retail outlets which sell Tesla automobiles, and they have a one-price model, consumer choice is clearly limited to alternative makes and not on competing Tesla's models. This pricing strategy although not discussed by Tesla as a reason they advocate consumer-direct sales at least represents a well reasoned desire for Tesla to fight for consumer-direct sales because if they control the price they can maximize their profit from the sale of each and every vehicle they sell.

When consumers go to buy a new car today they are benefited by fierce competition between local franchised dealers in every market across America. Sarah Rubenoff, FTC Staffers, NADA Debate Tesla Sales Model, Auto Remarketing, April 30, 2014, at 24. This competition can be seen in online vehicle searches, in social media advertising, newspaper ads and by visiting one of the over 33,000 franchised new dealerships vying for each consumers patronage. This competition drives down prices not only within brands but also across brands. If you take this concept out of

the equation prices will arguably be higher and if there is a consumer-direct seller they will realistically be the beneficiaries not the consumer. Id.

Consumer advocates have made similar insinuations that when manufacturers sell direct they cut out the middleman – the car dealer. The implication is by selling direct, manufacturers will offer products to consumers at a lower price and thereby enhance the value proposition to consumers. On the surface the argument appears to have merit. Opponents counter that this is an “absolutely false myth”. Jonathan Collegio, Tesla’s Attempt to Dealer Model Irks Other Automakers, Politico via NADA Headlines June 19, 2014, <https://www.politicopro.com>. The argument against lower prices by cutting out dealers is that as long as cars are being sold to consumers there are costs associated with the sale. Id. Costs such as rent, staff, lights, to name a few must be borne by either dealers or manufactures. Id. Mr. Collegio states “The dealer model is better for consumers because competition between local dealer minimizes those costs.” Id. Small local businesses are the backbone to the American economy and these entrepreneurial businesses are able to make decisions that aid in minimizing costs and ultimately aiding consumers. Despite assumptions automotive retailing is not a business model that is based on high returns, instead it is a business model based on high entrepreneurial ingenuity. 2012 was a great year for most automotive franchised retailers and even though it was a great year the pretax profit of average dealerships was a mere 2.2%. Jamie LaReau, NADA: U.S. dealers' average pretax profit rose 6% in 2012, Automotive News, July 1, 2013, <http://www.autonews.com/article/20130701/RETAIL07/130709991/nada-u-s-dealers-average-pretax-profit-rose-6-in-2012>.

Opponents to franchise protections also argue that franchise laws inhibit opportunities to experiment with new approaches like the consumer-direct model proposed by Ford Motors in 1998 and squelched in 2000 by the judiciary and the similar consumer-direct model now proposed by Tesla. They argue that franchise laws are overprotective and fail to allow new innovation in the way consumers buy new cars. 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, 163 (2007).

Although the battle has been over simplified by both sides on virtually all the issues and distilled down to a battle between car dealers and customers, the effects of changing the franchise system and allowing direct manufacturer to consumer sales has a far greater impact than most of the parties acknowledge. Consumer advocates should take a hard look at the customer choice argument and consider whether competition is enhanced when manufacturers sell directly to consumers. The alternative that there is actually more competition, allowing greater choice to consumers when manufacturers sell to a host of regional dealers with diverse interest selling the same product to the same market seems to represent the more plausible argument for actual consumer advocates.

Consumer issues related to consumer-direct sales:

There has been little litigation relating to the issue of jurisdiction for Tesla consumers, the actual parties that purchase vehicles from Tesla “Galleries” one such battle emerged in early 2014. As sales volumes increase for Tesla these issues will

become more and more prevalent simply due to more and more Tesla vehicles being in consumer's hands and on this nation's roads. Even though Tesla continues to argue that it is better for consumers to be allowed to buy consumer-direct, one of Tesla's buyers is questioning whether Tesla really has his or other consumers in mind. Paul A. Eisenstein, Top Lemon Law Lawyer Takes on Tesla, The Detroit Bureau, April 8, 2014, <http://www.thedetroitbureau.com/2014/04/top-lemon-law-lawyer-takes-on-tesla/>.

Vince Megna, a lawyer famous for fighting for consumer rights against automotive manufacturers by utilizing state lemon laws takes issue with the Tesla consumer-direct model. *Id.* Megna has brought suit against Tesla arguing that Tesla is trying to use their "gallery" model and contract language in an effort to override Wisconsin lemon laws that were enacted to protect the state's customers. In this case, the purchaser allegedly suffered a host of problems with his Model S and after having to take the vehicle to the nearest service center, located 283 miles away from his home, the vehicle was off road for a total of 66 days. *Id.* According to Megna, the problems with the car clearly trigger Wisconsin's lemon laws, which state that a car can be deemed a lemon once the car is off road for just 30 days, less than half the time alleged in this case. *Id.* Also according to Megna, Tesla refused to buy back the vehicle and is trying to extract the consumer from the ability to use Wisconsin's lemon law. *Id.* Had the purchaser bought the vehicle from a Wisconsin dealer the consumer would clearly be protected by the Wisconsin Lemon Law. However, under the current Tesla sales model, Megna alleges Tesla "is using its sales contact

as a shield” and seeking to require buyers to “take any dispute to Northern California where Tesla is based, rather than local courts”. Id.

Opponents of strong state franchise laws as being outdated or stifling innovative sales process, often point to state lemon laws as key protections for consumers to downplay the consumer protection argument, dealers and their advocates, used to argue in favor of state franchise law. John Delacourt in the Journal of Law’s E-Commerce Symposium in May 2006 stated:

“Although consumer protection concerns are often raised in support of franchise law, state “lemon” laws are actually the principal source of consumer protection in the automotive context. These laws are essentially intended to bolster consumer bargaining power with manufacturers and to address concerns that manufacturers might otherwise respond inadequately, or unduly slowly, to consumer complaints regarding defective vehicles. Lemon laws have now been enacted in all fifty states. They require automobile manufacturers to provide refunds or replacement vehicles if, after a reasonable number of repair attempts, the vehicle still fails to satisfy the terms of the warranty. Once the consumer has satisfied the statutory requirement of notice and has made a reasonable number of repair attempts, the burden shifts to the manufacturer to demonstrate that the vehicle is not a lemon. 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, 163 (2007).

Although lemon laws are a great consumer tool against manufacturers if the jurisdiction in which a claim can be met is not clear the tool is vastly diminished as can be seen in the case Vince Megna is fighting.

This is an indicator of just one distinct advantage consumers have when purchasing vehicles from local state legislated franchise dealers and an advantage that opponents either fail to mention or have yet to consider. When consumers purchase cars in their community jurisdiction and state laws are clearly enforceable and litigation barriers are dramatically reduced. Compare the argument that Tesla makes in its contract, that jurisdiction is only in California. Just as is the case for this

Wisconsin Tesla customer it is “more difficult for an owner to press a case because of the costs and challenges of hiring an attorney out of state can be daunting”. Megna argues indirectly against the proposed Tesla model stating Tesla is “a company that doesn’t have to follow state rules” and “it really puts a person in a tough, tough situation”. As cases like this surface, courts will have to interpret state law to determine jurisdiction and the legislatures desire to protect its consumers.

State protections for independent dealers from automobile manufacturers:

“In statehouses from North Carolina to Washington, Tesla is battling auto dealers for the right to sell cars directly to consumers”. Collegio, supra. The fights heating up since direct-consumer sales are prohibited in almost every state’s franchise laws. When Tesla began opening automobile retail “Galleries” in 2008 the battles began and end is not in sight. Roger Quinland, Has the Traditional Auto Franchise System Run Out of Gas?, The Franchise Lawyer, last visit September 27, 2014, http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html. Every state has some form of legal protection for their independent franchised dealers. Legislatures have created laws to protect the interests of auto dealers because they have a major impact on state and local economies. Although state prohibitions vary, most are rooted in two underlying principles. Id. The first principal is that if auto manufacturers sell cars directly to consumers the process will endanger the businesses of local automobile franchisees, who don’t have the resources to compete with manufacturer pricing and who are very important to local economies.

Id. The second principal is that consumers need local dealers to utilize their knowledge, skill and experience to support local buyers in the sales and service process as advocates in the process. Id.

In Georgia for example, the Georgia Motor Vehicle Franchise Practices act outlines the legislature's intent in the legislative findings section under O.C.G.A. §10-1-621 stating:

*"The General Assembly finds and declares that:
(1) The distribution and sale of motor vehicles within this state are vital to the general economy of this state and to the public interest and public welfare;
(3) The maintenance of full and fair competition among dealers and others is in the public interest; and
(4) The maintenance of strong and sound dealerships is essential to provide continuing and necessary reliable services to the consuming public in this state and to provide stable employment to the citizens of this state." O.C.G.A. §10-1-621 (2010).*

Although state laws vary in their approach to dealing with consumer-direct manufacturer sales, Georgia's legislative intent to protect a vital economic and public interest of the state, to maintain "strong and sound dealerships" to provide "continuing and necessary reliable services to the consuming public" is at least in part representative of the general legislative intent behind the varying state franchise laws just like protecting local dealers and ensuring consumers have local advocates with the large manufacturers. O.C.G.A. §10-1-621 (2010).

When Tesla started opening automobile retail stores they named the operations "Galleries". This semantic choice was thought by many as a strategy to try to bypass state franchise laws, which either prohibit consumer-direct sales by manufacturers or had some structured framework to control manufactures when operating within

the respective states. Thomas Johnson, [Palo Alto-based Tesla hits New Jersey roadblock](http://peninsulapress.com/2014/03/12/tesla-new-jersey/), Peninsula Press, March 12, 2014,<http://peninsulapress.com/2014/03/12/tesla-new-jersey/>. Tesla argues that since no automobile orders are actually fulfilled at the Galleries they are not actually dealerships and they therefore do not fall under the States jurisdictional franchise legislations. Although Tesla has persuasively argued this in some states they have lost in others and generally the outcome comes down to the text of the legislation, the interpretation of the courts and ultimately the legislature's reaction to the courts. Most states laws prevent carmakers from selling directly to consumers but the legislatures have the option to change the legislation to favor consumer-direct sales or conversely to strengthen their stance against such consumer-direct sales. These varying actions are being proposed in legislatures across America. Currently there are proceedings or actions taking place in at least 10 states in which Tesla is being challenged. Ahmed, supra.

State Franchise Laws Vary Jurisdictionally:

In the United States there are 50 different interpretations of franchise law protections because every state has its own franchise laws and none are uniform. Based on differing state laws, it is very difficult for a company like Tesla to operate a unique direct-to-consumer sales operation in the multi-state environment and successfully navigate each states franchise laws. Although the laws as discussed have differing legislative intents, the laws none-the-less has to be dealt with. Proponents like Brian Shaffer, an advocate for franchise laws claims that the laws not only are set up to benefit dealers they were fundamentally enacted and exist to

serve the public interest, including the interest of consumers, local communities, and small businesses alike. Paul Shaffer, An Assessment of Franchise Laws and Internet Auto Sales, National Automobile Dealers Association, 2001, http://www.nada.org/pdf/shaffer_report.pdf. Advocates like Mr. Shaffer argue that auto dealers owe no apologies for the protections they receive from state regulation as they are similar to the protections against unrestricted entry that is afforded to many other community-centric industries, such as physicians, hairdressers, taxicabs, hospitals, utilities and more. Id. Most of these other industry protections don't even have the large costs associated with setting up their operations and as such could arguably be considered less deserving of such protections.

The most universal restriction imposed by state automotive franchise law is the bar on manufacturers' sales of new vehicles directly to consumers. Sales made directly by the manufacturer to the consumer are theoretically prohibited in all fifty states, as every state has laws that require new vehicle sales to be made through new car dealers. The battles we are seeing between Tesla and the various states are not the prohibition itself but the interpretation of the prohibition. Franchise model advocates and stakeholders traditionally assumed that judiciaries would interpret the prohibition on direct-consumer sales as extending even to situations in which dealer reliance on a potentially competitive manufacturer rationale is not applicable. This assumption would lend itself to situations such as when a manufacturer is a new entrant in a given market and, therefore, has not yet asked dealers to make investments of any kind. For example if a manufacturer such as Tesla wants to distribute its products in America, the state automobile manufacturer dealer laws

required the automobile manufacturer to establish a network of dealerships to sell and service its products, notwithstanding that it theoretically would prefer to pursue a model in which it sold its vehicles directly to consumers.

Most states franchise laws further prohibit automobile manufacturers from being licensed dealers, except under special, very limited circumstances. Solveig Singleton, Will the Net Turn Car Dealers into Dinosaurs?, CATO Institute, July 25, 2000, <http://www.cato.org/publications/briefing-paper/will-net-turn-car-dealers-dinosaurs-state-limits-auto-sales-online>. Ultimately these are the laws and protections that Tesla must combat in order to sell their vehicles directly to consumers without independent franchised dealers.

State Laws that protect Franchisees from their Franchisors:

In some states the franchise laws have been recently interpreted narrowly by state courts to encompass prohibitions on manufacturers related to operating stores that compete with their brand-specific franchisees instead of the broader traditional assumptions. Historically dealers and legislators may have thought that their franchise laws prohibited all manufacturer consumer-direct new cars sales. However, there have been some surprise rulings as a result of Tesla entering the marketplace. In Jurisdictions like Massachusetts and New York, the laws clearly protect dealers from direct competition from manufacturers selling directly to consumers against their respective franchisees, but not necessarily from unrelated manufacturers like Tesla. The laws contain language that prohibit consumer-direct sales by automotive manufacturers but in states with franchise protections like

Massachusetts and New York, the Tesla litigation issue has turned on the issue of standing or more accurately on a lack of standing. In these states, the courts have summed up the issue as; whether the individual party(s) seeking relief sustained an injury? To establish standing in an action, the courts have ruled that Petitioners must show that they will suffer an injury in fact that is distinct from that of the general public. Transactive Corp. v. New York State Dep't of Soc. Servs., 92 N.Y.2d 579, 580, 706 N.E.2d 1180 (1998).

In Greater N.Y., the Petitioner claimed that the purpose for New York's franchise law was "to prevent the opening of factory stores' owned by a franchisor." Greater New York Auto. Dealers Ass'n v. Dep't of Motor Vehicles of State of New York, 42 Misc. 3d 1217(A), 984 N.Y.S.2d 632 (Sup. Ct. 2011). Tesla, argued, "the Franchised Dealer Act in N.Y. was enacted to regulate the relationship between a dealer and an affiliated car company in a franchise relationship." *Id* at 878. The Petitioners sought a judgment to cancel or annul Tesla's registration that the DMV had issued to Tesla to operate as a new car dealer. *Id* at 876. Tesla moved to dismiss the Petition on the grounds that the Petitioners lacked standing. *Id*. The facts showed that Tesla operated dealerships in New York but that they had no franchisees and as such Tesla argued that the operations were dealerships not franchises. *Id* at 879. The DMV agreed and concluded that Tesla was a dealer and not a franchisor and therefore the Court ruled that the state's Franchise Act was not applicable to the situation. *Id* at 879. The court held that the since the Petitioners were not franchisees of Tesla, the Petitioners did not have standing pursuant to an action under the Franchise Dealership Act because there was no relationship between the

petitioner and Tesla. Id at 881. This ruling debunked the traditional view at least in New York that when state franchise laws prohibit direct-consumer sales there must be a franchisee to consummate sales. When state laws are worded to protect dealers from the manufacturers they represent without greater legal protections, the dealers may not have standing and therefore manufacturers like Tesla may not be forced to abide by the state franchise laws. The Greater New York Auto Dealers Association (GNYADA), of course, was not pleased with the ruling, arguing that Tesla's factory owned dealer model is clearly prohibited by the states franchise dealer law. Although GNYADA is clearly in opposition to the opinion they have not made an official statement as to whether they will appeal the decision. Roger Quinland, Has the Traditional Auto Franchise System Run Out of Gas?, The Franchise Lawyer, last visit Sept. 27, 2014, http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html.

In a very similar case, the Massachusetts State Automobile Dealers Association sought to enjoin Tesla from operating a store in Massachusetts. Mass. Auto. Dealers Assoc., Inc. et al v. Tesla Motors MA Inc., No. CV2012-1691, (Mas Super. Ct.), (Dec. 31, 2012). Just like in Greater N.Y., the Association claimed that Tesla was violating Massachusetts's law by conducting sales within the state at dealerships, which Tesla owned. Id. Tesla argued that since all the orders they took in their "Gallery" are actually fulfilled at its California factory, there is no actual sale-taking place in Massachusetts. Id. The dealers association countered that Tesla was merely arguing a concept that was designed by Tesla to circumvent the intent of the

Massachusetts legislation set up to protect the states consumers and franchised auto dealers. *Id.* The Court denied the Dealers Association on the grounds that the state law didn't necessarily give the non-Tesla dealers standing, as they were "not affiliated with Tesla." *Id.* Similarly to the Greater N.Y. case, The Massachusetts Auto Dealers Association is unhappy with the ruling and is considering an appeal in the courts ruling. *Quinland, supra.*

Although these jurisdictions' legislatures created laws to protect franchised dealers the laws were made at a time when all of the major automotive manufacturers had franchisees in the various jurisdictions and as such the franchise laws prohibited consumer-direct sales and regulated manufacturer behavior. Tesla's founder Elon Musk believes when states implemented franchise laws, "the intent was simply to prevent a fair and longstanding deal between an existing auto company and its dealers from being broken, not to prevent a new company that has no franchisees from selling directly to consumers." Elon Musk, [To the People of New Jersey](http://www.teslamotors.com/sv_SE/blog/people-new-jersey), Tesla, March 14, 2014, http://www.teslamotors.com/sv_SE/blog/people-new-jersey. Clearly the laws of New York and Massachusetts were designed by the legislatures to protect their states independent franchised dealers from over-reaching tactics of the manufacturers that they represented. The real question were the laws designed to protect their dealers and the states citizens from direct-to-consumer sales? When these laws were enacted, the greatest threat was thought to be unfair competition from the manufacturers against the very dealers that they selected and used to retail the cars they manufactured. To prohibit unfair competition in light of the investments the franchised dealers made in the state and

local communities these legislatures passed legislation as seen in New York and Massachusetts. Although one must dig through the legislative history of each jurisdiction to determine just what the specific legislatures intended Mr. Musk's theory is a reasonable view of what legislators desired given the risks associated with dealer operations when such legislation was enacted.

On the other hand it is very plausible that the legislatures failed to recognize that an automotive manufacturer would surface with an ambition like Tesla to sell exclusively and directly to consumers with no franchisees. If the legislatures intent was indeed to offer their states franchised dealer's greater protection New York and Massachusetts legislatures have the option to go back and alter their laws to extend the protections of their constituent car dealers and citizens. According to Seth Berkowitz, the president of one of the leading car review and pricing web sites; Edmunds.com believes that even with Tesla's perceived wins even in these states with theoretically Tesla-friendly franchise law, is not over as "it's still quite possible that there will be legislative action to stop them". Asma Khalid, Mass High Court To Hear Arguments in Tesla Case, Boston's NPR News, May 6, 2014, <http://www.wbur.org/2014/05/06/tesla-massachusetts-supreme-court>. In fact in the last legislative session in Massachusetts for example there were two competing bills introduced: one to protect the existing Tesla sales model and another bill to stop Tesla from selling in the state. Id. At this point neither bill has become law but this is indicative of the slippery ground that Tesla is on in even the states that they have already had preliminary victories. Other state legislatures have taken decisive action to bolster statutory protections for their states dealers and consumers and

have added new laws in an effort to clearly limit Tesla and other companies with similar ambitions ability to operate stores selling automobiles directly to the consumer. Johnson, Supra.

No matter what the original legislative intent, jurisdictions with legislation like New York and Massachusetts so far have handed down judicial decisions that have been favorable for Tesla. The courts have ruled that since Tesla has no franchisees the non-Tesla franchisees lack standing and therefore cannot judicially stop Tesla from setting up dealerships devoid of local independent owners in their states. Although Tesla has won these battles the war is very likely just beginning.

State Laws that protect Independent Automotive Dealers from Manufacturer

Direct Sales:

Alternatively to the laws in New York and Massachusetts many state franchise laws make consumer-direct manufacturer sales clearly illegal. In states like Texas, Arizona, Colorado, Virginia, North Carolina New Jersey, Georgia and others, Tesla has a much tougher battle. According to Elon Musk in these states “the laws were written in an overzealous or ambiguous manner” they are none-the less the states franchise laws. Elon Musk, To the People of NJ, Tesla, March 14, 2014, <http://www.teslamotors.com/blog/people-new-jersey>. These states’ legislation does more than simply regulate the relationship(s) between the automotive manufacturer and their franchised dealer; the laws prohibit manufacturer direct sales.

In some cases legislatures considered Tesla galleries as ventures that were operating within perceived loopholes in their state laws and as such they took decisive action to stop Tesla. In Arizona for example, state legislatures changed the law to include language that forbids Tesla from not only selling cars in the galleries but that clearly make it unlawful to discuss prices, offer test drives, etc. at its Galleries in Arizona. Thomas Johnson, [Palo Alto-based Tesla hits New Jersey roadblock](http://peninsulapress.com/2014/03/12/tesla-new-jersey/), Peninsula Press, March 12, 2014,<http://peninsulapress.com/2014/03/12/tesla-new-jersey/>.

Georgia is a good example of a state that has enacted legislation to prohibit consumer-direct sales by manufacturers. In Georgia the Georgia Motor Vehicle Franchise Practices Act has been adopted to protect the sale and service of automobiles in the state because the legislature determined that “the distribution and sale of motor vehicles... are vital to the general economy...” O.C.G.A §10-1-621 (1). The act defines whom it applies to under O.C.G.A. §10-1-624. Persons Subject to Article;

“(a) Any person who engages directly or indirectly in purposeful contacts within this state in connection with the offering of advertising for sale or has business dealings with respect to a new motor vehicle sale within this state shall be subject to the to the provisions of this article and shall be subject to the jurisdiction of the courts of this state.”

Since Tesla clearly desires to engage directly in purposeful contacts within Georgia to sell new motor vehicles they are subject to the provisions of O.C.G.A. §10-1-624.

O.C.G.A. §10-1-664.1 outlines the Restrictions on the Ownership, Operation, or Control of Dealerships by Manufacturers providing:

“(c) ...No manufacturer or franchisor shall offer to sell or sell, directly or indirectly, any new motor vehicle to a consumer in this state, except through a

new motor vehicle dealer holding a franchise for the line make covering such new motor vehicle”.

In Georgia, since Tesla is the manufacturer of Tesla vehicles they cannot offer to sell except through new motor vehicle dealers. Georgia law is a good example of the type of franchise law that restricts Tesla from operating sales locations in the state without legislative changes; nonetheless, Georgia still is a battleground for Tesla.

Georgia is the most recent state that seeks to bar distribution of Tesla from their company store. In Georgia Tesla has yet to open a gallery but a recent petition filed with the Georgia Department of Revenue asserts that Tesla is selling vehicles from their service shop in Marietta, an Atlanta suburb. Alan Ohnsman & Margaret Newkirk, Tesla Fight Erupts in Georgia as Dealers Seek Sales Ban, Bloomberg, Aug 30, 2014, <http://www.bloomberg.com/news/2014-08-29/tesla-fight-erupts-in-georgia-as-dealers-seek-sales-ban.html>. The petition asserts that even though Georgia allows manufactures only to sell vehicles made “in accordance with custom design specifications of the customer” and retail fewer than 150 cars per year directly to consumers, Tesla sold 173 vehicles at its Georgia outlet in the proceeding 9 months. Id. Commentators such as Eric Ibara, senior analyst for Kelley Blue book commented on the petition stating: “it’s difficult to find fault in the dealers association point that manufacturers should adhere to the existing laws”. Id.

In New Jersey, the circumstances and sentiment are similar. Tesla’s Musk accused the governor of going back on his word when the New Jersey Motor Vehicle Commission voted to uphold the ban on direct manufacturer sales. Johnson, *supra*. The governor responded with a statement:

“Since Tesla first began operating in New Jersey one year ago, it was made clear that the company would need to engage the Legislature on a bill to establish their new direct-sales operations under New Jersey law. This administration does not find it appropriate to unilaterally change the way cars are sold in New Jersey without legislation and Tesla has been aware of this position since the beginning.” Id at 2.

New Jersey franchise laws are an example of another state that makes direct-consumer sales seemingly impossible without legislative changes.

Texas has similar laws that make selling cars direct-to-consumers impossible without legislative changes. As a result in Texas, Elon Musk appeared personally before the House Business and Industry Committee to try to get support for two bills, Texas H.B 3351 and Texas S.B 1659. The bills that were designed to allow Tesla to get around the Texas franchise laws and sell cars directly to consumers. If the Bills had been adopted they would have given Tesla a very narrow exemption from Texas franchise law providing that “American manufacturers of electric cars that have never previously had franchised dealerships could sell cars directly to consumers in Texas”. Roger M. Quinland, [Has the Traditional Auto Franchise System Run Out of Gas?](http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html), The Franchise Lawyer, last visit Sept. 27, 2014, http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html. Prior to being voted on Tx. H.B. 3351 was enhanced to further protect dealers by adding that if Tesla sold more than 5,000 vehicles a year in Texas it would be subject to the states franchise laws. Id. Both of the bills failed to even reach the floor and became a good indicator to Tesla that Texas does not intend to change its franchise laws to allow Tesla to sell direct to consumers.

In Virginia the results of Tesla's lobbying to change the protections came out very similarly. Tesla applied to the Virginia Department of Motor Vehicles to grant it a special exemption to operate in the state but the application was declined. Quinland, supra.

In North Carolina, the Senate unanimously passed a preemptive bill to deter Tesla from selling in the state. If the bill passes the North Carolina Senate, Tesla will be precluded from selling its cars in North Carolina except through independent dealers.

TESLA Galleries Operational Allowances:

In the states where direct sales to consumers are more clearly banned in their franchise laws there are very strict limitations on what "Tesla Galleries" are allowed to offer consumers. For instance in states like Texas, Arizona, Colorado and Virginia where Tesla has set up "galleries" the gallery employees are not allowed to take orders for car purchases, they cannot take customer payments, make delivery arrangements or even offer test drives. Johnson, Supra. In these states the customer's only option is to order a Tesla vehicle online from their factory in California. Id. When the vehicle is ready, it is delivered to the customer's home in an unmarked truck. Id.

In these states the judiciary does not provide a promising route for Tesla and they have for the most part failed in judicial challenges. Tesla has found some victories in lobbying state legislatures for changes or compromises with very narrow allowances for electric specific vehicles and volume-capped exceptions.

Ultimately, in states with tough franchise laws, compromise may be the best option for Tesla.

Built in Exceptions for Small Volume manufacturers:

In the cases of smaller automotive manufacturers that do not have the capability to attract franchisees many of the states created exceptions to allow very limited sales by these smaller manufacturers that would not be in numbers that could harm the states franchised auto dealers or the states citizens. In Georgia as previously mentioned for example, O.C.G.A. §10-1-664.1(a)(7) allows manufacturers a very limited exception stating that the act shall not prohibit:

“A manufacturer from selling new motor vehicles to customers if such vehicles are manufactured or assembled in accordance with custom design specifications of the customer and such sales are limited to no more than 150 vehicles per year”. O.C.G.A §10-1-664.1

Tesla could operate as a very small manufacturer under these varying exceptions but ultimately they may not be able to operate profitably with the low volumes that these exceptions allow. In states like Georgia, Tesla will likely find their fate as they surpass the maximum volume allowed by law. Tesla therefore needs victories such as those they have found in New York and Massachusetts to make their business model feasible and the various small volume manufacturer exemptions do not represent a feasible or profitable alternative to operating within the laws of the various states they sell their vehicles in.

Lobbying for Compromise Legislation.

The alternative to lobby state legislatures for narrow exceptions to allow Tesla to sell limited numbers at limited stores for electric only vehicles is a reasonable alternative for Tesla. For example, after the New Jersey Motor Vehicles Commission voted unanimously in March 2014 to uphold the direct-sales ban on manufacturer to consumer automotive sales, Tesla went back and lobbied for specifically crafted legislation that would allow them to operate within distinct parameters in the state. [Tesla pushes NJ bill to follow NY lead allowing direct sales](http://www.crainsnewyork.com/article/20140618/TRANSPORTATION/140619864/tesla-pushes-nj-bill-to-follow-ny-lead-allowing-direct-sales), Crain's New York Business, June 18, 2014, <http://www.crainsnewyork.com/article/20140618/TRANSPORTATION/140619864/tesla-pushes-nj-bill-to-follow-ny-lead-allowing-direct-sales>. Although Tesla suffered as the state enforced their law, which does not allow Tesla to sell direct to consumers, Tesla's lobbied efforts for alternative legislation prompted lawmakers to draft New Jersey Bill A3216, which is currently pending. The bill would supersede the current legislation disallowing direct sales and a limited exception for Tesla to operate with a limit of four locations. After much legislative pressure the New Jersey Assembly approved the bill to create a special exception for direct sales of zero-emission vehicles while preserving the legislative protections for franchised dealerships. Id. The bill allows:

"Sales by any zero-emission manufacturer licensed by the commission on or before Jan. 1, 2014. New Jersey Bill A3216.

Although this is much better than the broad ban on Tesla from selling directly to consumers in New Jersey it is little more than a good start for Tesla as the bill has yet to be adopted by the New Jersey Senate and at this point simply represents a

much needed inroad to what may be the necessary compromise to allow Tesla to sell direct to consumers in the state.

In Washington, the legislature modified its existing direct sales ban by creating an exception for Tesla similar to the proposed New Jersey legislation. Prior to the compromise legislation had been drafted to explicitly prohibit expansion by Tesla in Washington State. The exception that was a result of a compromise between dealers and Tesla is very narrow and only applies to manufacturers that sold cars direct as of January 1, 2014. Johnson, *Supra*.

In Late March 2014, Ohio approved a bill, which formally barred automakers from selling directly to consumers except for a maximum of three outlets for electric-car builders. Ahmed, *supra*. As such Tesla successfully negotiated a narrow exception allowing Tesla them to operate three stores as long as they don't sell their company and continue to exclusively produce all-electric vehicles. Jason Siu, [Tesla Store is Ohio are Safe](#), Autoguide.com, March 26, 2014, <http://www.autoguide.com/auto-news/tag/tesla-dealers>. While Tesla lobbied to get the Ohio bill presented to legislators, GM officially testified to the Ohio State Senate Committee expressing their opposition to the state granting any direct dealer licenses to Tesla. Nikki Gordon, [GM Backstabs Tesla Motors in Ohio as NJ Legislators Try to Kill Anti-Tesla Rules](#), Transport Evolved, March 13, 2014, <https://transportevolved.com/2014/03/13/gm-backstabs-tesla-motors-in-ohio-as-nj-legislators-try-to-kill-anti-tesla-rules/>. GM contends that Tesla should compete under the same laws that they do and is opposed to any state creating special Tesla exclusions. *Id.*

In Georgia, Tesla ran out of time before the legislature considered their proposed exception. Tesla operated in Georgia under the low volume exception previously mentioned. O.C.G.A. §10-1-664.1(a)(7) allows manufacturers a very limited exception stating that the act shall not prohibit: “... *more than 150 vehicles per year*”. O.C.G.A. §10-1-664.1(a)(7). Prior to the GADA filing a petition with the Georgia Department of Revenue seeking to ban Tesla sales in Georgia. Tesla was lobbying the Georgia legislature to try to get the legislature to alter the exception and increase the yearly sales volume more than the current 150 cars per year. Ohnsmann & Newkirk, supra. A bill was written by a legislator whose district serves in the city where Tesla is considering opening its first Georgia Gallery. The bill has not been adopted and the exception holds at 150 cars per year. Tesla has breached this limit and is facing the Georgia Department of Revenue as a result. The GDR findings are still pending.

Tesla has also faced failures in their lobbying efforts to create narrow exceptions in other states. As previously discussed, Tesla’s efforts in Texas to find a compromise failed. The president of the Texas Automobile Dealers Association, commented; “This happens all the time, someone wants an exception to the franchise laws... If we made an exception for everybody that showed up in legislation, before long the integrity of the entire franchise system is in peril.” ABC New Nightline, [Why Texas Bans the Sale of Tesla cars](http://news.yahoo.com/blogs/nightline-fix/why-texas-bans-sale-tesla-cars-140842349.html), Yahoo News, August 22, 2013, <http://news.yahoo.com/blogs/nightline-fix/why-texas-bans-sale-tesla-cars-140842349.html>. The next chance to bring new legislation will be in 2015 so until then no Texas resident can buy a Tesla in Texas.

In Colorado as opposed to Texas, the state did not require Tesla to close their “gallery”. However, the state legislature responded to Tesla’s lobbying efforts by enacting new state legislation prohibiting Tesla from opening any additional stores. Evan Puschak, Tesla vs. the auto dealers of America, MSNBC, August 28, 2013, <http://www.msnbc.com/the-last-word/tesla-vs-the-auto-dealers-america>. As such, Tesla is allowed to operate one store in the state but will not be able to open others without legislative changes.

Tesla’s Musk sees the battle to sell vehicles direct to consumers as; “central to our mission to accelerate the shift to sustainable transportation, a new paradigm in the automotive industry”. Johnson, *supra*. He has said that if Tesla sees nonstop battles at the state level he would rather fight one federal battle. *Id.* Compromise through state legislatures has resulted in mixed results for Tesla and these varying results may lead Tesla to try to bring the fight into the federal realm as indicated by Musk. Ultimately time will tell but even in light of Musk’s forewarnings legislative compromise may be the only viable option for Tesla in the states that prohibit direct-consumer sales especially as some states are moving to create new laws to further limit Tesla consumer-direct sales. There is risk for Tesla in alienating states because more states may be prompted, as others have done, to further enhance their franchise laws and make Tesla’s battle that much harder.

Constitutional Challenge:

The issue as to whether there are ripe constitutional challenges against state regulation that prohibits consumer-direct sales by state franchise law was considered in Ford Motor Co. v. Texas Dept't of Transp. Ford Motor Co. v. Texas Dep't of Transp., 106 F. Supp. 2d 905, 908 (W.D. Tex. 2000) aff'd, 264 F.3d 493 (5th Cir. 2001). In 1998 Ford Motor Company (Ford) created a plan to sell vehicles directly to consumers in the state of Texas. *Id.* The following year the Texas Department of transportation filed a complaint against Ford which alleged it had violated Texas Franchise law by selling vehicles directly to consumers without a dealer's license. *Id.* at 908. Ford argued that the Texas Department of Transportation, acted in violation of the First Amendment, the Due Process Clause, and the Commerce Clause. *Id.* The Court concluded that Ford's argument was an attempt to avoid the Texas Motor Vehicle Franchise Law, which prohibits manufacturers from selling vehicles to consumers and "cloak the attack in a constitutional challenge". The court ruled that Texas exercised a legitimate states police power to regulate who is qualified to sell motor vehicles in the state and under what conditions. *Id.* at 918. The courts dicta indicated that they believed that the arguments would have been more appropriately addressed to the Texas Legislature than in a federal district court. *Id.* The court held that Ford failed to establish any enforceable constitutional challenges and ordered summary judgment on behalf of the Texas Motor Vehicle Commission thereby prohibiting Ford from selling consumer-direct in Texas. *Id.*

If Tesla were to challenge state laws that bar consumer-direct sales from manufacturers, based on similar constitutional arguments, the conclusion should end up just like that in the Texas Ford case. In Ford, their plan was less overreaching in the facts as Ford was selling pre-owned cars and they were doing so in participation with franchised dealers. In the case of Tesla there would be even less of an argument in that Tesla would be trying to sell new cars with no participation from the very dealers the state law is designed to protect.

In Ford, the Court recognized that Texas had a valid state interest in equalizing the market power between manufacturers and dealers and therefore the franchise laws were based on valid legislative findings to pursue that reasonable goal. *Id.* The same argument could be made by Texas and the same result should result if Tesla were to constitutionally challenge states franchise laws. When states have a rational basis for their franchise laws and there is a legitimate state interest that is being protected by forbidding consumer-direct sales, the states should clearly prevail over constitutional challenges and as such this alternative seems to offer little promise to Tesla.

Federal Fight:

Plodding through the various state legislatures and judiciaries with varying state laws has proven to be difficult, costly and with mixed results for Tesla. As such Musk has consistently said that he considers a federal battle as an option. Amy Wilson, [Tesla's Musk: I'll Take Store Fight Federal](http://www.autonews.com/article/20130415/RETAIL07/304159943/teslasmusk), Automotive News, Apr. 15, 2013, [http://www.autonews.com/article/20130415/RETAIL07/304159943/teslasmusk:](http://www.autonews.com/article/20130415/RETAIL07/304159943/teslasmusk)

-ill-take-store-fight-federal#. Although Musk has repeatedly made this and similar statements, the likelihood that Tesla would be effective in convincing a federal court to invalidate the various state auto franchise laws is most unlikely.

Opponents to Tesla's direct sales model point out "buying a car isn't like buying a pair of shoes online. Cars require licensing to operate, insurance and financing to take home, and contain hazardous materials, so states are fully within their rights to protect consumers by standardizing the way cars are sold". Sarah Rubenoff, FTC Staffers, NADA Debate Tesla Sales Model, Auto Remarketing, April 30, 2014, at 24. Bearing in mind Tesla's opponents suggests that federal franchise regulation could be a viable albeit unlikely alternative. Under "The Franchise Act", 15 U.S.C. § 1221 the act does not prohibit auto manufacturers from selling consumer-direct. The preliminary obstacle however is that when the Franchise Act is in conflict with state law, the Act states that it:

"...shall not invalidate any provision of the laws of any State except insofar as there is a direct conflict between an express provision of this chapter and an express provision of State law which can not be reconciled." Cynthia Barmore, Tesla Unplugged: Automobile Franchise Laws and the Threat to the Electric Vehicle Market, 18 Va. J.L. & Tech. 185, 198-99 (2014)

Although state law would preempt federal franchise law if it were in direct conflict with state law, the Federal Franchise Act theoretically could permit the direct sale of automobiles with caveats such as with electric engines similar to the exceptions many states have recently passed or are considering in their legislatures. Id at 6.

With Tesla and Musk's influence the company is sure to be utilizing its lobbying power at the federal level to garner support for a law that would support a federal exception that would meet the ambitions that Tesla aims to achieve.

Tesla Compromise:

Elon Musk “admits that auto dealers constantly approach Tesla about becoming franchised dealers”. Quinland, *supra*. That notwithstanding, he argues that Tesla does not believe that franchisees would have the “Fervor needed to convert new buyers to electric cars and take business away from gasoline cars”. John Voelcker, Tesla loses legal battles to Texas, North Carolina Dealers, Green Car Reports, June 6, 2013, http://www.greencarreports.com/news/1084622_tesla-loses-legal-battles-to-texas-north-carolina-dealers. Even in light of Tesla’s desire to sell consumer-direct, Elon Musk has indicated that Tesla may be willing to use franchised dealers on a limited basis if they fail to alter states laws and once the company is on a more solid economic footing. Roger M. Quinland, Has the Traditional Auto Franchise System Run Out of Gas?, The Franchise Lawyer, last visit Sept. 27, 2014, http://www.americanbar.org/publications/franchise_lawyer/2013/summer_2013/has_traditional_automobile_franchise_system_run_out_gas.html. These indications hint at the idea that Tesla may be willing to open a discussion of the creation of a dual retail network consisting of Tesla-owned stores and independently owned franchise dealerships. *Id.*

Additionally, Tesla claims to be finding great success in China. Alan Ohnsman & Margaret Newkirk, Tesla Fight Erupts in Georgia as Dealers Seek Sales Ban, Bloomberg, Aug 30, 2014, <http://www.bloomberg.com/news/2014-08-29/tesla-fight-erupts-in-georgia-as-dealers-seek-sales-ban.html>. According to Tesla sales in China may match its U.S. business by as early as 2015. *Id.* As this market may become Tesla’s single biggest market their success in China may lessen the

significance on the domestic disputes and further prod a compromised dual network of dealers. Id.

Regardless of Tesla's impression with car dealers they are a persuasive group that has not only shown great success in retailing traditional vehicles for decades, they have also shown that they can outsell Tesla when marketing all electric vehicles. Zachary Shahan, [Nissan Leaf Still King, Ford Fusion Energi Sales Jump 201%](http://cleantechnica.com/2014/08/05/nissan-leaf-still-king-ford-fusion-energi-sales-jump-201/), Clean Technica, August 5th, 2014, <http://cleantechnica.com/2014/08/05/nissan-leaf-still-king-ford-fusion-energi-sales-jump-201/>. In addition to the fact that traditional franchised Nissan, Chevrolet, Toyota and Ford dealers sold more cars than Tesla in the latest sales months there is a large pool of dealers who are willing and able candidates in any of the states that have barred direct sales to Tesla. These dealers offer Tesla a viable alternative to fighting the laws. A compromised and dual sales network would not only have the advantage of offering consumers alternative places to purchase Tesla vehicles, it would provide eager participants to start putting their capital, ambition and local organizations to the task of making Tesla an American success story.

Conclusion:

Innovative changes may be necessary to enhance the competitive nature of American automotive manufacturing but to arbitrarily change the way cars are distributed in the United States would have far reaching effects. Those effects should be considered in great detail prior to creating judicial or legislative changes that will influence such a large portion of the United States economic engine. When

Charles Wilson declared “what is good for the country is good for General Motors and vice versa” he may have meant what is good for the country is good for the automotive industry and vice versa. There are nearly 17,700 new car dealerships representing almost 32,000 automobile manufacturers with franchise agreements and these dealers are undeniably an important and integral part of the automotive industry and need strong state franchise laws to protect their interests, consumers’ interests and the communities that depend on the automotive industry for their current and future livelihood.

When the President and the federal government took action in 2009 to save the American automotive industry, they took action not only for the failing manufacturers but also the countless workers, communities, suppliers, dealers and of peripheral businesses that rely on the industry all across America for their very survival. The actions of the federal government were not just to protect the corporations but also to protect the dependents. As a result, the American automotive industry and the related businesses have emerged with a remarkable resurgence and positive cumulative effects across the country. This is clearly evidenced with job creation, escalating real estate values, growth in tax revenue and continued increasing automotive based commerce. Independent franchised automotive dealers played and are playing an important role in this resurgence.

The outcome of consumer-direct sales remains to be seen, but no matter what side each party takes in the battle, the war is very costly. Compromise in legislation to create exceptions, compromise to utilize independent dealers where legislative exceptions are not realistic and compromise to be held liable under state consumer

protection laws are all necessary on both sides of the debate. Tesla's battle with dealers is just one of the many hurdles standing in Musk's way of this American manufacturer becoming a mainstream success. For the good of the American automotive industry, technological advancement, reducing the environmental impact of automobiles and for the benefit of the good of the consumer, all the parties should work towards compromise to work within the generally established framework to provide this stellar car to the American consumer. With compromise, America will be one step closer to being the automotive technological leader in this race for automotive innovation bringing us one step closer to regaining the automotive leadership position America once enjoyed.