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IN THE SUPREME COURT OF THE STATE OF DELAWARE

TESLA, INC., Appellant, v. THE DELAWARE DIVISION OF MOTOR VEHICLES, Appellee.	No. 375,2022 CASE BELOW: SUPERIOR COURT OF THE STATE OF DELAWARE C.A. No. N21A-09-001-CLS

BRIEF OF LEGAL AND ECONOMIC SCHOLARS AS AMICI CURIAE IN SUPPORT OF APPELLANT

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STATEMENT OF AMICI INTEREST

Amici are law professors, economists, or other academics with expertise in competition law and economic regulation. Amici do not work for Tesla, nor have they been compensated in any way for their participation in this brief.

SUMMARY OF ARGUMENT

Amici understand that the legal issue before the Court is whether Delaware's Franchise Act, 6 Del. C. § 4913 ("Franchise Act"), disqualifies a non-franchising manufacturer—a company that offers cars for sale directly to the consuming public and does not employ independent franchised dealers—from obtaining a Dealer License. Amici submit that it would be entirely against the history and purposes of dealer franchise laws and poor public policy to prohibit a non-franchising manufacturer to sell its own cars to consumers. Direct sales prohibitions arose in the mid-twentieth century as protections for franchised dealers against intrabrand competition by their own franchising manufacturers. They were not intended to restrict interbrand competition by manufacturers that chose not to franchise at all. There is no legitimate public policy reason for prohibiting a non-franchising manufacturer from selling its own cars, and such restrictions will slow market acceptance of EVs and diminish consumer choice and innovation.

ARGUMENT

I. DIRECT SALES PROHIBITIONS WERE INTENDED TO PREVENT INTRABRAND COMPETITION BY MANUFACTURERS AGAINST THEIR OWN FRANCHISED DEALERS, NOT INTERBRAND COMPETITION BY NON-FRANCHISING MANUFACTURERS

This Court has observed that "historical context leading to the enactment" of a category of statutes "generally" is important to the task of statutory interpretation. *A.W. Fin. Servs., S.A. v. Empire Res., Inc.*, 981 A.2d 1114, 1125 (D.E. 2009) (considering historical context of enactment of escheat statutes). The historical context in which franchise dealer acts arose is clear and highly informative to the question before the Court. In the mid-twentieth century, franchised dealers complained that they were being exploited by their franchising manufacturers. This led to the passage of dealer protection laws in every state, including restrictions on direct sales by manufacturers. These statutes had nothing at all to do with restricting sales by non-franchising manufacturers, which would not have threatened the kinds of exploitations about which the dealer successfully complained.

A. Direct Sales Prohibitions Arose from the Perception of Franchisee Exploitation by Franchising Manufacturers

Automotive manufacturer franchising of dealers began in 1898 with a franchise by General Motors to sell steam automobiles. *See* Francine Lafontaine & Fiona Scott Morton, *Markets: State Franchise Laws, Dealer Terminations, and the*

Auto Crisis, 24 J. ECON. PERSP. 233, 234 (2010). However, for the first few decades of the 20th century, franchising was not the predominant distribution model. Rather, manufacturers employed a variety of distribution methods including direct distribution through factory-owned stores and traveling salesmen, and sales through wholesalers, retail department stores, and consignment arrangements. *See* Thomas G. Marx, *The Development of the Franchise Distribution System in the U.S. Automobile Industry*, 59 BUS. HIST. REV. 465, 465-66 (1985). As automobile consumption intensified, however, the manufacturers moved increasingly toward an independent franchised dealer model in order to focus on their core competency in manufacturing and find additional sources of capital to fund their distribution operations. *See generally* Daniel A. Crane, *Tesla, Dealer Franchise Laws, and the Politics of Crony Capitalism*, 101 Iowa L. Rev. 573, 578-80 (2016).

The dealer-franchise system that has largely prevailed since the mid-twentieth century grew out of lobbying efforts by automobile dealers from the 1930s to the 1950s in response to perceived abuses of the franchise relationship by car manufacturers. *See* Crane, *supra at* 577-79. At that time, General Motors, Ford, and Chrysler ("the Big Three") dominated the market. Dealers were largely family-owned "mom and pop" shops. Manufacturers were perceived as having grossly unequal bargaining power and were able to secure contracts that imposed

draconian terms on the dealers. *See* Friedrich Kessler, *Automobile Dealer Franchises: Vertical Integration by Contract*, 66 YALE L.J. 1135, 1155 (1957); CHARLES MASON HEWITT, JR., AUTOMOBILE FRANCHISE AGREEMENTS 23-40 (1956); BEDROS PETER PASHIGIAN, THE DISTRIBUTION OF AUTOMOBILES, AN ECONOMIC ANALYSIS OF THE FRANCHISE SYSTEM (1961). For example, during the Depression, Henry Ford kept his factories running at "full tilt" and allegedly was able to "force" dealers to buy inventories of Model Ts that they would be unable to sell, under threat of not getting any more inventory in the future if they refused delivery. *See* James Surowiecki, Dealer's Choice, NEW YORKER (Sept. 4, 2006), http://www.newyorker.com/magazine/2006/09/04/dealers-choice-2. General Motors was similarly perceived to be exploitative of its dealers. According to a 1956 Senate Committee report, franchise agreements of the 1950s typically did not require the manufacturer to supply the dealer with any inventory and allowed the manufacturer to terminate the franchise relationship at will without any showing of cause. S. REP. NO. 2073, at 3 (1956). Conversely, the manufacturers could often force dealerships to accept cars whether the dealer could sell them or not. Thus, the franchise agreements were perceived as shifting risk downward to dealers and reward upwards to the manufacturers.

During the 1930s to 1950s, the dealers pressured Congress to enact a statutory scheme protecting them from the power of the Big Three. They obtained relatively little of what they wanted from the federal government. A 1939 report by the Federal Trade Commission ("FTC") found some franchising abuses by manufacturers, but also that the use of manufacturer power to squeeze the dealers actually created intensive retail competition to the benefit of consumers. FED. TRADE COMM'N, ANNUAL REPORT OF THE FEDERAL TRADE COMMISSION FOR THE FISCAL YEAR ENDED JUNE 30 1939, at 24-25 (1939), https://www.ftc.gov/sites/default/files/documents/reports_annual/annual-report-1939/ar1939_0.pdf. The FTC also accused the dealers themselves of employing various anti-consumer practices, such as "padding" new car prices, price fixing, and "packing" finance charges. Eventually, the dealers secured a modest federal victory with the Automobile Dealers' Day in Court Act of 1956, Pub. L. No. 84-1026, 70 Stat. 1125, which allows dealers to bring a federal suit against a manufacturer who, without good faith, fails to comply with the terms of a franchise agreement or terminates, cancels, or refuses to renew a franchise. *See generally Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc*., 473 U.S. 614 (1985).

The dealers secured more significant victories in state legislatures. During the same time period, states began to pass statutes governing automotive franchise

relations. Today, all 50 states have such laws. Their terms vary, but they commonly include prohibitions on forcing dealers to accept unwanted cars, protections against termination of franchise agreements, and restrictions on granting additional franchises in a franchised dealer's geographic market area. Crane, *supra at* 578-79.

One of the typical provisions in these dealer protection statutes—which is reflected in Delaware's Franchise Act—is a prohibition on direct sales by a franchising manufacturer. *See* Cynthia Barmore, *Tesla Unplugged: Automobile Franchise Laws and the Threat to the Electric Vehicle Market*, 18 Va. J. L. & Tech. 185, 189 (2013). The rationale for these direct sales prohibitions was that it was unfair for a manufacturer to induce its franchised dealer to make significant investments in promoting the manufacturer's brand and then open up its own retail store in competition with its franchised dealer. Crane, *supra*. The manufacturer could ostensibly sell below its dealer's price (by keeping the wholesale price to the dealer high) and unfairly siphon off the benefits of the dealer's investment in the brand. To prevent such exploitation of their superior bargaining power, manufacturers would be prohibited from competing against their own franchised dealers.

Since at the time of these statutes the three relevant manufacturers—General Motors, Ford, and Chrysler—were all in the franchising business, most state

statutes did not specifically spell out that the statutory prohibition was intended to apply to franchising manufacturers. That was simply assumed. However, the structure of many of these statutes makes clear that manufacturer competition against its own franchisees was the exclusive concern. For example, the California statute prohibits a manufacturer from opening a retail store within a ten-mile radius of its franchised dealer. California Vehicle Code - VEH § 11713.3. Delaware's statute defines a "dealer" not to "include" "a manufacturer … who sells or distributes vehicles to licensed dealers." 21 *Del. C.* § 6301(3)(f). Similarly, the sponsors to the 2001 amendments to the Delaware Franchise Act noted that their purpose was to "clarify[y] the individual responsibilities in dealings between Manufacturers and Automobile Dealers. … This Bill also provides that all dealers be afforded the same opportunity to compete and that a manufacturer can only own a dealership under certain limitations and for a limited amount of time and will not compete directly with *its* dealers." Delaware Bill Summary, 2001 Reg. Sess. S.B. 80 (emphasis added). The legislative focus was on protecting dealers in franchise relationship from exploitation by their franchising manufacturer, not in curtailing interbrand competition.

This historical context provides important guidance on how to interpret a statutory prohibition on manufacturer direct sales. Direct sales prohibitions arose as part of a larger package of protections for dealers from unfair exploitation by

their franchising manufacturer. These statutes were not intended to protect franchisees from interbrand competition from manufacturers that did not franchise at all.

B. Courts Have Recognized that Direct Sales Prohibitions Were Not Intended to Prevent Interbrand Competition by Non-Franchising Manufacturers

Judicial decisions interpreting other states' motor vehicle franchise acts reflect the historical context discussed above. The decision of the Massachusetts Supreme Court in *Massachusetts State Auto. Dealers Ass'n, Inc. v. Tesla Motors, M.A., Inc.*, 15 N.E.3d 1152 (Mass. 2014) is the leading precedent. The Massachusetts car dealers' association sued Tesla for unfair trade practices for opening a gallery in the state. The legal question presented was whether the dealers had standing to sue Tesla under amendments to the Massachusetts franchise dealer statute. Although the court only ruled on the issue of standing—finding that the dealers lacked it—its reasoning showcases the importance of the context of the direct sales prohibitions in determining how to interpret them.

As the court explained, the direct sales prohibition "was enacted in recognition of the potentially oppressive power of automobile manufacturers and distributors in relation to their affiliated dealers." *Id.* at 679 (citing *Beard Motors, Inc. v. Toyota Motor Distribs., Inc*., 480 N.E.2d 303, 303 (Mass. 1985)). The direct sales prohibition was part of a "Dealers' 'Bill of Rights' Provision," that "was

intended to protect franchised dealerships from specific types of abuses by their manufacturers." *Id.* (citation omitted).

The statute created a private right of action for "any motor vehicle dealer" injured by a violation of the statute, and the dealers argued that they were such parties under a literal reading of the statute. *Id.* at 681. After casting doubt on whether the statute even applied to Tesla, the court came to what it thought the more significant point: The statute had to be read in the context of "cause of its enactment, the mischief or imperfection to be remedied and the main object to be accomplished." *Id.* at 682 (citations omitted). The dealers argued that they were intended beneficiaries of the statute, since direct sales would permit Tesla to save costs and sell at a lower price to consumers, thus competing unfairly with the dealers. *Id.* The court rejected this argument. "The type of competitive injury" the dealers described "between unaffiliated entities" was "not within the statute's area of concern." *Id.* at 684. "Historically, the statute was intended "to protect motor vehicle dealers from a host of unfair acts and practices historically directed at them ***by their own brand*** manufacturers and distributors." *Id.* at 684-85 (emphasis added). "It would be anomalous to find, within this detailed list of rights and protections that are conferred on dealers vis-à-vis their manufacturers and distributors, a lone provision giving dealers protection against competition from an unaffiliated manufacturer." *Id.* at 685. The court concluded that the direct sales

prohibition "was intended and understood only to prohibit manufacturer-owned dealerships when, unlike Tesla, the manufacturer already had an affiliated dealer or dealers in Massachusetts." *Id.* at 688.

The Massachusetts Supreme Court got the history exactly right. So did the New York Supreme Court in *Greater New York Auto. Dealers Ass'n v. Department of Motor Vehicles*, 969 N.Y.S.2d 721 (N.Y. S. Ct. 2013), another decision denying the dealers standing to challenge Tesla's opening of a retail operation. Like the Massachusetts court, the New York court understood the state's direct sales prohibition to regulate the relationship between a franchising manufacturer and its franchised dealer, not interbrand competition by non-franchising manufacturers:

> The Franchised Dealer Act regulates the relationship between a car company (manufacturer) and its franchised dealers. In order to commence an action for a violation of Article 17–A of the VTL Law, there must be a franchise relationship between the franchisor and the franchisee. Manufacturers and dealers cannot utilize the Franchised Dealer Act as a means to sue their competitors.

Id. at 726.

The United States Supreme Court has long recognized the critical distinction between the regulation of intrabrand competition—competition among separate sellers of the same brand of product—and interbrand competition—competition between sellers in different brands. *See, e.g., Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 878 (2007). Since Tesla does not have any franchised

dealers, its dealer license application in this case solely concerns interbrand competition—competition between Tesla and dealers who sell different brands of cars. There is no historical evidence that the direct sales prohibitions in dealer protection statutes were addressed to interbrand competition. They were solely concerned with protecting dealers from exploitation by their own franchising manufacturers.

II. THERE IS NO LEGITIMATE PUBLIC POLICY GROUND FOR DENYING A NON-FRANCHISING MANUFACTURER THE RIGHT TO SELL ITS CARS DIRECTLY TO CONSUMERS.

As noted in the previous section, the historical concern with allowing car manufacturers to open their own retail stores—that they might unfairly undermine their own franchised dealers—simply does not apply to a manufacturer that does not employ dealers. Nor is there any other plausible justification for such a prohibition. To the contrary, prohibiting direct sales by non-franchising manufacturers will harm consumer choice, impede innovation, and slow the penetration of EV technology.

A. There Is No Consumer Protection Justification for Prohibiting Direct Sales by Non-Franchising Manufacturers.

Since the historically grounded legislative purpose for direct sales prohibitions is protecting dealers from exploitation by their franchising manufacturer, there is no reason to consider other potential justifications for preventing direct sales by non-franchising manufacturers. Nonetheless, in recent years lobbyists for the car dealers have sought to re-cast the direct sales bans as consumer protection measures. Such arguments have no basis in history, public policy, or economics.

First, such arguments are entirely contrary to the history of the dealer franchise acts. As noted above, the vehicle franchise acts of the mid-twentieth

century, from which contemporary state statutes descend, were concerned with protecting *dealers*, not *consumers.* These were not consumer protection statutes.

Second, it is notable that the arguments in favor of consumer protection are being advanced by dealers who stand to gain financially from the limitation of competition rather than by consumer advocates. The consumer advocates are all on the side of permitting direct sales. For example, the senior leadership of the Federal Trade Commission—the preeminent federal consumer protection organization—has expressed the view that direct sales prohibitions "operate as a special protection for dealers—a protection that is likely harming both competition and consumers."[2] Similarly, the Consumer Federation of America, Consumer Action, and Consumers for Auto Reliability and Safety have argued that direct sales prohibitions are harmful to consumer choice and should be repealed.[3] Not a single consumer organization has joined the dealers self-serving claim that protecting them from interbrand competition will benefit consumers.

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[2] 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 (statement by Directors of Bureaus of Economics and Competition and Office of Policy Planning).

[3]https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjdk6rEhIH7AhXirYkEHTfVAF0QFnoECA4QAQ&url=https%3A%2F%2Fwww.autonews.com%2Fassets%2FPDF%2FCA98362217.PDF&usg=AOvVaw2q-aEMuK_w6Dcepj_A27AP.

Finally, there is simply no plausible economic merit to the argument that prohibiting consumers from choosing to buy directly from a manufacturer is in the consumer's interest. Such arguments have been repeatedly debunked by leading economists, including past senior leaders of the Justice Department's Antitrust Division and Federal Trade Commission.[4] *See also* Daniel A. Crane, *Why Intra-Brand Dealer Competition Is Irrelevant to the Price Effects of Tesla's Vertical Integration*, 165 U. Pa. L. Rev. Online 179 (2017). In sum, there is no viable consumer protection reason for prohibiting direct sales.

B. Prohibiting Non-Franchising Manufacturers from Selling Directly Will Diminish Consumer Choice, Impede Innovation, and Slow the Penetration of EV Technology.

Not only is there no viable justification for prohibiting direct sales by non-franchising manufacturers, but there are important public reasons for doing so, particularly as applied to the new world of electric vehicles. Prohibiting consumers from buying directly from manufacturers limits consumer freedom and choice, impedes innovation, and retards the penetration of EV technology.

To amici's knowledge, every EV start-up that has announced its plans to sell EVs in the United States has announced that it will pursue a direct sales model because selling through franchised dealers would be a significant competitive

[4] https://pluginamerica.org/wp-content/uploads/2021/04/Direct-Sales-Nationwide-Organizations-Open-Letter-4.13.pdf.

disadvantage. This list includes a large and diverse set of companies—not just well-known manufacturers like Tesla, but newer car companies like Rivian and Lucid, medium and heavy duty truck manufacturers like Arrival, and solar-powered car makers like Aptera. These companies have uniformly argued that the franchise dealer model is not suitable for EV sales by start-up companies that do not already have an established dealer network.

The argument that direct sales are critical to the success of EV start-ups runs as follows: The traditional dealer model is based on high-pressure sales tactics to sell existing inventory to customers who already understand the technology, and then to earn the majority of the dealership's profits when the customer returns for service on the car. None of those assumptions work for EV sales. Customers need to be educated about the new technology, and most customers interact with an EV company a number of times before deciding to buy its product. There is no existing inventory sitting on the lot; EVs are typically build-to-order. And the profits dealers can expect from service are significantly lower than with internal combustion cars, since an EV's service needs tend to be much lower. Not surprisingly, secret shopper studies of EV by dealers by the Sierra Club and

Consumer Reports have found that dealers are ill-motivated and ill-prepared to sell EVs.[5]

If the EV start-ups' arguments are correct, then prohibiting direct sales by non-franchising EV start-ups could have serious, negative consequences for innovation and EV market penetration. To be clear, amici take no position on whether these EV start-ups are correct, or have the right distribution strategy. Which distribution strategies work for which companies and which consumers can only be ascertained in a competitive market when companies and consumers can freely experiment and choose. Unless there is some compelling public policy reason to prohibit non-franchising manufacturers from pursuing a direct sales strategy, that strategy should be permitted. As noted throughout this brief, there is no such public policy reason. Neither the original justification for direct sales prohibitions, nor any more recent arguments by car dealers, support a prohibition on direct sales as applied to non-franchising manufacturers.[6]

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[5] https://www.sierraclub.org/press-releases/2022/01/sierra-club-releases-first-ever-nationwide-investigation-electric-vehicle; https://www.consumerreports.org/cro/news/2014/04/dealers-not-always-plugged-in-about-electric-cars-secret-shopper-study-reveals/index.htm.

[6] Amici take no position on whether any of the original justifications for direct sales prohibitions as applied to franchising manufacturers are still viable.

CONCLUSION

Amici respectfully submit that historical and public policy considerations support a reading of Delaware law that would permit a non-franchising manufacturer to sell its own cars directly to consumers.

Dated: December 9, 2022

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