

# Car Dealer Bill Restricts Competition and Limits Consumer Choice

Car companies should be able to sell products directly to consumers

September 21, 2020



By [Dan Crane](#)

In the fall of 2014, the car dealers lobby promoted a bill in the Michigan Legislature that passed and stopped Tesla from selling cars directly to consumers. Simply by eliminating the word “its” from Michigan’s [Motor Vehicle Franchise Act](#), the law suddenly prohibited car companies from opening their own show rooms or service centers in Michigan.

This is a major problem for companies making electric vehicles, such as Tesla. Car dealers make most of their money not from selling cars but from servicing them. Electric vehicles require far less service, making them less profitable for traditional dealers. Tesla, and most other EV companies, therefore, prefer to sell their vehicles directly to consumers and service those vehicles themselves.

In 2016, Tesla brought a constitutional challenge against this law in federal court in Grand Rapids. Earlier this year, the [state settled with Tesla](#). Under the terms of the settlement, Tesla, and other EV companies, are allowed to sell and service cars in Michigan, with a few minor restrictions.

But auto dealers are promoting a new bill, [House Bill 6233](#), that would codify the Tesla settlement, but also severely limit their competitors. In fact, the bill would make Michigan law even



more draconian than it was before the Tesla settlement. It would define “sell” to include “offering test or demonstration drives for a new motor vehicle.” This would mean that car manufacturers could not even let customers test drive their vehicles.

In the past, the car dealers’ lobby has argued that prohibiting direct distribution is necessary to protect consumers, but this argument is frivolous. Not a single consumer organization backs the dealers on this issue. To the contrary, the U.S. Federal Trade Commission – the leading consumer protection agency in the country – has [publicly stated](#) that direct distribution bans are bad for consumers. So have the Consumer Federation of America, Consumer Action, Consumers for Auto Reliability and Safety, and the American Antitrust Institute.

On the merits, the dealers’ consumer protection arguments make little sense. They argue manufacturers will overcharge customers if they can sell directly to them. But their alternative, that adding a layer of costs between manufacturers and consumers reduces prices has no basis in economics. While direct distribution may not be the right model for every car company, prohibiting it is bad for consumer choice and innovation. The optimal mix of distribution strategies should be determined by competition and consumer response in the market – not by the Legislature selecting a one-size-fits-all model.

The right of a car company to sell its products directly to consumers is an issue that resonates with people from a wide variety of ideological perspectives. A coalition of environmental groups is opposing HB 6233 because the bill erects new entry barriers to electric vehicles. Consumer groups oppose these measures because they deny consumers options and potentially raise prices. Free-market proponents like Americans for Prosperity and the Institute for Justice stress how this denies companies and consumers the right to decide for themselves how to buy and sell cars.

The bill is also constitutionally suspect. It carves out a special privilege just for Tesla and denies it to all other manufacturers, even ones similarly situated. If the legal challenge brought by

Tesla had merit – as the federal district court indicated that it might and the state apparently recognized in settling – then this new prohibition should be unconstitutional, too. It restricts EV companies similarly to how the law once did for Tesla. By passing this bill, the Legislature is guaranteeing that Michigan taxpayers will have to fund the defense of another lawsuit challenging a blatantly unconstitutional statute.

Michigan has taken great steps forward to become a leader in mobility innovation. Unfortunately, the dealers are trying to codify car distribution as it stood in 1950. After the Legislature passed its anti-Tesla bill, the Information Technology & Innovation Foundation gave Michigan one of its dreaded “Luddite Awards.” Policymakers should avoid a repeat.

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## **Open Letter by Michigan Academics in Opposition to Michigan H.B. 6233**

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We, the signatories of this letter, are professors employed at public or private universities in the State of Michigan. We specialize in economics, competition policy, market regulation, industrial organization, or other disciplines bearing on the questions presented in this letter.

We write in opposition to Michigan H.B. 6233, which we understand is currently being considered by the legislature. In brief, the bill would bolster Michigan's existing and problematic dealer franchise law provisions that prohibit a car manufacturer from opening showrooms or service centers in the state in order to transact directly with consumers. The dealer franchise law was last amended in 2014 in a move clearly intended to block Tesla from entering the state. That led to a federal lawsuit by Tesla in 2016, which the State settled earlier this year. The settlement effectively allows Tesla to sell cars and operate service centers in Michigan. H.B. 6233 would codify that settlement, but only as to Tesla, and double down on the prohibition on direct sales and service as to all other car manufacturers, including Ford, GM, and Chrysler and even other electric vehicle ("EV") manufacturers like Rivian, Lordstown Motors, and Lucid Motors situated just like Tesla. In fact, the bill would make Michigan law even more draconian than it was before the Tesla settlement, by defining "sell" to include "offering test or demonstration drives for a new motor vehicle." This would mean that car manufacturers could not even establish opportunities (other than at an independent dealership) for customers to test drive their vehicles in the State of Michigan.

This Bill is bad policy, bad for the state of Michigan, bad for Michigan consumers and manufacturers, bad for the environment, bad for innovation, and probably unconstitutional.

A brief review of the history of dealer franchise laws may help explain how we got to where we are today. In the mid-twentieth centuries, car dealers were mostly "mom and pop" sole proprietorships. By contrast, the "Big Three" auto companies were hegemonic firms that faced relatively little domestic or foreign competition. The dealers began to complain to state legislatures that the car companies were taking advantage of them in a variety of ways. This led almost all of the states to pass dealer franchise laws intended to protect the dealers. Among other things, these laws prohibited a manufacturer from opening its own showrooms or service centers and transacting directly with customers. The dealers successfully argued that if the manufacturers were allowed to distribute directly to consumers, they could unfairly undermine their own franchised dealers.

Fast-forward to 2020. The situation is very different. First, the dealership system has grown from its "mom and pop" roots to one where enormous companies operate large dealer networks. The top 10 dealership groups alone earn over \$80 billion in annual revenue, much more than most car

companies.<sup>1</sup> Second, the car manufacturer market has become far more competitive. Today, there are at least 15-20 major manufacturer groups selling cars in the U.S. This gives dealers more choices, and hence more leverage in contractual negotiations with manufacturers. Third, and perhaps most importantly, technological and market changes have led new entrants into the market—particularly companies selling EVs—to choose to distribute directly to consumers and not to use franchised dealers at all. As the Massachusetts Supreme Court has recognized, the original concerns that animated the direct distribution prohibitions—protecting a franchisee from its own franchisor—do not apply to a company that is not using franchisees.<sup>2</sup>

The dealers understand that they can no longer stand on the original justification of the dealer protection laws. Instead, they have tried to recast these prohibitions as *consumer* protection measures. These arguments are frivolous and have repeatedly been rebutted.

First, observe that, if direct distribution really threatened consumer interests, one would expect to see consumer protection organizations advocating against it. But just the opposite has happened. The staff of the U.S. Federal Trade Commission—the leading consumer protection agency in the country—has publicly stated that direct distribution bans are *bad for consumers*.<sup>3</sup> So have the Consumer Federation of America, Consumer Action, Consumers for Auto Reliability and Safety, and the American Antitrust Institute.<sup>4</sup> Compared to these non-profit organizations looking out for consumer interests, the car dealers' lobby is a very poor proxy for consumer interests.

On the merits, the dealers' consumer protection arguments make little sense. The dealers have argued that manufacturers will overcharge customers if they can sell directly to them.<sup>5</sup> The argument that adding a mandatory layer of costs between the manufacturer and the consumer will reduce consumer prices has no basis in economics. Nor do arguments that dealers are necessary to advocate for consumer interests in obtaining recalls or warranty service make any sense.

While direct distribution may not be the right model for every car company, prohibiting direct distribution by all car manufacturers is bad for consumer choice and innovation. The optimal mix of distribution strategies should be determined by competition and consumer response in the market—not by the legislature selecting a one-size-fits-all model. Further, EV companies have stated that channeling their products through franchised dealers is not a viable business model for them. This means that mandating that EV manufacturers sell only through dealers raises entry barriers for EV manufacturers and will slow the spread of EVs in the market. That, in turn, is bad environmental policy.

Finally, we address a particularly pernicious feature of H.B. 6233—that it makes the Tesla settlement a one-firm carve out and prohibits similarly situated companies from enjoying the same privileges that Tesla has secured through litigation. This is constitutionally suspect. If the constitutional challenge brought by Tesla had merit—as the federal district court indicated that it

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<sup>1</sup> Daniel A. Crane, *Tesla, Dealer Franchise Laws, and the Politics of Crony Capitalism*, 101 Iowa L. Rev. 57, 601 (2016).

<sup>2</sup> *Massachusetts State Auto Dealers Ass'n, Inc. v. Tesla Motors MA, Inc.*, 15 N.E. 3d 1152, 1157 (Mass. 2014).

<sup>3</sup> [https://www.ftc.gov/system/files/documents/advocacy\\_documents/ftc-staff-comment-regarding-michigan-senate-bill-268-which-would-create-limited-exception-current/150511michiganautocycle.pdf](https://www.ftc.gov/system/files/documents/advocacy_documents/ftc-staff-comment-regarding-michigan-senate-bill-268-which-would-create-limited-exception-current/150511michiganautocycle.pdf).

<sup>4</sup> <https://www.autonews.com/assets/PDF/CA98362217.PDF>.

<sup>5</sup> Crane, *supra* n. 1 at 594 n. 111 (collecting quotes from dealers).

might and the State apparently recognized in settling—then the prohibition is unconstitutional as to other companies as well. Further, by explicitly recognizing a right for Tesla but not for other EV companies, the bill would unconstitutionally discriminate between similarly situated manufacturers.

As residents of Michigan proud to see our state taking the lead on mobility innovation, we are disappointed to see another dealer-backed effort to codify car distribution as it stood in 1950. In 2015, after the legislature passed its anti-Tesla bill, the Information Technology & Innovation Foundation gave Michigan one of its dreaded “Luddite Awards.” Let’s do better this time. We call on the legislature not to pass H.B. 6233, or for Governor Whitmer to veto it in the unfortunate event that it reaches her desk.

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# Tesla's Settlement with the State of Michigan

by Daniel Crane   January 21, 2020

Tesla and the State of Michigan have settled Tesla's constitutional challenge to Michigan's refusal to grant Tesla's request for a Class A license, which would have allowed Tesla to open a company-owned dealership in the state. The lawsuit, which was filed in federal court in the Western District of Michigan in 2016 and was scheduled to go to trial this year, grew out of a 2014 legislative amendment to Michigan's automobile dealer law that made it unlawful for an automobile manufacturer to open its own retail store in the state, essentially forcing automobile manufacturers to distribute cars through franchised dealers. I detailed the nefarious circumstances and effects of the 2014 legislation in [\*Tesla, Dealer Franchise Laws, and the Politics of Crony Capitalism\*, 101 Iowa L. Rev. 573 \(2016\)](#).

There are two important terms to the settlement: (1) the state will not contest Tesla's right to operate service centers in Michigan through a subsidiary; and (2) the state will not contest Tesla's right to market cars to consumers in Michigan through a "gallery" model. This settlement allows Tesla to sell and service cars in Michigan as it wants, and thus represents a total victory for Tesla in Michigan. It could also be a tipping point in Tesla's ongoing battle for the right to engage in direct distribution in other states.

In my view, the service component is the more important aspect of the settlement. Tesla was already able to sell cars to customers in Michigan by marketing them over the Internet and delivering them out of state, so the agreement on the gallery marketing model is helpful but not essential. On the other hand, until today Tesla was prohibited from opening a service center in Michigan, which required Michigan Tesla owners to drive to Ohio for service. It will now be able to open service centers in Michigan through a subsidiary. (The subsidiary requirement will not impose any greater burden than a few hours of corporate lawyer time). Having access to service centers in Michigan will significantly increase the appeal of owning a Tesla in the Wolverine State.



then have to complete the dealer sales transaction over the internet or telephone with Tesla in California (or wherever Tesla houses its sales function). The car will then be delivered to the customer in Michigan, which will increase the convenience of the buyer experience. The only remaining limit is that the sales contract needs to say that title will transfer out of state; otherwise, the customer can configure and order the car from within the state.

There is no good reason to deny Tesla the right to open whatever sort of sales operation it wants in Michigan, but this remaining limitation will have relatively little effect on Tesla's business model. Even in states where Tesla has complete freedom to sell cars as it wants, it doesn't generally open traditional dealerships with lots of inventory sitting on a lot. The company operates on a custom order basis and usually uses the sort of galleries it will now be able to open in Michigan. So, while still arbitrary and annoying, the Michigan settlement gives Tesla everything it needs to compete in Michigan.

Tesla is clearly a big winner in this settlement. Who are the other winners? And who are the losers?

Other new electric vehicle manufacturers, like Ford and Amazon-backed Rivian Motors (which will begin selling cars in 2020) and Faraday Future (which hopefully will be able to get to market eventually) will benefit from the trail Tesla has blazed. Having settled on these terms with Tesla, it would seem legally very difficult for the state to deny a similar arrangement to any other company situated like Tesla.

The car dealer's lobby, which has fought tooth-and-nail to stop Tesla from distributing directly on a state-by-state basis, is clearly a big loser. Michigan, the state with the most pro-dealer law on direct distribution, has now opened the doors for new EV companies to bypass the traditional dealer model entirely.

In the short run, traditional car companies like General Motors and Ford are also losers. GM, in particular, has backed the dealers politically in opposing the right to engage in direct distribution, apparently because forcing Tesla to distribute through the dated and increasingly inefficient dealer model will slow Tesla's market penetration. Not only does the Michigan settlement allow Tesla to avoid the cumbersome dealer model and to start gaining significant



Just as there is no good basis in public policy to limit Tesla's right to engage in direct distribution, there is also no reasonable basis to prohibit it to traditional car manufacturers either. As I have previously detailed at length, there is simply no consumer protection reason that any car company shouldn't be able to choose how it sells cars to consumers. As companies like Tesla and Rivian accustom car buyers to the benefits of dealing directly with the manufacturer, there will be increasing competitive pressure on GM, Ford, Chrysler, and foreign auto makers to seek legislative changes in hold-out states like Michigan that still prohibit direct distribution.

Finally, although the immediate consequences of the settlement will be felt only in Michigan, the settlement will put increasing pressure on other hold-out states that still block Tesla from selling to consumers. The more states that allow direct distribution and the more customers that experience it, the less credible the dealers' lobby will be in arguing that direct distribution harms consumers. With new entry by other companies like Rivian on a direct distribution model, the political and legal battles over car distribution are at a tipping point. Although there will still be a place for franchised dealers to play a role in car distribution for some time, the inflexible and mandatory system created by the dealer laws of the mid-twentieth century is on its last legs.

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