



Written by [Bob Adelman](#) on March 24, 2014

Tesla Sales Model Upsetting Traditional Auto Dealers

In Washington State, Elon Musk, the founder and CEO of Tesla Motors, [has created a way](#) to sell his cars without having to go through a car dealer by persuading the state legislature to carve out an exception to the law just for his company. Along the way, he has made it harder for any new car company to follow his lead in selling “factory direct” to consumers. That’s a deal existing car dealers in Washington can live with.



Musk has been characterized as the Steve Jobs of the car business, even though he cut his teeth and made his fortune (estimated to be around \$12 billion) through three other companies he founded or co-founded: Zip2, PayPal, and SpaceX. But he has been putting his heart and soul — and his money — into Tesla ever since founding it 10 years ago, building a company which he says is aimed at offering electric cars at prices affordable to average consumers.

His Tesla Roadster’s base price was \$109,000 while his Model S (shown) is a little cheaper, coming in at about \$57,000. His company sells fewer than 25,000 units worldwide, but hopes — indeed, plans — to bring down the cost of production over time so that it can become everyman’s EV. He’s following the Silicon Valley “model,” where initial offerings of such items as cellphones and laptops are highly priced but see great reductions in price when sold in volume, eventually making them affordable to anyone. His next offering, for example, is an SUV codenamed BlueStar which is expected to sell for around \$30,000.

One way to keep costs down is reflected in Musk’s business model: selling directly to consumers with no intermediate dealers paying their salesmen commissions and hoping to make additional profits through their service department. With Musk’s determination has come the realization that the traditional car dealer sales model is being threatened. Using Nicola Tesla’s invention of the alternate-current (AC) motor, Musk has built a car that doesn’t need servicing: no spark plugs, no oil changes, no “regularly scheduled maintenance.” Selling them through galleries in shopping malls which provide information but no sales people keeps marketing costs to a minimum.

But victory in Washington is a rare one for Musk, who has had much greater difficulties with car dealers in Texas and New Jersey accepting competition that ultimately could threaten their very existence. As Tammy Darvish, a vice president of the Darcars Automotive Group in Silver Spring, Maryland, said, “Our issue is not with Tesla itself. It’s with [their sales] model. How can we as auto dealers compete with manufacturers in the same market when we are completely dependent upon them for our inventories?”

That word “dependent” spells out the challenges car dealers will face if the Tesla model — selling directly to customers — gains traction. For decades car dealers have operated under “Colgate pricing” — otherwise known as “unilateral policy” pricing — whereby the manufacturers not only provide cars and trucks but also financing for the dealers. Manufacturers also state that the prices dealers charge may not fall below a certain level or they will terminate the relationship with the dealer.



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In 1919 the Supreme Court ruled in *United States v. Colgate and Co.* that a manufacturer was free to deal with whomever it wished, or not. This allowed car makers to announce the terms under which their dealers would be free to operate. The Supreme Court amplified that ruling in *Monsanto v. Spray-Rite Service Corp.* in 1984 whereby car makers can announce re-sale price minimums in advance and then refuse to deal with any dealers who fail to honor those minimums. Since there is no contract and the parties do not officially agree on the price, there is no collusion and therefore no violation of the Sherman Anti-Trust Act.

All of this has allowed more than 17,000 car dealers to generate profits to support local charities — and politicians. In the 2011-2012 election cycle, according to the National Institute on Money in State Politics, auto dealers and their employees donated more than \$15 million to state and local candidates. In that same cycle, Tesla donated \$500.

Just last week New Jersey announced that the state's motor vehicle commission — not the state legislature — would not allow Tesla to sell cars directly to consumers. Musk stated,

[New Jersey now] imposes stringent licensing rules that would, among other things, require all new motor vehicles to be sold through middlemen and block Tesla's direct sales model. Tesla will no longer [be able to] sell electric cars in New Jersey, effective April 1.... It has done so without any reasonable notice or even a public hearing.

In a press release issued last Friday, Musk wrote an open letter "to the people of New Jersey", explaining [what just happened](#):

On Tuesday, under pressure from the New Jersey auto dealer lobby to protect its monopoly, the New Jersey Motor Vehicle Commission, composed of political appointees of the Governor, ended your right to purchase vehicles at a manufacturer store within the state.

Governor Christie had promised that this would be put to a vote of the elected state legislature, which is the appropriate way to change the law. When it became apparent to the auto dealer lobby that this approach would not succeed, they cut a backroom deal with the Governor to circumvent the legislative process and pass a regulation that is fundamentally contrary to the intent of the law.

Using existing car dealers to market its products would be fatal to Tesla, said Musk, as there is little incentive to do so:

They make most of their profit from service, but electric cars require much less service than gasoline cars. There are no oil, spark plug or fuel filter changes, no tune-ups and no smog checks needed for an electric car.

Also, all Tesla Model S vehicles are capable of over-the-air updates to upgrade the software, just like your phone or computer, so no visit to the service center is required for that either.

Musk took pains to obliterate the claim by car dealers that such a law protects consumers by always providing for them a place to go to get service in the event of a breakdown. According to Musk, his cars don't break down:

Consumer Reports conducts an annual survey of 1.1 million subscribers, which factors in quality, reliability and consumer satisfaction. The Tesla Model S was the top overall pick of any vehicle in the world, scoring 99 out of 100. This is the highest score any car has ever received.

By comparison, in the industry report card, Ford, which sells their cars through franchise dealers, received a score of 50. BMW, which makes competing premium sedans, received a score of 66.



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In Texas, Musk has run into the same collective resistance, the state requiring all new cars to be sold through car dealers and not by dealing directly with the manufacturer. This has all but shut down Tesla sales in Texas. A Tesla buyer, for example, may purchase his new car online at the company's website, but it must be treated as an out-of-state transaction. When his new car is brought into the state, the new owner then registers the car in his name and pays the sales tax.

Consumers are clearly leaning Tesla's way. In poll after poll, car buyers voted in favor of letting Tesla sell its cars direct if they so desire. Said Musk,

Consumers across the country have also voiced their opinion on the sales model they prefer. In North Carolina, a Triangle Business Journal poll found that 97 percent of people polled said Tesla should be allowed to sell cars directly. A poll by the Austin Business Journal showed that 86 percent of respondents were in favor of direct sales, and in a *Los Angeles Times* poll 99 percent of respondents came to the same conclusion.

These aren't polls that we commissioned and there are many more like them. We have not seen a single poll that didn't result in an overwhelming majority saying they preferred the direct model to the traditional dealer model.

In his analysis of the battle between Tesla's Musk and traditional car dealers who are unwilling to let Tesla threaten their present profitable business model, economist Jeffrey Dorfman, writing in *Forbes* magazine, said,

Auto dealers are not looking to help consumers; rather, they simply want to capture more profits for themselves. The proof is the money the auto dealers are spending to secure their victories in state legislatures.

The only reason to spend money to secure legislation is because that legislation will capture profits that will more than replace the money spent. If consumers end up winning as part of that process, car dealers certainly will not mind, but that is not their aim.

We economists call such behavior "rent seeking."

Tesla's Musk is focusing his attention right where it should be focused: on the well-being of his customers. If his behavior is threatening to the status quo, then those defending the status quo ought to be looking at changing their behavior rather than running to government for protection.

A graduate of Cornell University and a former investment advisor, Bob is a regular contributor to The New American magazine and blogs frequently at www.LightFromTheRight.com, primarily on economics and politics. He can be reached at badelman@thenewamerican.com.



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