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No. 15-

IN THE

Supreme Court of the United States

ALLIANCE OF AUTOMOBILE MANUFACTURERS, INC.

Petitioner,

v.

MELODY A. CURREY, IN HER OFFICIAL CAPACITY AS THE COMMISSIONER OF THE DEPARTMENT OF MOTOR VEHICLES OF THE STATE OF CONNECTICUT,

Respondent,

CONNECTICUT AUTOMOTIVE RETAILERS ASSOCIATION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether there is a cognizable burden on interstate commerce under a dormant Commerce Clause analysis where a state requires motor vehicle manufacturers and distributors (all out-of-state) to pay significantly increased amounts to in-state dealers for warranty repairs, but prohibits the manufacturers and distributors from recovering those increased costs within the state, thereby ensuring that the costs of the state's regulations imposed on interstate commerce are borne entirely out-of-state.

2. Whether a state statute that imposes significantly increased costs for warranty reimbursements on manufacturers and distributors, but, for the first time in the state's legislative history, interferes with the manufacturers' and distributors' longstanding contractual rights to price their products sold in the state by prohibiting recovery of those costs in the state, is subject to challenge under the Contract Clause of the U.S. Constitution.

PARTIES TO THE PROCEEDING

The Petitioner here and below is the Alliance of Automobile Manufacturers, Inc. ("Petitioner" or the "Alliance").

The Respondents here and below are Melody A. Currey, in her official capacity as the Commissioner of the Department of Motor Vehicles of the State of Connecticut (the "Commissioner"), and the Connecticut Automotive Retailers Association ("CARA").

CORPORATE DISCLOSURE STATEMENT

The Alliance, a non-governmental entity, is an Internal Revenue Code section 501(c)(6) not-for-profit trade association of car and light truck manufacturers, whose members consist of: BMW Group, FCA US LLC, Ford Motor Company, General Motors LLC, Jaguar Land Rover, Mazda Motor of America, Inc., Mercedes-Benz USA, LLC, Mitsubishi Motors North America, Inc., Porsche Cars North America, Inc., Toyota Motor Sales, Inc., Volkswagen Group of America, Inc., and Volvo Car Corporation. The Alliance does not have any outstanding shares or debt securities in the hands of the public, nor does it have a parent company. No publicly held company has a 10% or greater ownership interest in the Alliance.

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The summary order of the court of appeals is unpublished. Petitioner's Appendix ("Pet. App.") 1a-11a. The order of the court of appeals denying Petitioner's motion for rehearing *en banc* is unpublished. Pet. App. 81a-82a. The decision of the district court (Pet. App. 27a-80a) granting Respondents' motion to dismiss is reported at 984 F. Supp. 2d 32 (D. Conn. 2013), and the decision of the district court (Pet. App. 12a-26a) denying Petitioner's motion to reopen is unpublished.

JURISDICTION

The judgment of the court of appeals was entered on July 16, 2015. A petition for rehearing *en banc* was denied on July 9, 2015. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS OF LAW

The following constitutional and statutory provisions are relevant to this petition:

> U.S. Const. art. I, § 8, cl. 3 states, in pertinent part:
>
> The Congress shall have Power . . . To regulate Commerce . . . among the several States . . . .
>
> U.S. Const. art. I, § 10, cl. 1 states, in pertinent part:
>
> No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .
>
> The relevant provisions of Conn. Gen. Stat. §§ 42-133s, 42-133cc, 42-133ee, and 14-67 are set forth at Pet. App. 83a-90a.

STATEMENT OF THE CASE

New motor vehicle dealers wield largely unrestrained political power in nearly every state. They have used that power to expand protectionist legislation to unprecedented levels. States like Connecticut have granted in-state dealers essentially unfettered discretion to set above-market rates manufacturers must pay for warranty repairs, which only dealers can perform due to a state-mandated monopoly granted to them. In the more recent iterations of these dealer protection laws, states are enacting measures that prohibit manufacturers from raising prices within the state to recover the significant costs imposed by such state laws. In essence, these states have recognized that their dealer protection laws impose significant costs on interstate commerce and have required that those costs must be borne only out-of-state.

In 2009, at the behest of CARA, the Connecticut General Assembly enacted amendments (the "2009 Amendments") to the Connecticut Franchise Act (the "CFA") that represent the very type of failure in the political process that the Commerce and Contract Clauses of the U.S. Constitution are designed to prevent. The 2009 Amendments effectuate a naked transfer of wealth from out-of-state manufacturers solely for the financial benefit of in-state dealers, by substantially increasing warranty reimbursements that manufacturers must pay to the dealers. The 2009 Amendments expressly shift the costs of the statute to out-of-state manufacturers, dealers, and consumers by prohibiting recovery of these costs in Connecticut, ensuring that no in-state actor bears them. This legislation overstepped constitutional bounds.

The court of appeals held that the 2009 Amendments do not warrant weighing under the dormant Commerce Clause because they "do not 'impose a burden on interstate commerce that is qualitatively or quantitatively different from that imposed on intrastate commerce.'" This holding conflicts with decisions of this Court and other courts of appeals, and profoundly distorts the democratic process—shifting the costs of regulation away from the voters—and the constitutional analysis required by this Court's decision in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970).

A. Factual Background

The Alliance is a non-profit trade association composed of twelve major motor vehicle manufacturers ("Members"). In March 2013, the Alliance brought a declaratory judgment action against the Commissioner, challenging the constitutionality of the 2009 Amendments to the CFA.

Two statutory provisions of the 2009 Amendments are at issue: the Warranty Price Hike Provisions (codified in Conn. Gen. Stat. § 42-133s(a) through Conn. Gen. Stat. § 42-133s(f)) and the Cost Recovery Ban (codified in Conn. Gen. Stat. § 42-133s(g)). The Warranty Price Hike Provisions were enacted to increase warranty reimbursements on the parts a dealer uses in warranty repairs to levels above the significant profit margins already being paid per existing contracts (40% or more above dealer cost), and to increase the amounts paid for the labor performed to undertake warranty repairs. All manufacturers paying these increased amounts are out-of-state. The Cost Recovery Ban, recognizing that manufacturer costs would increase, prohibits

manufacturers (regardless of where located) from recovering these higher costs in Connecticut. Never before had Connecticut prohibited manufacturers from exercising preexisting contract rights to adjust their prices of goods sold into Connecticut. The costs imposed by the Warranty Price Hike Provisions for the benefit of Connecticut dealers are thus shifted out-of-state. This framework, by precluding the costs of the regulation from being recovered from anyone in-state, interferes with a basic democratic principle: the benefits of state regulation must be weighed against its costs. Rather, the in-state dealers have orchestrated a naked transfer of wealth to themselves, but have insulated this transfer from political evaluation by shifting its costs out-of-state.

1. Warranty Reimbursement and the Parties' Contractual Relationship

Members (and other motor vehicle manufacturers and distributors) sell new motor vehicles and replacement parts in the United States to independent authorized dealers. Dealers in turn sell or lease vehicles to retail customers and perform repairs and service. JA17 (¶ 13).[1] Connecticut law grants dealers a monopoly—dealers are the Members' sole means of selling new motor vehicles and providing warranty service on those vehicles in Connecticut. JA17-18 (¶ 15). Under Connecticut law, Members may not sell vehicles to consumers directly and are expressly prohibited from directly or indirectly performing warranty or other service. *Id.*

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[1] "JA" cites are to the Joint Appendix filed in the court of appeals.

(citing Conn. Gen. Stat. §§ 42-133cc(8) & (16)). Dealers thus have a legislatively-created monopoly on both the retail sale and the warranty servicing of Members' vehicles. *Id.*

In connection with the retail sale of their motor vehicles, Members provide consumers with a limited, written warranty of various parts, systems and accessories. JA18 (¶ 20). Members also at times voluntarily pay for recall, goodwill and "special policy" repairs beyond the expiration of the written warranty. *Id.* Certain Members provide customers with a manufacturer-paid maintenance plan in connection with their purchase of a new motor vehicle. *Id.*

Member warranties on their vehicles provide dealers with many benefits during the warranty period and beyond. Dealers market vehicles to consumers with the assurance that defects arising while the vehicle is under warranty coverage will be repaired or corrected at no charge to the consumer, providing dealers with a dedicated group of service customers for whom they need not compete with independent and often lower-cost repair shops. Warranty service also provides a stable stream of revenue to the dealership, and an opportunity to attract customer-pay work, either in conjunction with warranty repairs or after such coverage ends. JA19 (¶ 24). Members have historically provided dealers with reimbursement amounts that not only fully cover a dealer's costs of performing warranty repairs, but that allow the dealer to make significant profits. JA20 (¶ 26).

The contractual relationships between each Member and its authorized dealers are contained in written dealer sales and service agreements ("Dealer

Agreements"). JA18 (¶ 16). Pursuant to the Dealer Agreements, dealers agree to perform warranty and certain other "Covered Repairs." JA18 (¶ 21). Per those Dealer Agreements, Members agree to reimburse their dealers based on a methodology that, for parts, uses a mark-up over the dealer cost of the parts or a preexisting parts price (such as the manufacturer's suggested retail price, or "MSRP"). For a dealer's warranty labor, the contracts provide for reimbursement on an agreed hourly rate, multiplied by a labor time guide that provides the labor hours allotted for a specific repair or service. JA19 (¶ 22).

2. The 2009 Amendments

Despite enjoying legislative insulation from competition on multiple fronts, and despite a history of earning significant profits on the warranty reimbursements they contractually received from the manufacturers (who paid dealers a 40% or more mark-up on parts used in warranty repairs (JA20 (¶ 26); JA109-110 (¶ 34))), dealers in Connecticut wanted more. The only occasion that manufacturers pay money to dealers is for warranty reimbursements, so those reimbursements became the target for a legislative scheme to transfer money from manufacturers to dealers. In 2009, for the first time in the history of Connecticut's motor vehicle laws, the Connecticut General Assembly removed warranty parts reimbursement from the realm of agreement between manufacturers and dealers by adopting the Parts Price Hike Provision, Conn. Gen. Stat. § 42-133s(b). The General Assembly also adopted the Labor Price Hike Provision, Conn. Gen. Stat. § 42-133s(c). *See* JA15 (¶ 3). These provisions serve no legitimate public purpose. They help

neither consumers nor competition, but simply benefit a local, politically powerful special interest group at the expense of out-of-state interests. JA15, JA16 (¶¶ 4, 8). On top of these provisions, the General Assembly added the Cost Recovery Ban (codified in Conn. Gen. Stat. § 42-133s(g)), precluding the costs imposed by the Warranty Price Hike Provisions from being recovered in Connecticut.

Prior to 2009, Connecticut had never regulated the prices that manufacturers charged dealers for vehicles or parts. Nor had Connecticut ever regulated what costs motor vehicle manufacturers could recover from in-state buyers. Pricing of vehicles and parts, most basic to the supplier-dealer economic relationship, was always left to the free market and the parties' contractual relationships. The 2009 Amendments increased warranty reimbursements and simultaneously interfered with pricing, even though vehicles are priced at wholesale when sold to a dealer, but consumer warranties on those vehicles last for years after the retail sale.

Further, prior to 2009, Connecticut had only regulated reimbursements on the labor a dealer provided, and never on the warranty parts, which originated with the manufacturers. The prior legislation only required that "reasonable compensation" be paid for the dealer's labor. The amount could not be less than the hourly labor rate charged by dealers to nonwarranty customers, "provided that the rate charged to nonwarranty customers is reasonable." JA108-09 (¶ 31) (citing Public Act 82-445 (An Act Concerning Automobile Dealerships), § 2(b)). Connecticut thus protected dealers from labor reimbursement below costs, and protected manufacturers from paying dealers unreasonable

profit margins on labor services. *Id.* Beyond the "reasonable compensation" requirement for a dealer's labor, the Connecticut General Assembly left manufacturers and dealers free to contract for the amount of labor reimbursement, and did not regulate at all the amount at which manufacturers must reimburse their dealers for the manufacturer-supplied parts installed in a warranty repair. JA109 (¶ 32).

The Parts Price Hike Provision marked the first time that Connecticut sought to regulate reimbursement for parts used in warranty repairs. Furthermore, the 2009 statutory scheme not only takes the issue out of the realm of contract, but also out of the realm of "reasonableness." It allows Connecticut dealers to unilaterally set the price that manufacturers must pay. JA109-110 (¶¶ 34-35). These legislatively-increased prices are not only higher than the preexisting contract rates specified under the Dealer Agreements, but are even higher than a dealer's "retail" mark-up on parts or "retail" labor rate. Under the Parts Price Hike Provision, "[t]he retail rate customarily charged by the dealer for parts shall be established by the dealer" through the statutorily-mandated methodology, on the basis of which the dealer "declar[es] the average percentage mark-up." JA20 (¶ 27) (Conn. Gen. Stat. § 42-133s(b)). By statute, calculation of the mark-up for parts and labor excludes, among other things, "special events, specials or promotional discounts for retail customer repairs." Conn. Gen. Stat. § 42-133s(d). Thus, parts and labor reimbursements on warranty repairs end up exceeding retail prices. Even if manufacturers supply their own parts directly to a consumer for Covered Repairs (in lieu of the

dealer providing the parts from its inventory), the manufacturer must pay the dealer the state-mandated mark-up. JA21 (¶ 28) (Conn. Gen. Stat. § 42-133s(e)).

The statutory scheme precludes any realistic challenge to the dealer's disclosed rates, making the dealer's unilateral declaration of its rates the final word on the issue. The mark-up declared by the dealer is presumed "fair and reasonable." It goes into effect 30 days after declaration of the rate by the dealer, even if a manufacturer has timely objected to the rate and has proposed an alternative. JA20 (¶ 27) (Conn. Gen. Stat. §§ 42-133s(b) & (c)). At that point, failure to pay the declared rate subjects the manufacturer to the risk of damages, attorneys' fees, and possible loss of its license. Conn. Gen. Stat. §§ 42-133ee & 14-67(c). Although the statute purports to permit a manufacturer to rebut the "fair and reasonable" presumption, the presumption is in fact irrebuttable, because the statute affords no realistic remedy to manufacturers. The only forum in which to challenge a dealer's declared rate is a proceeding before the Commissioner (*see* Conn. Gen. Stat. §§ 42-133s(b) & (c)). However, only dealers are permitted to initiate such a proceeding. *Id.* Dealers, of course, have no reason to initiate any such proceeding, because by law the manufacturers must pay the dealer's declared rate or risk significant penalties. The purported remedy and challenge to a dealer's declared rate is thus illusory.

Because the dealer may exclude from its calculation, among other things, "specials or promotional discounts for retail customer repairs," Conn. Gen. Stat. § 42-133s(d), the state-mandated methodology allows the dealer to declare a rate that

exceeds the average prices paid by non-warranty customers for parts and labor. As a result, the 2009 Amendments require that reimbursements for Covered Repairs be set at or above the highest possible levels that a personal-use, retail consumer might be charged, even though the state already insulated the dealers from competition for warranty work and the parties' preexisting contract rates already afforded dealers a healthy profit on that work. JA20, JA21 (¶¶ 26, 30). In other words, the 2009 Amendments require that manufacturers must pay more for parts and service than non-warranty customers even though warranty service and parts sales represents a steady stream of business requiring no sales or marketing on the part of dealers.

Recognizing that the Warranty Price Hike Provisions will raise manufacturers' costs, the Cost Recovery Ban then prohibits manufacturers from recovering those higher costs in Connecticut. This contravenes existing contractual provisions. Members reserve their rights in the Dealer Agreements to set wholesale prices for motor vehicles and related products. JA22 (¶ 34). Members facing increased costs of doing business in a particular state may decide to increase their wholesale prices or otherwise recover their higher costs in that particular state, and have done so in other states. *Id.* The Cost Recovery Ban, however, seeks to trump this preexisting right:

> A manufacturer or distributor may not otherwise recover its costs from dealers within this state, including an increase in the wholesale price of a vehicle or surcharge imposed on a dealer solely in-

> tended to recover the cost of reimbursing a dealer for parts and labor pursuant to this section, provided a manufacturer or distributor shall not be prohibited from increasing prices for vehicles or parts in the normal course of business.

JA22 (¶ 35). The 2009 Amendments, therefore, not only mandate higher reimbursement levels, but interfere with wholesale pricing decisions by precluding recovery of those increased costs in Connecticut. The Connecticut General Assembly has sought nothing more than to increase the profits of Connecticut's motor vehicle dealers, to shift the resulting costs out-of-state, and thereby override both existing contracts and democratic constraints on state legislation.

B. The District Court Proceedings

In 2013, the Alliance filed suit in the District Court for the District of Connecticut, challenging the constitutionality of the 2009 Amendments. The district court had jurisdiction pursuant to 28 U.S.C. § 1331 and 28 U.S.C. § 1367. The Alliance sought, among other relief, a declaratory judgment that the Warranty Price Hike Provisions and the Cost Recovery Ban are unconstitutional under the Commerce, Due Process, and Contract Clauses of the U.S. Constitution.[2] The Alliance framed the Commerce Clause claim under *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), alleging that burdens on interstate commerce vastly outweighed any arguable

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[2] The dismissal of the Alliance's Due Process claim is not at issue here.

public purpose or putative local benefit. The Commissioner moved to dismiss all claims. CARA intervened as a defendant and joined the motion.

On November 26, 2013, the district court granted the motion to dismiss. In dismissing the Alliance's dormant Commerce Clause claim brought under *Pike*, the court ignored clear precedent, holding that there must be "actual or prospective competition between the supposedly favored and disfavored entities." Pet. App. 71a (internal citation and quotation omitted). The court dismissed the *Pike* claim because manufacturers and dealers "are not competitors in the same market." *Id.* It dismissed the Alliance's claim for discrimination under the dormant Commerce Clause for the same reason, ignoring that it was state law granting dealers the monopoly on warranty repairs and precluding manufacturers from performing warranty work that precluded such competition. The district court also rejected the Alliance's Commerce Clause challenge based on the regulation of extraterritorial transactions (the sales of vehicles and parts whose pricing is controlled occur outside the state).

In dismissing the Contract Clause claim, the district court held that the amendments "are scarcely beyond the foreseeable scope of preceding regulation," because "[w]arranty reimbursement rates have long been governed by provisions of the CFA similar in kind to the [Warranty Price Hike Provisions]," the court observed. *Id.* 64a, 66a. In the court's view, the prior regime "covers the same topic and shares the same overt legislative intent to protect dealers." *Id.* 66a. Its foreseeability analysis failed to account for the entirely new Cost Recovery Ban and its interference with pricing of parts and vehicles—issues of

longstanding contracts never before regulated by Connecticut. The district court relied almost exclusively on the extent to which the motor vehicle industry has been regulated in the past in assessing the Contract Clause claim.

Upon dismissal, the district court expressly afforded the Alliance an opportunity to move the court to reopen the case with a proposed amended complaint. The Alliance did so, expanding its allegations to address the district court's decision. The court then denied the motion on grounds that the proposed amendment would be futile, principally for the same reasons articulated in its earlier dismissal.

C. Proceedings on Appeal

On appeal, the Alliance argued that the district court erred in several respects. Among other errors, the district court wrongly concluded that a dormant Commerce Clause claim of undue burden under *Pike* requires direct competition between a plaintiff and defendant. The Alliance also argued that, in dismissing the Contract Clause claim, the district court misapplied the principle of foreseeability, misconstrued the history of the CFA, and improperly discounted significant differences alleged between the 2009 Amendments and the prior regulatory regime, particularly the 2009 adoption of the Cost Recovery Ban.

The court of appeals affirmed dismissal. Pet. App. 4a. In upholding the dismissal of the Alliance's *Pike* claim, the court of appeals reasoned in a single sentence that the 2009 Amendments "do not 'impose a burden on interstate commerce that is qualitatively or quantitatively different from that imposed on intrastate commerce.'" Pet. App. 7a

(quoting *Nat'l Elec. Mfrs. Ass'n v. Sorrell*, 272 F.3d 104, 109 (2d Cir. 2001). It offered no other explanation for affirming the *Pike* dismissal, and left undisturbed the district court's erroneous conclusion that undue burden claims fail in the absence of direct competition. *Id.*; *see id.* at 71a.

Because the court of appeals concluded as a threshold matter that the 2009 Amendments impose no cognizable burden on interstate commerce, it failed to look at the out-of-state cost-shifting effectuated by the 2009 Amendments or otherwise weigh permissible benefits of the regulatory scheme against its burden on interstate commerce.

The court of appeals affirmed dismissal of the Contract Clause claim. Because the relationship between motor vehicle manufacturers and Connecticut dealers "has long been the subject of close state regulation, including of warranty reimbursement rates," the court held that there was no substantial impairment of contracts. Pet. App. 8a-9a. The court gave the blanket Cost Recovery Ban little consideration. It held only that by closing a "loophole" in the Warranty Price Hike Provisions, the Cost Recovery Ban was "eminently foreseeable." *Id.* at 8a. The Cost Recovery Ban is far broader than prohibiting a manufacturer from surcharging a dealer for that dealer's higher warranty reimbursements, and actually prohibits all cost recovery in the state (*e.g.*, a per-vehicle surcharge on all vehicles), departed drastically from prior law by regulating the wholesale prices of motor vehicles, and by barring the in-state recovery of specific costs for the first time in the history of the CFA.

The court of appeals denied the Alliance's request for rehearing *en banc*. Pet. App. 82a.

REASONS FOR GRANTING THE PETITION

I. The Court of Appeals Mistakenly Applied a Facial Discrimination Standard to a Dormant Commerce Clause Challenge Brought Under *Pike v. Bruce Church.*

The Cost Recovery Ban is not simply another strain of state protectionist legislation. Connecticut has for years sheltered dealers from competition for warranty repairs and service, granting them a legislative-monopoly. *See supra* Statement of the Case A.1. Neither manufacturers nor independent repair shops may offer warranty services to Connecticut's consumers. Those provisions are not being challenged. In 2009, the Connecticut General Assembly handed dealers the statutory power to dictate the prices at which they get reimbursed by manufacturers for warranty repairs and service, and precluded any meaningful ability of a manufacturer to challenge the declared prices. The Cost Recovery Ban then took these protectionist measures to an unprecedented level, one that clearly crosses a constitutional boundary established in *Pike* and other dormant Commerce Clause cases, by mandating that the higher warranty costs required by state law would be borne solely out-of-state and by out-of-state actors. The Constitution permits states to regulate interstate commerce, but states may not export the costs of such regulation beyond their borders, thereby insulating the state that imposes regulation from the resultant costs of that regulation. At a minimum, the court of appeals' holding that Connecticut's law imposes no cognizable burden on interstate commerce sufficient even to warrant scrutiny under the dormant Commerce Clause is a gross distortion

of this Court's cases that warrants immediate review.

In *Pike*, this Court adopted a balancing test to assess whether state statutes that do not expressly discriminate between in-state and out-of-state interests violate the Commerce Clause. The Court held that

> [w]here the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld **unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.**

Pike, 397 U.S. at 142 (emphasis added). To determine whether a statue gives rise to a cognizable burden on interstate commerce, the analysis focuses on the extent to which a state has shifted the costs of its regulation to other states. This Court long ago recognized that the Commerce Clause prohibits state legislation that "by its necessary operation is a means of gaining a local benefit by throwing the attendant burdens on those without the state." *S.C. State Highway Dep't v. Barnwell Bros.*, 303 U.S. 177, 185-86 (1938).

As a practical matter and by its plain terms, the Cost Recovery Ban burdens interstate commerce by ensuring that the costs imposed by the Warranty Price Hike Provisions are borne exclusively out-of-state. It provides that

> [a] manufacturer or distributor may not otherwise recover its costs from dealers within this state, including an increase

> in the wholesale price of a vehicle or surcharge imposed on a dealer solely intended to recover the cost of reimbursing a dealer for parts and labor pursuant to this section . . . .

Conn. Gen. Stat. § 42-133s(g). The Connecticut General Assembly recognized that the Warranty Price Hike Provisions would impose substantial costs on manufacturers, so it enacted the Cost Recovery Ban to ensure that out-of-state manufacturers, dealers, and consumers bear those costs, not Connecticut's dealers or consumers. Thus a manufacturer can recoup the increased reimbursement amounts it must pay under the Warranty Price Hike Provisions, only from dealers or consumers outside of Connecticut. That holds true whether the manufacturer is located in or out of Connecticut. In reality, no manufacturer is located in Connecticut, but if one were to open a plant there, the Cost Recovery Ban would still force it to recoup from out-of-state dealers or consumers, for even the hypothetical Connecticut manufacturer could not "recover its costs from dealers within this state . . . ." Conn. Gen. Stat. § 42-133s(g). The Cost Recovery Ban plainly imposes a burden on interstate commerce and shifts the costs of regulation to commerce beyond the state's boundaries.

The court of appeals fundamentally misconstrued the well-established standard of *Pike*, applying a facial discrimination standard to a statute which not only precludes that competition, but whose very purpose is to ensure that the costs it imposes are borne out-of-state. Without looking beyond the face of the statute, which articulates no distinctions between in-state actors and their out-of-

state competitors, the court held that the 2009 Amendments "do not 'impose a burden on interstate commerce that is qualitatively or quantitatively different from that imposed on intrastate commerce.'" Pet. App. 7a (Summary Order at 3) (quoting *Sorrell*, 272 F.3d at 109). It said no more.

In articulating this erroneous standard, the court cited its decision in *Sorrell*, which in turn cited, among other cases, *Gary D. Peake Excavating Inc. v. Town Bd. of Town of Hancock*, 93 F.3d 68, 75 (2d Cir. 1996) and *USA Recycling, Inc. v. Town of Babylon*, 66 F.3d 1272, 1287 (2d Cir. 1995). The *Sorrell* decision examined the practical burdens of Vermont legislation on out-of-state manufacturers (which the court of appeals below failed to do) and relied on the fact that the Vermont legislation did not preclude those out-of-state manufacturers from recovering in Vermont at least a portion of the costs imposed by the challenged statute. *Sorrell*, therefore, does not support the court of appeal's decision.

In *Gary D. Peake Excavating*, the court upheld a town ordinance prohibiting the operation of garbage dumps, concluding that the ordinance imposed no incidental burdens on interstate commerce, because it applied equally to competing in-state and out-of-state contractors, and prevented private entities from operating landfills regardless of their state of origin. 93 F.3d at 76. Similarly, in *USA Recycling*, the court rejected a *Pike* challenge, determining that the regulation at issue did not impose different burdens on nonlocal versus local garbage haulers. 66 F.3d at 1287. The court of appeals' standard, therefore, appears to be that only statutes that impose "qualitatively or quantitatively different" burdens on out-of-state entities that

compete with in-state entities are cognizable under *Pike*. *Pike*, however, specifically encompasses situations where there is no such competition. The court erroneously imposed a more rigid discrimination-like standard in evaluating whether a state statute imposes a cognizable burden under *Pike*.

That approach defeats the purpose of a *Pike* challenge and would mean that one could never challenge a regulation that appears, at least facially, even-handed. The 2009 Amendments do not on their face treat in-state versus out-of-state manufacturers differently. Whether a manufacturer is located in Detroit or Hartford, it must reimburse its Connecticut dealers at warranty rates mandated by the 2009 Amendments, and it may not recover those increased costs from within Connecticut. In that sense, the statute is nondiscriminatory. But the law shifts the costs of regulation out-of-state, both explicitly and as a practical matter (since all manufacturers are in fact out-of-state). In that important respect, it clearly discriminates against out-of-state manufacturers, dealers and consumers in favor of in-state dealers.

In *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994), this Court made clear that the overall impact of a regulatory scheme is critical to a dormant Commerce Clause analysis. There, Massachusetts imposed a tax on all milk sold by dealers in the state, whether the milk was produced in Massachusetts or out. The entire tax was then used to subsidize Massachusetts dairy farmers. Even though the tax was nondiscriminatory, this Court held that "[b]y conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part

alone." 512 U.S. at 199-200. "It is the entire program," the Court continued, "not just the contributions to the fund or the distributions from that fund—that simultaneously burdens interstate commerce and discriminates in favor of local producers." *Id.* at 201. Eschewing formalism for a "case-by-case analysis of purposes and effects," this Court emphasized that its duty is to determine whether "in its practical operation," the statute "work[s] discrimination against interstate commerce." *Id.*

Like the program enacted by Massachusetts in *West Lynn*, Connecticut has created a legislative scheme whose totality is "more dangerous to interstate commerce" than the constituent parts. Those components—granting dealers a monopoly on warranty repairs and service, the Warranty Price Hike Provisions, and the Cost Recovery Ban—must be viewed in their entirety. For the reasons articulated above, the 2009 Amendments burden interstate commerce in a manner cognizable under *Pike*. The Cost Recovery Ban ensures that costs of Connecticut's protectionist scheme are borne elsewhere. The court of appeals failed to abide *West Lynn's* rejection of formalism in favor of a case-by-case analysis dependent on a statute's practical operation.

The decision by the court of appeals also conflicts with the principles underlying *Pike* balancing. The rationale underlying the rule, the Court explained long before *Pike*, is that "when the regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation

where it affects adversely some interests within the state." *S.C. State Highway Dep't*, 303 U.S. at 184-85 n.2. *Pike* balancing thus serves to check against abuse by state legislatures seeking to favor in-state interests at the expense of out-of-state interests. Because in-state interests are positioned to prevent or correct legislative abuse, statutes that burden in-state interests, even if out-of-state interests are burdened, are less likely to run afoul of the *Pike* standard. By contrast, where the adversely impacted in-state interests are few or non-existent, *Pike* serves to safeguard against legislative abuse. *See Raymond Motor Transp., Inc. v. Rice*, 434 U.S. 429, 444 n.18 (1978) (upholding state highway regulations that burdened both local and out-of-state interests, "thus insuring that a State's own political processes will serve as a check against unduly burdensome regulations"); *S. Pac. Co. v. Arizona*, 325 U.S. 761, 767-68 n.2 (1945) ("[T]he Court has often recognized that to the extent that the burden of state regulation falls on interests outside the state, it is unlikely to be alleviated by the operation of those political restraints normally exerted when interests within the state are affected."). To safeguard against state legislative abuse, under *Pike* balancing, burdens that as a practical matter fall more heavily on out-of-state interests are cognizable. *See Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 (1981) (applying *Pike* balancing after "granting that the out-of-state plastics industry is burdened relatively more heavily than the [in-state] pulpwood industry").

In the absence of the judicial scrutiny called for in *Pike*, state policy makers can escape the political costs of their decisions by imposing the costs

of those decisions on interests beyond their jurisdictional reach. That is precisely what the Connecticut General Assembly did by enacting the Cost Recovery Ban. Connecticut has imposed an explicit, direct transfer of wealth from out-of-state entities solely to in-state dealers, and has shifted the regulatory costs entirely out-of-state. By shifting the burdens of state regulation beyond its borders, Connecticut's policy makers have favored in-state interests without exposure to any political costs, the very type of legislation that *Pike* balancing is designed to scrutinize. The Cost Recovery Ban represents a breakdown in the legislative process that the Constitution cannot tolerate.

II. The Decision By the Court of Appeals Conflicts with Other Circuit Court Law.

The court of appeals' decision also conflicts with the holding of the Fourth Circuit in *Yamaha Motor Corp., U.S.A. v. Jim's Motorcycle, Inc.*, 401 F.3d 560 (4th Cir. 2005). There, the Fourth Circuit made clear that in a *Pike* challenge, courts look to whether the practical burdens of the statute fall predominantly on out-of-state entities. The court analyzed whether a provision of Virginia's motorcycle franchise law allowing existing dealers in Virginia to protest the establishment of a new dealership for the same brand anywhere in Virginia unduly burdened interstate commerce in violation of the dormant Commerce Clause. Like the 2009 Amendments, the Virginia statute made no distinction between in-state and out-of-state manufacturers. Even if there were motorcycle manufacturers in Virginia, the statute would "visit[ ] its effects equally upon both interstate and local business." *Yamaha*, 401 F.3d at 568 (internal

quotation and citation omitted). But in concluding that the statute imposed cognizable burdens on interstate commerce under *Pike*, the court specifically relied on the practical fact that "[t]here are no motorcycle manufacturers located in Virginia. And existing motorcycle dealers, the major in-state interests affected by the provision, stand to benefit from the law's enforcement." *Id.* at 573. The court noted that the in-state dealers "cannot 'be relied upon to prevent legislative abuse' because they 'ha[ve] been mollified by' the economic protection they currently enjoy." *Id.* (quoting *W. Lynn Creamery*, 512 U.S. at 200).

III. Review Is Warranted to Uphold a Robust Commerce Clause in the Face of Special Interest Legislation Run Amok in an Industry Important to the National Economy.

State regulation of the motor vehicle industry gained impetus in the mid-twentieth century when a few large manufacturers with considerable financial resources accounted for the vast majority of new motor vehicles sold in the U.S. At that time, the typical motor vehicle dealer was a small business with limited financial resources. In light of a then-perceived disparity in bargaining power between small dealers and a few large manufacturers, Congress and the states sought to regulate their interaction, purportedly to ensure consumers of ongoing, reliable delivery and servicing of motor vehicles.[3]

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[3] *See generally* Jessica Higashiyama, *State Automobile Dealer Franchise Laws: Have They Become the Proverbial*

(footnote continued on next page)

Over the last several decades the landscape has changed profoundly. Today, protectionist legislation like the 2009 Amendments no longer serves to rectify any perceived disparity in bargaining power. In the proceedings below, the Alliance adequately alleged that, on the other side of *Pike* balancing, the benefits of the 2009 Amendments inure to private actors only, and serve no legitimate public purpose.

In light of an alarming trend among state legislatures to expand dealer special interest legislation despite practical realities that undercut any argued need for that legislation, this case illustrates the importance of *Pike* balancing as a safeguard against the protectionist tendencies the Framers feared.

The practical realities of the industry, which would be part of the *Pike* balancing analysis, have changed principally in three ways. First, legislatures adopted numerous statutory provisions to protect dealers. Those provisions have tilted the relative bargaining powers of the parties dramatically. Dealers are statutorily protected from competition, from termination, from appointment of same-line make competitive dealers, and from all variety of "unreasonable" activities by manufacturers. *See, e.g.*, Conn. Gen. Stat. § 42-133cc. Legislation has eliminated any argued inequality of bargaining power that might otherwise have justified expanding special interest legislation.

Snake in the Grass?, University of California, Hastings College of the Law Discussion Paper, April 2009, http://ssrn.com/abstract=1394877.

In no other industry do retailers enjoy the level of statutory protection that has been afforded to new motor vehicle dealers.

Second, there is no longer any argued oligopoly power among the "Big Three." Manufacturers face substantially more competition today than they did during most of the twentieth century. With the rise of competition from foreign manufacturers, the Big Three (two of which recently went through bankruptcy) today account for far less a percentage of new motor vehicle sales in the U.S. than in the 1960s. With competition among manufacturers so much more robust than forty years ago, manufacturers must expend greater efforts to attract and retain quality dealers, and to elicit the levels of promotion and service that dealers must provide in order to sell vehicles. To survive in a competitive climate, the manufacturer-dealer relationship is necessarily symbiotic, not adversarial.

Third, recent decades have also witnessed a substantial increase in the scale, scope, and economic resources of motor vehicle dealers. Today's typical motor vehicle dealership is no longer a small business with limited resources. In 2013, the average dealership nationwide generated more than $41 million in revenue.[4] Fifty years ago, no dealer appeared in the Fortune 500. Five dealer companies—AutoNation, Penske, Sonic Automotive,

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[4] National Automobile Dealers Association, *NADA Data 2014: Annual Financial Profile of America's Franchised New-Car Dealerships* (2014), *available at* http://www.nadafrontpage.com/upload/wysiwyg/NADAData2014.pdf.

Group 1 Automotive, and Asbury Automotive Group—rank in the Fortune 500, each generating billions in revenue, with hundreds of dealerships in the U.S.[5] Unlike decades ago, many dealers now offer a broad array of motor vehicle makes, sourced from a number of different manufacturers. For example, firms such as AutoNation, Penske, Sonic Automotive, Group 1 Automotive, and Asbury Automotive Group operate many different dealer locations that together represent a wide variety of brands.[6] A dealer that sells the vehicles of multiple manufacturers is not beholden to a single manufacturer, and may therefore enjoy enhanced leverage in its interaction with manufacturers.[7] Moreover, because manufacturers generally adopt policies on a nationwide basis, the remaining smaller dealers obtain the benefits of the bargaining power exercised by larger dealers.

The change in relative bargaining power is both a result of special interest legislation and an

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[5]Fortune, *Fortune 500* (2015), http://fortune.com/fortune500/.

[6] SEC Form 10-K Annual Reports Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, for the fiscal year ended December 31, 2014, filed by Asbury Automotive Group, Inc., AutoNation, Inc., Group 1 Automotive, Inc., Penske Automotive Group, Inc., and Sonic Automotive, Inc.

[7] Dealers are also better organized than ever before. More than ninety percent of new motor vehicle dealers in the U.S. are members of the National Automobile Dealers Association, whose mission is in part to "represent[] dealers in legislative, regulatory, industry and public/media affairs arenas." NADA, *Fact Sheet*, http://www.nadafrontpage.com/1159.xml.

accelerant to further legislation. Against this backdrop, one industry commentator observes that

> [i]t is hardly surprising that car dealers have been able to lock down state legislatures across the nation in maintaining anticompetitive laws: After all, some of the richest people in nearly every town across the country are the owners of car dealerships. . . . [T]he car dealers dominate local business (especially in smaller towns), with economic power that translates directly into political might.[8]

Another commentator notes that automobile dealers have

> all the ingredients to become a powerful lobby, particularly in state politics. There are a lot of them; they have millions of dollars at stake in the laws governing car sale[s]; and thus they have the ability and inclination to rub elbows with—and make campaign donations to—state lawmakers. And they have used that influence, with remarkable effectiveness . . . .[9]

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[8] Neil Buchanan, *Political Power in the Auto Industry: Why Did Congress Protect Car Dealers?*, FindLaw, Dec. 17, 2009, http://writ.news.findlaw.com/buchanan/20091217.html.

[9] Neil Irwin, *Auto Dealers and State Legislatures Conspire to Make Cars More Expensive. Can Tesla Change That?* The Washington Post, May 14, 2013, http:/www.washingtonpost.com/blogs/wonkblog/wp/2013/05/14/auto-dealers-and-state-le.

Economists have concluded that the web of state legislation that dealers have so effectively procured delivers financial benefits to them at the expense of manufacturers.[10]

In short, the vigorous competition among manufacturers that did not exist fifty years ago, the increased size and sophistication of dealerships, and the influence dealers now wield through their lobbying efforts, ensure that historical bargaining disparities favoring manufacturers over dealers no longer provide a basis for ever-expanding legislation that protects dealers. Nor is there the constitutionally requisite correlation between the challenged statutory provisions and even the argued justification for them. The 2009 Amendments—like so many other dealer protections across the nation—are an unjustified wealth transfer from out-of-state manufacturers to in-state dealers with the legislative muscle to push their profits up through legislation.

This Court has said that in considering dormant Commerce Clause challenges, "it is the responsibility of the judiciary to determine whether action taken by state or local authorities unduly threatens the values the Commerce Clause was intended to serve." *Wardair Canada, Inc. v. Fla. Dep't of Revenue*, 477 U.S. 1, 7 (1986). The 2009 Amendments undermine those values. The core purpose of the Commerce Clause is to ensure that the nation, not the individual states, comprises "our

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[10] Francine Lafontaine and Fiona Scott Morton, *Markets: State Franchise Laws, Dealer Terminations, and the Auto Crisis*, 24 J. Econ. Persp. 233, 241 (2010).

economic unit." *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 537 (1949). By giving Congress the "Power . . . To regulate Commerce . . . among the several States[,]" the Framers recognized that the nascent union could not afford the economic Balkanization of the colonies. *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979). The dormant Commerce Clause thus operates "to ensure that the essential attributes of nationhood will not be jeopardized by States acting as independent economic actors." *Wardair Canada*, 477 U.S. at 12. The Framers wanted to eliminate the protectionist tendencies of individual states. Absent judicial interference, Connecticut and other state legislatures will continue to enact protectionist measures at their dealers' instance, measures that serve no purpose other than to increase profits of a locally powerful interest group, and that insulate the laws from the political process by exporting the resultant costs entirely out-of-state.

IV. The Court of Appeals Has Decided an Important Issue of Contract Clause Jurisprudence that Conflicts in Principle with Other Circuit Court Law.

Article I, Section 10 of the Constitution prohibits states from "impairing the Obligation of Contracts." Only substantial impairments violate the Contract Clause. *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992). Impairments that affect the terms upon which the parties have reasonably relied or that significantly alter the duties of the parties are substantial. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978). In measuring the degree to which a law disrupts contracting parties' expectations, courts

may consider whether prior regulation rendered the change in law foreseeable. *See Energy Reserves Group, Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 416 (1983).

The court of appeals affirmed dismissal of the Alliance's Contract Clause challenge. The court's analysis turned exclusively on its conclusion that prior regulation rendered the 2009 Amendments foreseeable. Pet. App. 8a ("The relationship between automobile manufacturers and Connecticut dealers has long been the subject of close state regulation, including of warranty reimbursement rates."). Foreseeable changes to the law, the theory goes, do not disrupt a contracting party's reasonable expectations. The court's decision, however, renders prior regulation a dispositive factor in the substantial impairment analysis, and essentially eviscerates the Contract Clause in any industry that has experienced heavy regulation. In this instance, a history of special interest legislation not only accomplishes ever expanding benefits for dealers, but is relied on to override even existing contractual provisions.

Until the 2009 Amendments, Connecticut had not restricted the ability of a manufacturer to tailor vehicle and parts prices to account for state-specific regulatory costs. The Cost Recovery Ban marked a drastic change from long-standing practice. For decades prior to 2009, there was simply no reason based on preexisting regulations to foresee that the ability to set prices of vehicles and parts in order to recover costs would be removed from the realm of contracts and become subject to state regulation. Longstanding contractual provisions reserved the manufacturer's contractual right to set prices.

JA112 (¶¶ 43-44). The competitive, free market was the constraint that underlay this contractual right. Many Dealer Agreements predate the adoption of the Cost Recovery Ban, and some even predate the adoption of the CFA in 1982. At the time of contracting, manufacturers could not reasonably foresee that the Connecticut General Assembly would take that contractual right away from them, destroying a long-held and reasonable expectation.

The Cost Recovery Ban goes far beyond closing a potential loophole to the higher warranty reimbursements mandated by the 2009 Amendments. Connecticut could have, but did not, take the narrow approach of precluding a manufacturer from recovering from a given dealer the higher costs submitted by that dealer—*i.e.*, giving with one hand and taking back that amount with the other. The state, rather, went much further by precluding any form of recovery. For example, the Cost Recovery Ban precludes a manufacturer from raising wholesale prices just to Connecticut dealers by, *e.g.*, imposing a uniform, per-vehicle or per-part surcharge on every vehicle or part sold in the state. In this fashion, the cost of regulation could be seen by those who buy the vehicles—*i.e.*, the voters who can ultimately decide through the ballot box if the costs are justified by the benefits.

Nor had Connecticut regulated the amount by which manufacturers must reimburse dealers for parts used in warranty repairs. Manufacturers and dealers were free to—and did—agree to the amounts that a dealer would receive for using manufacturer-sourced parts in a warranty repair. This is of particular importance, for warranties last years after the sale of the vehicle, and the parts at issue are

sourced from the manufacturer. Dealers, by contract, were already receiving a 40% or more mark-up on the parts they used in warranty repairs. The 2009 Amendments removed the subject of parts reimbursement amounts from the realm of negotiation and contract.

In short, the 2009 Amendments not only mandate that a dealer's unilateral declaration of mark-up overrides any applicable contractual provisions, but also, for the first time in the history of Connecticut's motor vehicle laws, the Connecticut General Assembly (i) restricted a manufacturer's contractual right to adjust the wholesale price of vehicles and parts sold to Connecticut dealers, and (ii) otherwise precluded recovery in Connecticut of the increased costs of doing business. The fact that the industry has been historically regulated does not mean that imposing the fundamental changes to the manufacturer-dealer relationship that the 2009 Amendments impose was foreseeable—unless the Contract Clause is to be read out of the Constitution.

This Court's review is needed to provide lower courts with guidance as to the extent to which prior regulation in an industry is dispositive of the substantial impairment analysis. Other courts of appeals have concluded that prior regulation is not dispositive. *See, e.g., Equip. Mfrs. Instit. v. Janklow*, 300 F.3d 842, 855-59 (8th Cir. 2002) (considering extensively the "the nature of the impairment produced by [the Act] on the pre-existing dealership agreements" before "consider[ing] how previous regulation affects the extent of the impairment"); *Chrysler Corp. v. Kolosso Auto Sales, Inc.*, 148 F.3d 892, 895 (7th Cir. 1998) ("[A] history of regulation is never a sufficient condition for rejecting a challenge

based on the contracts clause."); *In re Workers' Comp. Refund*, 46 F.3d 813, 820 (8th Cir. 1995) ("[R]egulation does not automatically foreclose the possibility of contract impairment. Courts have found substantial impairment of contracts in heavily regulated areas of commerce.").

If the Constitution contemplates that manufacturers would foresee strict regulation of their most basic contractual rights concerning pricing of vehicles and parts due to the existence of prior regulation of other issues, then there is truly nothing left of contract rights. The Connecticut General Assembly would have free reign to rewrite contracts—and effectuate additional and greater wealth transfers at its whim—merely because it has regulated the motor vehicle manufacturer-dealer relationship in the past. This cannot be the case for the Contract Clause to retain meaning. *See, e.g.*, *Allied Structural Steel*, 438 U.S. at 245 ("If the Contract Clause is to retain any meaning at all, however, it must be understood to impose *some* limits upon the power of a State to abridge existing contractual relationships . . . .") (emphasis in the original); *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 22 (1977) ("[P]rivate contracts are not subject to unlimited modification under the police power."). Leaving the decision of the court of appeals in place will upend one reason the Framers designed the Contract Clause—to combat their fear of naked preferences by the distribution of wealth to one group at the expense of another "solely on the ground that those favored have exercised the raw political power to obtain what they want." *See* Cass R. Sunstein, Naked Preferences and the Constitution, 84 Colum. L. Rev. 1689, 1689 (1984).

CONCLUSION

The decision of the court of appeals departs from dormant Commerce Clause principles enunciated by this Court, conflicts in principle with other circuit court law, and presents issues of extraordinary public importance. The Court should grant the petition and either reverse or set the case for argument.

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