What Will it Take to Get You in a New Car Today?: A Proposal for a New Federal Automobile Dealer Act

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TABLE OF CONTENTS

I. INTRODUCTION

Recently, the bottom dropped out of the automotive industry requiring Detroit's "Big Three" automakers to seek funds from Congress in order to survive. What went wrong? In addition to poor product quality and labor costs, commentators have repeatedly pointed to the over-dealered market as a problem.[1] But getting rid of dealers (or in this economy, letting poorly performing dealers fail) can only be a short term fix because the current regulatory scheme governing the manufacturer-dealer

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1. *See, e.g.*, Kate Linebaugh, *The Trials of the Auto Dealer: Long a Road to Wealth in Towns Across America, Selling Cars Has Turned Into a Struggle to Survive, Not Always Successful*, WALL ST. J., Jan. 3, 2009, at A1.

relationship incentivizes manufacturers to keep adding dealers to compensate for mediocre dealers that fail to cover their markets or provide quality service to customers. This is a problem not only for the Big Three automakers, which have the most mature dealer networks in the United States, but also for import companies such as Toyota, Honda and Nissan. Although import companies have been more circumspect in building their dealer networks, the incentives currently in place may lead them, albeit years from now, into the same position as the Big Three. At its essence, the manufacturer-dealer relationship is a contractual one as an applicant does not become a dealer until a dealer agreement is signed.[2] But one major impediment to improving and managing dealer networks is that the tools, which manufacturers had in place to manage their networks, as set out in the dealer agreement, have been supplanted.[3] Instead, for the past fifty years, automobile manufacturers and dealers have been governed by a patchwork of state and federal statutes in which the courts, administrative agencies, and specially set boards have stepped in and taken a paternalistic role in determining how the relationship ought to be conducted.[4]

Virtually every aspect of the manufacturer-dealer relationship is now governed by statute. The purported need for these statutes stems from the widely circulated (but unsubstantiated) belief that manufacturers abuse their bargaining power in their relationships with dealers and, therefore, the dealers' source of livelihood needs protection[5]

I submit that it is the state dealer statutes, supposedly designed to protect dealers, that have instead contributed to an over-dealered market, the financial ruin of hundreds of dealers in the current economy and the dire straits in which the Big Three automakers find themselves. In Part One, I describe the current statutory scheme that governs the manufacturer-dealer relationship, why that scheme was first conceived and how it has changed over time. Part Two analyzes the problems with this statutory scheme from an economic and practical business perspective and asks: Are these statutes necessary to protect dealers? And what impediments do manufacturers face in managing their dealer networks? In Part Three, I propose a new federal Automobile Dealers' Day in Court Act, which should resolve at least some of these

2. *See generally* Benito Arruñada et al., *Contractual Allocation of Decision Rights and Incentives: The Case of Automobile Distribution*, 17 J.L. Econ. & Org. 257 (2001) (examining economics of automobile franchising in Spain).

3. All fifty states have statutes in place that govern that motor vehicle manufacturer-dealer relationship, notwithstanding the terms of their contracts. Walter F. Forehand & John W. Forehand, *Motor Vehicle Dealers & Motor Vehicle Manufacturers: Florida Reacts to Pressures in the Marketplace*, 29 Fla. St. U. L. Rev. 1057, 1064 (2001).

4. *Id.* at 1063-64.

5. *See, e.g.*, Crivelli v. Gen. Motors Corp., 215 F.3d 386, 390 (3d Cir. 2000) ("Their underlying goal, similar to that which motivated the state statutes regulating the franchise relationship generally, is to protect the franchisee who has invested substantial capital in the franchise and who is therefore vulnerable to a manufacturer who may take advantage of this firm-specific investment.").

problems. Finally, in Part Four, I describe a hypothetical automobile distribution system, which could arise if the reforms I suggest are adopted.

II. THE MANUFACTURER-DEALER RELATIONSHIP

Historically and internationally, the relationship between dealers and manufacturers is governed by contract, commonly known as the dealer agreement.[6] The dealer agreement outlines the rights and responsibilities of both parties.[7] For the dealer, that includes selling and servicing the manufacturer's products, meeting certain sales and customer service objectives, providing an adequate facility and performing warranty service.[8] The manufacturer, for its part, must supply the vehicles and parts needed for sales and service and must reimburse the dealer for performing warranty service, for the warranty is a contractual obligation from the manufacturer to the customer.[9] The dealer agreement also generally gives manufacturers the right to approve transfers of the dealership and to terminate under certain conditions.[10] In most states, the manufacturer-dealer relationship is generally not considered a franchise under state law because no franchise fee is required.[11]

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6. *See* Arruñada et al., *supra* note 2, at 259.

7. *See, e.g.*, Daimler Chrysler Motors Co. v. Clemente, 668 S.E.2d 737, 742 (2008) ("The Dealer Agreement set forth a number of standards that had to be met by Metro to retain the franchise and delineated several situations in which Chrysler Motors could terminate the franchise, whether with or without notice or an opportunity to cure. In addition to sales and service standards, the Dealer Agreement described a number of financial standards that Metro was required to meet.").

8. *See id.*

9. State lemon laws and the federal Magnuson-Moss Act also require manufacturers to stand by their warranties and their products. *See* Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. § 2307 (2006).

10. *See DaimlerChrysler*, 668 S.E.2d at 742 (describing provisions of dealer agreement).

11. Each state has its own definition of a "franchise." Some states such as California, Illinois, Indiana, Iowa, Michigan, Virginia, and Washington use the "Marketing Plan Definition," under which a franchisee may "(a) …engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in a substantial part by a franchisor; and (b) The operation of the franchisee's business pursuant to that plan or system is associated with the franchisor's trademark…or other commercial symbol designating the franchisor or its affiliate; and (c) The franchisee is required to pay, directly or indirectly, a franchise fee." Thomas J. Collin, *State Franchise Laws and the Small Business Franchise Act of 1999: Barriers to Efficient Distribution*, 55 BUS. LAW. 1699, 1706 (2000) (quoting Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20001(a) – (c) (West 1997)) (noting that the other states use the same definition "with minor editorial adjustments."). Other states such as Hawaii, Minnesota, and Nebraska define a franchise using a "community of interest" standard plus the payment of a franchise fee or some other consideration. That is, the franchisor must grant a trademark license and there must be a community of interest between the supplier and the dealer. *Id.* at 1716. A small minority of states such as New Jersey define a franchise without regard to whether a franchise fee is paid. *Id.*

Adding to and often superseding the terms of the dealer agreement are federal and state statutes that govern the automobile manufacturer-dealer relationship. In this Part, I will first discuss the federal Automobile Dealer's Day in Court Act, the impetus for the Act, and recent amendments. Second, I describe common provisions in state dealer acts, the genesis of those acts and how they affect the manufacturer-dealer relationship.

A. *Automobile Dealer's Day in Court Act*

Responding to concerns that manufacturers were taking advantage of dealers, Congress passed the Automobile Dealers' Day in Court Act ("ADDICA") in 1956.[12] In the years preceding passage of ADDICA, the Federal Trade Commission and the National Automobile Dealers Association, among others, asserted that dealer agreements were contracts of adhesion and that manufacturers were unfairly using termination as a way of coercing dealers in their day-to-day operations after inducing them to make large investments of time and capital in their dealerships.[13] Specifically, the FTC found that:

> [M]otor-vehicle manufacturers, and, by reason of their great power, especially General Motors Corporation, Chrysler Corporation and Ford Motor Co., have been, and still are, imposing on their respective dealers unfair and inequitable conditions of trade, by requiring such dealers to accept, and operate under, agreements that inadequately define the rights and obligations of the parties and are, moreover, objectionable in respect to defect of mutuality; that some dealers, in fact, report that they have been subjected to rigid inspections of premises and accounts, and to arbitrary requirements by their respective motor-vehicle manufacturers to accept for resale, quantities of motor vehicles or other goods, deemed excessive by the dealer, or to make investments in operating plants or equipment without adequate guaranty as to term of agreement or even supply of merchandise; and that adequate provisions are not included for an equitable method of liquidation of such investments, sometimes made at the insistence of the respective motor-vehicle manufacture.[14]

The language of ADDICA is deceptively simple: manufacturers are required "to act in good faith in performing or complying with any of the terms or provisions of the franchise, or in terminating, canceling, or not renewing the franchise with said dealer . . . ."[15] Courts have generally held that failing to act in good faith requires unfair coercion, intimidation or threats that will result in sanctions if the dealer does

12. 15 U.S.C. §§ 1221-26 (2006).
13. *See* 1939 FTC ANN. REP. 22.
14. *Id.* at 25-26.
15. 15 U.S.C. § 1222 (2006).

not comply with the demand.[16] In construing ADDICA in this way, court after court has reiterated that the Act was intended to remedy the harsh and unfair conduct that manufacturers have engaged in.[17]

More recently, in 2002, ADDICA was amended to include an anti-arbitration provision.[18] Against the great weight of legislation and authority favoring alternative dispute resolution, arbitration clauses in dealer agreements entered into or modified after November 2, 2002, are no longer enforceable unless the parties agree to arbitrate *after* the dispute arises.[19] Again, this amendment was motivated by the desire to provide further protection for dealers from opportunistic manufacturer behavior and allow dealers their "day in court."[20]

B. *State Dealer Acts*

Although state dealer acts have been in existence since 1936, they have evolved substantially since that time.[21] As with ADDICA, the impetus for state dealer acts are claims that manufacturers have abused their positions of power and taken advantage of dealers.[22] Many state dealer acts include a statement of purpose, which justifies the legislation based on the twin needs of protecting dealer investments and preventing manufacturers from exerting undue control .[23]

16. *See* E. Auto Distribs., Inc. v. Peugeot Motors of Am., Inc., 795 F.2d 329, 336 (4th Cir. 1986); Globe Motors, Inc. v. Studebaker-Packard Corp., 328 F.2d 645, 646 (3d Cir. 1964).

17. *See, e.g.*, New Motor Vehicle Bd. of Cal. v. Orrin W. Fox, Co., 439 U.S. 96, 100-01 (1978) ("The disparity in bargaining power between automobile manufacturers and their dealers prompted Congress and some 25 States to enact legislation to protect retail car dealers from perceived abusive and oppressive acts by the manufacturers."). Fields Jeep-Eagle, Inc. v. Chrysler Corp., 645 N.E.2d 946, 954 (Ill. 1995) ("We recognize the interest of the State in regulating the dealings of motor vehicle manufacturers and dealers so as to redress the disparity in economic and bargaining power between manufacturers and their franchisees.") (citing *New Motor Vehicle Bd. of Cal.*, 439 U.S. at 112 (Marshall, J. concurring)).

18. *See* 15 U.S.C. § 1226(a)(2) (2006).

19. *See id.* ("Notwithstanding any other provision of law, whenever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to such contract, arbitration may be used to settle such controversy only if after such controversy arises all parties to such controversy consent in writing to use arbitration to settle such controversy."); *see also* § 1226(b) ("Subsection (a) of this section shall apply to contracts entered into, amended, altered, modified, renewed, or extended after November 2, 2002.").

20. *See* MOTOR VEHICLE FRANCHISE CONTRACT ARBITRATION FAIRNESS ACT, S. REP. NO. 107-266, at 2 (2002); *see also* Carl J. Chiappa & David Stoelting, *Tip of the Iceberg? New Law Exempts Car Dealers from Federal Arbitration Act,* 22 FRANCHISE L.J. 219, 219 (2003).

21. E. W. Eckard, Jr. *The Effects of State Automobile Dealer Entry Regulation on New Car Prices*, 23 ECON. INQUIRY 223, 223 (1985).

22. *Id.*

23. ALA. CODE § 8-20-2 (LexisNexis 2002); ARK. CODE ANN. § 23-112-102 (2004); COLO. REV. STAT. § 12-6-101 (2009); DEL. CODE ANN. tit. 6, § 4901 (2005); GA CODE ANN. § 10-1-621

Courts have reinforced these assertions by citing the purposes of these state dealer acts in construing other provisions of the acts;[24] other courts have then cited these cases for those propositions,[25] perpetuating the belief that dealers need to be protected from abuse by manufacturers. For example, the Supreme Court has considered the terms of a state motor vehicle dealer act in one case, *New Motor Vehicle Bd. of Cal. v. Orrin W. Fox, Co.*, finding that "[t]he disparity in bargaining power between automobile manufacturers and their dealers prompted Congress and some 25 States to enact legislation to protect retail car dealers from perceived abusive and oppressive acts by the manufacturers."[26] Other courts have also recognized the significant investments that dealers make in their dealerships and the potential for manufacturers to take advantage of these investments to justify state legislative protections of dealers.[27]

These dealer acts do not just cover terminations and non-renewals—the reason why these state statutes were passed in the first place—but virtually every aspect of the manufacturer-dealer relationship.[28] It is not surprising that increasingly severe restrictions are being passed given the purported reason for these state dealer acts.[29] If manufacturers possess and use this unfair bargaining power to coerce dealers into entering into contracts with one-sided termination provisions, it is expected that manufacturers would also attempt to otherwise take advantage of dealers. These

(2009); HAW. REV. STAT. § 437-1 (1993 & Supp. 2008); 815 ILL. COMP. STAT. ANN. 710/1.1 (LexisNexis 2008); KY. REV. STAT. ANN. § 190.015 (LexisNexis 1997Supp.); LA. REV. STAT. ANN. § 32:1251(Supp. 2009)); ME. REV. STAT. ANN. tit. 10, § 1182 (2009); MINN. STAT. ANN. § 80E.01 (-WEST 2009); MISS. CODE. ANN. § 63-17-53 (2004); NEB. REV. STAT. § 60-1401.01 (2004); N.J. STAT. ANN. § 56:10-7.2 (West 2001); N.Y. VEHICLE AND TRAFFIC LAW § 460 (McKinney 1996 & Supp. 2009); N.C. GEN. STAT. ANN. § 20-285 (2007); OKLA. STAT. ANN. tit. 47, § 561 (West 2000); 49 PA. CODE § 19.1 (1996 & Supp.2009); UTAH CODE ANN. § 13-14-101 (2009); VT. STAT. ANN. tit. 9, § 4084 (2004); WASH. REV. CODE § 46.70.005 (2001); W. VA. CODE § 17A-6A-1 (2009).

24. *See, e.g.*, New Motor Vehicle Bd. of Cal. v. Orrin W. Fox Co., 439 U.S. 96, 100-01 (1978) (citing the disparity in bargaining power between manufacturers and dealers).

25. *See, e.g.*, Fields Jeep-Eagle, Inc. v. Chrysler Corp., 645 N.E.2d 946, 954 (1994) ("We recognize the interest of the State in regulating the dealings of motor vehicle manufacturers and dealers so as to redress the disparity in economic and bargaining power between manufacturers and their franchisees.") (citing New Motor Vehicle Bd. of Cal. v. Orrin W. Fox Co., 439 U.S. 96, 112 (1978) (Marshall, J., concurring)).

26. *New Motor Vehicle Bd. of Cal.*, 439 U.S. at 100-01.

27. *See, e.g.*, Crivelli, v. General Motors Corp., 215 F.3d 386, 390 (3d Cir. 2000) ("Their underlying goal, similar to that which motivated the state statutes regulating the franchise relationship generally, is to protect the franchisee who has invested substantial capital in the franchise and who is therefore vulnerable to a manufacturer who may take advantage of this firm-specific investment.").

28. Richard L. Smith, *Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution*, 25 J.L. & ECON. 125, 132-33 (1982) (describing state regulation of automobile franchising).

29. *See* Forehand & Forehand, *supra* note 3, at 1063-64 (discussing Wisconsin and Florida Dealers' Acts).

restrictions include permitting dealers to protest relocations and add points and to require manufacturers to approve transfers. Manufacturers are also restricted in the allocation of new vehicles, reimbursements to dealers for warranty work, and in how they may make incentive and bonus payments.[30] All state dealer acts also prohibit manufacturers from selling vehicles directly to consumers and require manufacturers to use authorized dealers for warranty work.[31] Additionally, state dealer acts restrict the forum and law that can be applied to the manufacturer-dealer relationship within the state.[32]

Reviewing the current restrictions on manufacturers in state dealer acts demonstrates how they have essentially supplanted the dealer agreement to define the terms of the manufacturer-dealer relationship.

1. Terminations and Non-Renewals

State dealer acts typically require good cause for termination—as defined by statute.[33] Some circumstances are generally not disputed as good cause and are

30. For statutes governing allocation, see *infra* note 79. For statutes governing warranty, see *infra* note 73.

31. The state dealer acts generally permit manufacturers to temporarily own a dealership, usually for a period of one year to twenty-four months. Manufacturers often use this exception to further their diversity goals, appointing operators from underrepresented backgrounds who are permitted to purchase the manufacturer's interest over time.

32. For statutes governing forum and applicable law, see *infra* notes 83 and 92.

33. ALA. CODE § 8-20-5(a)–(c) (LexisNexis 2002); ALASKA STAT. § 45.25.110(a)(1)(B), (c) (2008); ARIZ. REV. STAT. ANN. §§ 28-4452(A), 28-4457(D)–(E), 28-4493(A)(10) (2004); ARK. CODE ANN. § 4-72-204(a), (d) (2004); CAL. VEH. CODE §§ 3060(a)(2), 3061 (West 2000); COLO. REV. STAT. § 12-6-120(1)(d) (2009); CONN. GEN. STAT. ANN. § 42-133f(a), 42-133v (a)–(b) (West 2004); DEL. CODE ANN. tit. 6, § 4906(a)(2), (b) (2005); FLA. STAT. ANN. § 320.641(3) (West 2005 & Supp. 2008); GA. CODE ANN. § 10-1-651(a)–(c) (-2009); HAW. REV. STAT. § 437-28(a)(21)(C) (1993 & Supp. 2008); IDAHO CODE ANN. § 49-1614(1), (4) (2008 & Supp. 2009); 815 ILL. COMP. STAT. ANN. 710/4(d)(6), 710/9(a), 710/12(d) (West 2008 & Supp. 2009); IND. CODE ANN. § 23-2-2.7-1(7)–(8) (LexisNexis 1999 & Supp. 2009); IOWA CODE ANN. §§ 322.3(5), 322.6(3), 322A.2, 322A.15 (West 2005 & Supp. 2009); KAN. STAT. ANN. § 8-2414(b), (d), (e) (2001); KY. REV. STAT. ANN. §§ 190.040(1)(o), .045(1)(b), .045(2) (LexisNexis 1997 & Supp.2009); LA. REV. STAT. ANN. § 32:1261(1)(d) (2002); ME. REV. STAT. ANN. tit. 10, §§ 1174(3)(O)–(P), 1434(3)(N)–(P) (2009); MD. CODE ANN., TRANSP. § 15-206.1, 15-209(a)(1), (b)(1), (c)(1) (LexisNexis 2009); MASS. ANN. LAWS ch. 93B, §§ 5(a), 5(h), 5(j), 12 (LexisNexis 2005); MICH. COMP. LAWS ANN. § 445.1567 (West 2002); MINN. STAT. ANN. §§ 80E.06, .07(1)(a) (West 2009); MISS. CODE ANN. §§ 63-17-73(1)(d)(3), 63-17-137 (2004); MO. REV. STAT. § 407.825(5) (2000 & Supp. 2009); MONT. CODE ANN. §§ 61-4-205(1), 61-4-207(1) (2009); NEB. REV. STAT. §§ 60-1420(1)(a), 60-1433 (2004); NEV. REV. STAT. §§ 482.36352(2)(a)(1), .36355, .36356 (2007); N.H. REV. STAT. ANN. §§ 357-C:3(III)(c), C:7(I)(c), C:7(II) (LexisNexis 2008); N.J. STAT. ANN. § 56:10-5 (West 2001); N.M. STAT. §§ 57-16-5(F), 57-16-8, 57-16-9 (1996 & Supp. 2009); N.Y. VEH. & TRAF. LAW § 463(2)(d)(1) (McKinney Supp. 2009); N.C. GEN. STAT. ANN. § 20-305(3), (6)(a) (2009); OHIO REV. CODE ANN. § 4517.54(A), .54(D), .55(A), .59(A), .65(B) (LexisNexis 2003); OKLA. STAT. ANN. tit. 47, § 565.2(A)–(B) (West 2000); OR. REV. STAT. ANN. § 650.140(1)–(2) (West 2003 &

found in most state dealer acts, such as: if the dealer is convicted of a felony, if the dealership is closed for a certain number of business days, or if the dealership is insolvent.[34] Many statutes also permit termination upon a material breach of a provision of the dealer agreement.[35] States dealer acts also generally permit termination for sales or service underperformance, but those circumstances often require giving the dealer an opportunity to cure.[36] These cure periods can be as long as six months,[37] and, in practice, manufacturers often give dealers multiple cure periods because the penalty for mistakenly terminating a dealer can be treble damages plus attorney's fees and costs.[38]

If the dealer fails to cure, state dealer acts generally provide that a written notice of termination must be given at least thirty to sixty days, and sometimes longer, before the termination becomes effective.[39] During that time, most state dealer acts permit a dealer to protest the termination, which results in an automatic stay without the need to go to court and obtain an injunction.[40] In many states, if the dealer protests the termination, it bears the burden of making a prima facie case that the termination was unlawful, at which time the burden of persuasion shifts to the manufacturer to prove that it had good cause to terminate.[41]

Some states also have special provisions for termination above and beyond the "good cause" standard..[42] In Florida, when termination is based on fraudulent acts committed by the dealer or its employees in connection with their relationship with the manufacturer, the manufacturer must prove that the dealer-principal had actual knowledge of the fraud upon which the termination is based.[43] Therefore, a manufacturer cannot terminate if the dealer-principal permits one of his managers or

Supp. 2009); 63 PA. CONS. STAT. ANN. § 818.13(a) (West Supp. 2009); R.I. GEN. LAWS §§ 31-5-23(7), 31-5-35(3), 31-5.1-4(d)(1)-(3), (d)(6)(III) (2002); S.C. CODE ANN. §§ 56-15-40(3)(c), 56-15-90 (2006); S.D. CODIFIED LAWS §§ 32-6B-45(1), 32-6B-46, 37-5-3 (2004); TENN. CODE ANN. § 55-17-114(c)(3) (2008); TEX. OCC. CODE ANN. §§ 2301.453(a)(3), .455 (Vernon 2004); UTAH CODE ANN. § 13-14-301(1)(b) 13-14-305(1) (2009); VT. STAT. ANN. tit. 9, §§ 4089(a)–(b), 4092(c) (2004); VA. CODE ANN. §§ 46.2-1569(5), 46.2-1573(D), 46.2-1976(6), 46.2-1982(D) (2005); WASH. REV. CODE §§ 46.70.180(14)(b), .96.030, .96.060(1) (2001); W. VA. CODE §§ 17A-6A-4(1)(d), 17A-6A-(2), 17A-6A-5, 17A-6A-7(e) (2009); WIS. STAT. ANN. § 218.0116(1)(i) (West 2009); WYO. STAT. ANN. § 31-16-109(a), (d), (f) (2009).

34. *See, e.g.*, GA. CODE ANN. § 10-1-651(e)(1)(B) (2009).

35. *See, e.g.*, *id.* § 10-1-651(b).

36. *See, e.g.*, *id.* § 10-1-651(c).

37. *See, e.g.*, *id.* § 10-1-651(c)(3).

38. *See, e.g.*, FLA. STAT. ANN. § 320.697 (West 2005).

39. *See, e.g.*, GA. CODE ANN. § 10-1-651(e)(1)(A) (2009) (providing for 90 day notice of termination).

40. *See, e.g.*, FLA. STAT. ANN. § 320.641(7) (West 2005).

41. *See, e.g.*, *id.* § 320.697.

42. *See, e.g.*, *id.* § 320.6412.

43. *See id.*

employees to commit the fraud by failing to create adequate internal controls within the dealership or even if the dealer agreement provides that the dealer-principal is held responsible for any of the acts of the dealership entity or its employees.[44] For example, in many dealerships, a dealership employee—usually the service manager—is responsible for submitting claims to the manufacturer for reimbursement of repairs performed under warranty.[45] In those circumstances where incorrect information such as the mileage of the vehicle is provided to the manufacturer to make ineligible repairs reimbursable, the Florida statute would not permit termination unless the dealer-principal actually knew of the practice.[46]

2. Relocations and Add Points[47]

In addition to preventing their own terminations, under many state dealer acts, dealers also possess the right to protest and potentially block the relocation or addition of another dealer selling the same line-makes within a certain radius.[48] These statutes generally provide that manufacturers must give notice when relocating or adding a dealer within certain distances from an existing dealer, giving the existing dealer an opportunity to protest or block the relocation or add point.[49] As with

44. *See id.*

45. *See* Chrysler Corp. v. Lee Janssen Motor Co., 619 N.W.2d 78, 83 (Neb. Ct. App. 2000) (explaining roles of service manager and warranty clerk).

46. *See* FL. STAT. ANN. § 320.6412 (West 2005).

47. "Add point" is an automobile industry term for establishing an additional dealership location in a market.

48. *See, e.g.*, ALA. CODE § 8-20-4 (3)(l) (LexisNexis 2002); ALASKA STAT. § 45.25.180(b) (2008); ARIZ. REV. STAT. ANN. §§ 28-4452(C), -4453(B) (2004); ARK. CODE ANN. §§ 23-112-308(a)(23), -311(a) (2004 & Supp. 2009); CAL. VEH. CODE § 3062(a)(1) (West 2000 & Supp. 2009); CONN. GEN. STAT. ANN. § 42-133dd(a) (West 2009); DEL. CODE ANN. tit. 6, § 4915(a) (2005 & Supp. 2008); FLA. ADMIN. CODE ANN. r. 15C-7.004(6) (2009); FLA. STAT. ANN. § 320.642(1), (6) (West 2005 & Supp. 2008); 815 ILL. COMP. STAT. ANN. 710/4(e)(8) (West 2008 & Supp. 2009); IND. CODE ANN. § 9-23-3-24(d) (LexisNexis 1999 & Supp. 2009); KAN. STAT. ANN. § 8-2430(a) (2001); KY. REV. STAT. ANN. § 190.047(6)(c) (LexisNexis 1997 & Supp. 2009); LA. REV. STAT. ANN. § 32:1257(B)(1) (2002); ME. REV. STAT. ANN. tit. 10, §§ 1174-A(1), 1435(1) (2009); MASS. ANN. LAWS ch. 93B, § 6(d) (LexisNexis 2005); MICH. COMP. LAWS ANN. § 445.1576(3) (West 2002); MINN. STAT. ANN. § 80E.14(1) (West 2009); MISS. CODE ANN. § 63-17-116(3)–(4) (2004); MO. REV. STAT. § 407.817(3)–(4) (2000); N.H. REV. STAT. ANN. § 357-C:9(I) (LexisNexis 2008); N.J. STAT. ANN. § 56:10-19 (West 2001); N.C. GEN. STAT. ANN. § 20-305(5) (2007 & Supp. 2009); OHIO REV. CODE ANN. § 4517.50(A) (LexisNexis 2003); OKLA. STAT. ANN. tit. 47, § 578.1(A), (C) (West 2000 & Supp. 2009); OR. REV. STAT. ANN. § 650.150(1) (West 2003 & Supp. 2009); 63 PA. CONS. STAT. ANN. § 818.27(a)(1) (West Supp. 2009); R.I. GEN. LAWS § 31-5.1-4.2(a) (2002 & Supp. 2009); 43 TEX. ADMIN. CODE § 8.105(a) (2009); VT. STAT. ANN. tit. 9, § 4098(a) (2004); VA. CODE ANN. § 46.2-1569(4) (2005 & S.. 2009); W. VA. CODE § 17A-6A-12(2)–(3) (2009); WIS. STAT. ANN. § 218.0116(7)(a)(1) (West 2009); WYO. STAT. ANN. § 31-16-111(a) (2009).

49. *See e.g.*, ARIZ. REV. STAT. ANN. § 28-4408 (2009); COLO. REV. STAT. § 12-6-120.3(1) (2009); GA. CODE ANN. § 10-1-664(a) (2009); IDAHO CODE ANN. § 49-1616(1) (2008); WASH. REV.

terminations, if a dealer protests a relocation, the manufacturer bears the burden of showing inadequate representation by the existing dealers in the community or territory to justify adding or relocating a dealer to the area.[50] This showing often requires the use of marketing and industry experts to determine the boundaries of the relevant market area, review the new car registrations in that market, and analyze whether a new dealer is justified.[51] Some state dealers acts, such as Florida's, have very specific criteria for determining whether the market is being adequately represented.[52]

3. Transfers

State dealer acts also govern the sale or transfer of franchise rights, notwithstanding contractual terms providing that the dealer agreement is between the manufacturer and dealer and therefore non-transferable.[53] Generally, manufacturers retain the right under the dealer agreement to approve the sale.[54] If a dealer desires to

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CODE § 46.96.140(3) (2001).

50. *See, e.g.*, GA. CODE ANN. § 10-1-664(b) (2009).

51. *See* W&D Imports, Inc. v. American Honda Motor Co., 2008 WL 281576, at *5-8 (N.J. Super. Ct. App. Div. Feb. 4, 2008) (describing use of expert testimony in add point case); Grubbs Nissan Mid-Cities, Ltd v. Nissan North America, Inc., 2007 WL 1518115, at *2 (Tex. App.May 23, 2007) (describing use of expert testimony in add point case).

52. The Florida dealer act provides eleven factors that the Department of Motor Vehicles may consider in determining whether existing dealers are "providing adequate representation in the community…for the line-make," including:

> 1. The impact of the establishment of the proposed or relocated dealer on the consumers, public interest, existing dealers, and the licensee….
>
> 2. The size and permanency of investment reasonably made…by the existing dealer or dealers to perform their obligations under the dealer agreement
>
> ….
>
> 4. Any actions by the licensees in denying its existing dealer or dealers of the same line-make the opportunity for reasonable growth, market expansion, or relocation….
>
> ….
>
> 7. Whether benefits to consumers will likely occur from the establishment or relocation of the dealership which cannot be obtained by other geographic or demographic changes or expected changes in the community or territory.
>
> ….
>
> 10. Whether the establishment or relocation of the proposed dealership appears to be warranted and justified based on economic and marketing conditions pertinent to dealers competing in the community or territory, including anticipated future changes.

See FLA. STAT. ANN. § 320.642(2)(b)(1)–(11) (West 2005 & Supp. 2009).

53. *See* Smith, *supra* note 28, at 139.

54. *See* Forehand & Forehand, *supra* note 3, at 1096 (describing process by which a seller-dealer is required to notify and provide opportunity for manufacturer to object under terms of dealer agreement).

sell its interest, notice to the manufacturer of the potential sale is required, and most state dealer acts require manufacturers to approve the sale unless the manufacturer has a legitimate, business reason not to approve the buyer.[55] These legitimate, business reasons often need to be based on generally applied or published criteria that the manufacturer uses to assess each potential transfer.[56] If the manufacturer fails to respond to the notice of sale within a certain time frame, usually sixty days, the manufacturer is deemed to have approved the sale.[57] Some states make it more difficult for manufacturers to deny consent to the transfer in circumstances such as: a sale or transfer to an existing dealer,[58] a transfer to the spouse or child of the dealer-

55. ALA. CODE § 8-20-4(3)(i), (k) (LexisNexis 2002); ARIZ. REV. STAT. ANN. § 28-4457(A)(1) (2004 & Supp. 2009); ARK. CODE ANN. §§ 4-72-205, 23-112-403(a)(2)(I) (2004); CAL. VEH. CODE § 11713.3(d)(1) (2000 & Supp. 2009); COLO. REV. STAT. § 12-6-120(1)(i) (2009); CONN. GEN. STAT. ANN. §§ 42-133bb(5), 42-133cc(10) (West 2009); DEL. CODE ANN. tit. 6, §§ 4910(a), 4911, 4913(a)(5) (2005); FLA. STAT. ANN. §§ 320.643(1)(a), .643(2)(a), .644(1), .644(5) (West 2004); GA. CODE ANN. §§ 10-1-653, 10-1-663(a)(2) (2009); IDAHO CODE ANN. § 49-1613(3)(i), (k) (2008); 815 ILL. COMP. STAT. ANN. 710/4(e)(6) (West Supp. 2009); IND. CODE ANN. §§ 9-23-3-11, 9-23-3-12 (LexisNexis 1999 & 2009); IOWA CODE ANN. § 322A.11(2) (West 2005); KAN. STAT. ANN. § 8-2416(a), (d) (2001); KY. REV. STAT. ANN. § 190.047(1)–(4) (LexisNexis 1997); LA. REV. STAT. ANN. § 32:1261(1)(i) (2002 & Supp. 2009); ME. REV. STAT. ANN. tit. 10, § 1174(3)(I), (3)(Q)(1), (3)(Q)(4) (2009); MD. CODE ANN., TRANSP. § 15-211(d)(1), (e)–(g) (LexisNexis 2009); MASS. ANN. LAWS ch. 93B, § 4(d)(3) (LexisNexis 2005); MICH. COMP. LAWS ANN. §§ 445.1568(d), .1574(1)(k) (West 2002); MINN. STAT. ANN. §§ 80E.07(1)(a), 80E.13(j) (West 2009); MISS. CODE ANN. § 63-17-73(1)(d)(9) (2004); MO. REV. STAT. §§ 407.825(7)(a), 407.1332(1), (3) (2000 & Supp. 2008); MONT. CODE ANN. §§ 61-4-150(1), 4-150(2)(a), 4-205(5) (2009); NEB. REV. STAT. §§ 60-1429(2), 60-1430 (2004); NEV. REV. STAT. § 482.36371(1)(a), (c) (2007); N.H. REV. STAT. ANN. §§ 357-C:3(III)(i), C:7(III)(a), C:7(III)(d) (LexisNexis2008 & Supp. 2009); N.J. STAT. ANN. §§ 56:10-6, 56:10-7(d) (West 2001); N.M. STAT. § 57-16-5(L) (1996 & Supp. 2009); N.Y. VEH. & TRAF. LAW § 463(2)(k) (McKinney 1996 & Supp. 2009); N.C. GEN. STAT. ANN. § 20-305(4) (2007 & Supp. 2009); N.D. CENT. CODE ANN. § 51-07-02.2 (2005); OHIO REV. CODE ANN. §§ 4517.56(A), 4517.59(C) (LexisNexis 2002); OKLA. STAT. ANN. tit. 47, § 565.3(A), (B) (West 2000 & Supp. 2009); OR. REV. STAT. ANN. § 650.162(1)–(3) (West 2003); 63 PA. CONS. STAT. ANN. § 818.12(b)(3) (West Supp. 2009); R.I. GEN. LAWS § 31-5.1-4(c)(7), (14) (2002 & Supp. 2006); S.C. CODE ANN. § 56-15-40(3)(i) (2006); S.D. CODIFIED LAWS § 32-6B-49(1), 32-6B-76 (2004); TENN. CODE ANN. § 55-17-114(c)(7) (2008 & Supp. 2009); TEX. OCC. CODE ANN. §§ 2301.359(a), .359(e), .458 (Vernon 2004); VT. STAT. ANN. tit. 9, § 4097(10), (11) (2004 & Supp. 2009); VA. CODE ANN. §§ 46.2-1569(3), 46.2-1976(4) (2005 & Supp. 2009); WASH. REV. CODE § 46.96.200(1), (5) (2001); W. VA. CODE § 17A-6A-10(2)(m) (2009); WIS. STAT. ANN. § 218.0134(2)(a) (West 2009); WYO. STAT. ANN. § 31-16-108(c)(ix) (2001).

56. *See, e.g.*, TEX. OCC. CODE ANN. § 2301.359(e) (Vernon 2004) ("It is unreasonable for a manufacturer or distributor to reject a prospective transferee who is of good moral character and who meets the written, reasonable, and uniformly applied standards or qualifications, if any, of the manufacturer or distributor relating to the prospective transferee's business experience and financial qualifications.").

57. *See, e.g.*, 63 PA. CONS. STAT. ANN. § 818.12(b)(5) (West Supp. 2009) (requiring manufacturer review within sixty days of receipt of forms); TEX. OCC. CODE ANN. § 2301.359(d) (Vernon 2004) (also requiring manufacturer review within sixty days).

58. *See, e.g.*, GA. CODE ANN. § 10-1-653 (2009).

principal, or a transfer to one of the senior managers of the dealership upon the death or incapacity of the dealer-principal.[59]

Some states also restrict a manufacturer's contractual right of first refusal by statute or case law.[60] Manufacturers often have a right of first refusal provision in the dealer agreement, permitting the manufacturer to step into the shoes of a potential purchaser and purchase the dealership.[61] Some courts, such as those in Florida and Iowa, have held that contractual rights of first refusal by the manufacturer violate the state dealer act's transfer provisions and therefore are void.[62] These courts reason that, because the state's transfer provisions prohibit manufacturers from unreasonably

59. *See, e.g.*, *id.* § 10-1-652(a), (d), (f), (g).

60. ALA. CODE § 8-20-4(3)(k) (LexisNexis 2002); ARIZ. REV. STAT. ANN. § 28-4459 (2004); CAL. VEH. CODE § 11713.3(t) (West Supp. 2009); DEL. CODE ANN. tit. 6, §§ 4910(c)–(d), 4914(a) (2005); GA. CODE ANN. § 10-1-663.1 (2009); IDAHO CODE ANN. § 49-1613(6) (2008); 815 ILL. COMP. STAT. ANN. 710/7 (West 2008); IND. CODE ANN. § 9-23-3-22(c) (LexisNexis Supp. 2009); IOWA CODE ANN. § 322A.12(2) (West 2005); KAN. STAT. ANN. § 8-2416(e) (2001); LA. REV. STAT. ANN. § 32:1267(B) (2002 & Supp. 2009); ME. REV. STAT. ANN. tit. 10, §§ 1441, 1174(3)(I), 1177 (2009); MASS. ANN. LAWS ch. 93B, § 10(a) (LexisNexis 2005); MINN. STAT. ANN. § 80E.13(j) (West 2009); MISS. CODE ANN. § 63-17-109(1), (2) (2004 & Supp. 2009); MO. REV. STAT. § 407.825(7)(c) (2000 & Supp. 2008); MONT. CODE ANN. § 61-4-141(1) (2009); NEV. REV. STAT. § 482.36419 (2009); N.H. REV. STAT. ANN. § 357-C:3(III)(n) (LexisNexis 2002 & Supp. 2009); N.J. STAT. ANN. §§ 56:10-13.6, -13.7 (West 2001); N.M. STAT. §§ 57-16-5(U), 57-16-8 (2005); N.Y. VEH. & TRAF. LAW § 466(1) (McKinney 1996 & Supp. 2009); N.C. GEN. STAT. ANN. § 20-305(18) (2007 & Supp. 2009); OKLA. STAT. ANN. tit. 47, § 565(B) (West 2000 & Supp. 2009); OR. REV. STAT. ANN. § 650.162(5) (West 2003); 63 PA. CONS. STAT. ANN. § 818.16 (West Supp. 2009); R.I. GEN. LAWS § 31-5.1-7 (2002); S.C. CODE ANN. § 56-15-70 (2006); S.D. CODIFIED LAWS § 32-6B-84 (Supp. 2009); VA. CODE ANN. §§ 46.2-1569.1, 46.2-1977 (2005); WASH. REV. CODE § 46.96.220 (Supp. 2009); W. VA. CODE § 17A-6A-10(2)(q) (2009); WIS. STAT. ANN. §§ 218.0114(9)(a)(4), (9)(d), 218.0116(1)(u) (West 2009); WYO. STAT. ANN. § 31-16-108(g) (2009).

61. Manufacturers are prohibited from directly owning and operating dealerships with certain exceptions. *See* discussion *supra* note 31. A common exception is to allow a manufacturer to temporarily own a dealership, usually for a period between one year and twenty-four months, while the manufacturer searches for another purchaser. *See, e.g.*, ALA. CODE § 8-20-4(3)(s)(1) (Lexis Nexis 2002) (allowing temporary ownership for up to twenty-four months); GA. CODE ANN. § 10-1-664.1(a)(1) (2009) (allowing temporary ownership for no more than twelve months); W. VA. CODE § 17A-6A-10(2)(i)–(k) (2009) (allowing temporary ownership for twelve months and possible entension to twenty-four months). Some manufacturers have been able to use these provisions to further diversity goals and install minority candidates as operators, eventually permitting them to buy out the manufacturer's dealership interest. *See, e.g.*, Frost v. Chrysler Motors Corp., 826 F.Supp. 1290, 1292 (W.D. Okla. 1993) (describing Chrysler's Minority Dealer Development Program); Rabbani v. General Motors Corp., No. 3:98cv425/RV, slip op. at 2-3, 7 (N.D. Fla. July 26, 2000) (describing General Motors' Minority Dealer Development Program and rejecting challenge under 42 U.S.C. § 1981).

62. Bob Zimmerman Ford, Inc. v. Midwest Auto. I, L.L.C., 679 N.W.2d 606, 611 (Iowa 2004); Bayview Buick-GMC Truck, Inc. v. General Motors Corp., 597 So.2d 887, 890 (Fla. Dist. Ct. App. 1992).

withholding consent to the sale of the dealership, the manufacturer cannot frustrate the sale by exercising a contractual right of first refusal.[63]

Other states have restricted the contractual rights of first refusal by prohibiting manufacturers from exercising this right when the sale is to certain protected parties such as the spouse or child of the dealer-principal or executive management of the dealership.[64] Some states also specify conditions under which the manufacturer may exercise the right of first refusal, ensuring that the seller receives the same or greater consideration as under the original sale agreement and permitting the would-be purchaser to recover from the manufacturer the reasonable expenses incurred to negotiate the sale.[65] Other states also address site control issues because the dealer corporation is often the entity that is the party to the dealer agreement with the right of first refusal but is not the owner of the dealership real estate.[66] These states permit manufacturers to acquire the same interest in the dealership real estate as the dealer entity.[67]

4. Warranty

In addition to dealer network decisions, state dealer acts also address day-to-day service operations such as warranty repair work.[68] As the warrantor of new vehicles, manufacturers have repair and replacement obligations, but, under most state laws, they are not permitted to directly service the vehicles and instead must use dealers.[69] Dealer agreements generally incorporate by reference policies and schedules which outline how dealers are reimbursed for both parts and labor used in performing warranty work.[70] For parts, manufacturers have historically paid a pre-determined

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63. *Bob Zimmerman Ford, Inc.*, 679 N.W.2d at 611; *Bayview Buick-GMC Truck, Inc.*, 597 So.2d at 890.

64. For example, in California, the manufacturer may not exercise the right of first refusal if the sale is to a:

> [F]amily member of an owner of the franchised business, nor a managerial employee of the franchisee owning 15 percent or more of the franchised business, nor a corporation, partnership, or other legal entity owned by the existing owners of the franchised business. For purposes of this paragraph, a "family member" means the spouse of an owner of the franchised business, the child, grandchild, brother, sister, or parent of an owner, or a spouse of one of those family members.

CAL. VEH. CODE § 11713.3(t)(4) (West 2000).

65. *See, e.g.*, GA. CODE ANN. § 10-1-663.1(5) (2009).

66. *See, e.g.*, 63 PA. CONS. STAT. ANN. § 818.16(2)(i) (West Supp. 2009).

67. *See, e.g.*, *id.*

68. *See* Forehand & Forehand, *supra* note 3, at 1083 & n.104 (describing the warranty reimbursement process and providing the governing Florida statute).

69. *See, e.g.*, ALA. CODE § 8-20-4(3)(s) (LexisNexis 2002).

70. *See, e.g.*, Tom Rice Buick-Pontiac v. General Motors Corp., 551 F.3d 149, 152 n.1 (2d Cir. 2008) (describing the warranty reimbursement provisions of General Motors' dealer agreement).

mark-up over the dealer cost for the parts.[71] For labor, manufacturers have generally chosen to pay dealers at their retail labor rate; however, the amount of time for each repair is determined by a manual that the manufacturer designates or compiles.[72]

State legislatures have stepped in and many state dealer acts require manufacturers to reimburse dealers for warranty work at the prices and rates charged by dealers to their retail customers.[73] The comparator population is often undefined, leading to litigation over who constitutes the customers that will set the manufacturers' prices, how those prices are calculated, and whether the dealer or manufacturer bears the burden of proving the prices.[74] In other states such as New

71. *See, e.g.*, *id.* at 152 (describing General Motors' practice of reimbursing dealers at 140% of dealer cost); Marler Ford Co. v. Ford Motor Co., 885 So.2d 654, 659 (La. Ct. App. 2004) ("For parts used in warranty repairs, Ford pays dealers a 40% mark-up above dealer cost.").

72. *See, e.g.*, General Motors Corp. v. Darling's, 444 F.3d 98, 101 (1st Cir. 2006) ("GM reimburses its North American dealers based on . . . the dealers' established hourly rates for labor, multiplied by GM's labor time guidelines, which provide the number of labor hours allotted for a specific repair."); *Marler*, 885 So.2d at 660 (describing Ford warranty labor reimbursement policies).

73. *See, e.g.*, ALA. CODE §§ 8-20-7(b), 32-17-1 (LexisNexis 2002); ARIZ. REV. STAT. ANN. § 28-4451(C), (E) (2004); ARK. CODE ANN. §§ 23-112-308(a)(18)(A), -313(a), (b) (2004 & Supp. 2009); CAL. VEH. CODE § 3065(a) (West 2000); COLO. REV. STAT. § 12-6-114 (2009); CONN. GEN. STAT. ANN. § 42-133s(a)–(c) (West 2004); DEL. CODE ANN. tit. 6, § 4903(a)–(b) (2005); FLA. STAT. ANN. § 320.696(1)(a) (West 2005 & Supp. 2009); GA. CODE ANN. § 10-1-641(a)(1)(B), (a)(2) (2009); HAW. REV. STAT. § 437-28(a)(21)(G) (1993 & Supp. 2003); IDAHO CODE ANN. § 49-1626(1)–(2) (2008); 815 ILL. COMP. STAT. ANN. 710/6(a)–(b) (West 2008 & Supp. 2009); IND. CODE ANN. § 9-23-3-14(b) (LexisNexis 1999 & Supp. 2009); KY. REV. STAT. ANN. § 190.046(1) (LexisNexis 1997 & Supp. 2009); LA. REV. STAT. ANN. § 32:1262(A)(1)–(2) (2002 & Supp. 2009); ME. REV. STAT. ANN. tit. 10, § 1176 (2009); MASS. ANN. LAWS ch. 93B, § 9(b) (LexisNexis 2005); MINN. STAT. ANN. § 80E.04(1)–(2) (West 2009); MISS. CODE ANN. § 63-17-85(j) (2004); MO. REV. STAT. §§ 407.828(1)–(2), .1338(1)–(2) (Supp. 2008); MONT. CODE ANN. § 61-4-204(4) (2009); NEB. REV. STAT § 60-1438(1)–(2) (2004); NEV. REV. STAT. § 597.680 (2007); N.H. REV. STAT. ANN. § 357-C:5(I), (II)(b)(1) (LexisNexis 2008); N.J. STAT. ANN. § 56:10-15(a) (West 2001); N.M. STAT. § 57-16-7(A) (1996 & Supp. 2009); N.Y. VEH. & TRAF. LAW § 465(1) (McKinney 1996 & Supp. 2009); N. C. GEN. STAT. ANN. § 20-305.1(a)–(b) (2007 & Supp. 2009); OHIO REV. CODE ANN. § 4517.52 (LexisNexis 2003); OKLA. STAT. ANN. tit. 47, § 565(A)(9)(b) (West 2000 & Supp. 2009); OR. REV. STAT. ANN. § 650.158(1)(a), (2) (West 2002); 63 PA. CONS. STAT. ANN. § 818.9(b) (West Supp. 2009); R.I. GEN. LAWS § 31-5.1-6(a) (2002); S.C. CODE ANN. § 56-15-60(A) (2000); S.D. CODIFIED LAWS §§ 32-6B-58, 32-6B-61 (2004 & Supp. 2009); TEX. OCC. CODE ANN. § 2301.402(a)–(b) (Vernon 2004); UTAH CODE ANN. § 13-14-204(3)(a)–(b) (2009); VT. STAT. ANN. tit. 9, § 4086(a)–(b) (2004 & Supp. 2009); VA. CODE ANN. §§ 46.2-1571(A)(1), 46.2-1979(A)(1) (2005 & Supp. 2009); WASH. REV. CODE § 46.96.105(1) (2001 & Supp. 2009); W. VA. CODE § 17A-6A-13(1)–(2) (2009); WIS. STAT. ANN. § 218.0125(2) (West 2009); WIS. ADMIN. CODE TRANS. § 139.06(8)(a) (2009); WYO. STAT. ANN. § 31-16-117(a)–(b) (2009).

74. *See, e.g.*, *Tom Rice Buick-Pontiac,* 551 F.3d at 159 (holding that under New York law, dealers are required to submit claims for additional reimbursement under statute prior to filing lawsuit); Jim White Agency Co. v. Nissan Motor Corp., 126 F.3d 832, 836 (6th Cir. 1997) (noting that dealer has burden of submitting claim showing what it charged to retail customers); Aspen Ford v. Ford Motor Co., 2006 WL 842397, *7 (E.D.N.Y. Mar. 28, 2006) (concluding that Ford dealers should have submitted claim under Ford's warranty reimbursement procedures before filing lawsuit).

Jersey, New York, Maine and Florida, the "retail" customer is defined in detail and generally excludes any customer that obtains a discounted price for services.[75]

Although these warranty reimbursement provisions raise the cost of doing business in the state, manufacturers have been precluded by many state dealer acts from recovering that cost through higher prices for vehicles and parts or lower incentive and bonus payments to dealers in the state.[76] In 2003, Maine was the first state to pass a cost recovery ban.[77] Other states have followed suit including Virginia, West Virginia and Florida.[78]

75. These states generally provide a procedure for the dealer to prove its average retail markup for parts through the submission of repair orders over a certain period of time. *See e.g.*, N.Y. VEH. & TRAF. LAW § 465 (McKinney 1996) ("For purposes of this section, the price and rate charged by the franchised motor vehicle dealer for parts may be established by submitting to the franchisor one hundred sequential nonwarranty customer-paid service repair orders or the number of sequential nonwarranty customer-paid service repair orders written within a ninety day period, whichever is less, covering repairs made no more than one hundred eighty days before the submission, and declaring the price and rate, including average markup for the franchised motor vehicle dealer as its reimbursement rate."). Certain types of repair orders, however, are excluded from the analysis. These exclusions generally include those services that are discounted by the dealers. *See, e.g.*, N.J. STAT. ANN. § 56:10-15(d) (West 2001) ("Only retail sales not involving warranty repairs, parts covered by subsection e. of this section, or parts supplied for routine vehicle maintenance, shall be considered in calculating average percentage markup."); ME. REV. STAT. ANN. tit. 10 § 1176 (Supp. 2008) ("Only retail sales not involving warranty repairs, not involving state inspection, not involving routine maintenance such as changing the oil and oil filter and not involving accessories may be considered in calculating the average percentage markup."); FLA. STAT. ANN. § 320.696(3)(b) (West Supp. 2009) ("In calculating the compensation to be paid for parts by the arithmetical mean percentage markup over dealer cost method in paragraph (a), parts discounted by a dealer for repairs made in group, fleet, insurance, or other third-party payer service work; parts used in repairs of government agencies' repairs for which volume discounts have been negotiated; parts used in special event, specials, or promotional discounts for retail customer repairs; parts sold at wholesale; parts used for internal repairs; engine assemblies and transmission assemblies; parts used in retail customer repairs for routine maintenance, such as fluids, filters and belts; nuts, bolts, fasteners, and similar items that do not have an individual part number; and tires shall be excluded in determining the percentage markup over dealer cost.")

76. Incentive and bonus payments are also regulated. For example, in Florida, the manufacturer must offer bonuses, incentives and other benefits to Florida dealers which manufacturer offer "nationally" or in the manufacturer defined zone or region in which Florida is included. FLA. STAT. ANN. § 320.64(10)(c) (West 2009). In addition to the cost recovery ban, this provision prevents manufacturers from recouping higher warranty costs through reductions of incentives and other bonus payments to Florida dealers.

77. The Alliance of Automobile Manufacturers challenged Maine's cost recovery ban as a violation of the dormant Commerce Clause. That challenge was rejected by the First Circuit Court of Appeals in 2005. *See* Alliance of Auto. Mfrs. v. Gwadosky, 430 F.3d 30, 43 (1st Cir. 2005).

78. VA. CODE ANN. § 46.2-1571(B)(5) (2005 & Supp. 2009); W. VA. CODE § 17A-6A-8a(3) (2009); FLA. STAT. ANN. § 320.696(1)(a) (West 2003 & Supp. 2009).

5. Allocation

State dealer acts also address the distribution of new vehicles to dealers within the state, prohibiting manufacturers from forcing dealers to purchase unwanted products while at the same time ensuring that manufacturers are not discriminating among dealers in allocating desired vehicles.[79] Most manufacturers use a predetermined formula to allocate vehicles based on the number of actual or projected sales by each dealer.[80] Some states have gone even further in restricting allocation.[81] In 2008, Florida passed a requirement that manufacturers ensure each dealer is offered an "equitable supply" of new vehicles by model, mix or colors.[82] The term "equitable supply" is not defined in the statute and raises additional questions such as whether a dealer would be compared only to other Florida dealers to determine whether the dealer has been provided an equitable supply. It is also unclear whether the size of a dealership or its sales numbers may be taken into

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79. ALA. CODE § 8-20-4(1)(a), (c), (3)(a), (c) (LexisNexis 2002); ARIZ. REV. STAT. ANN. § 28-4458(E) (2004); ARK. CODE ANN. § 23-112-403(a)(2)(A) (2004 & Supp. 2009); CAL. VEH. CODE § 11713.3(a), (u)(1)(A) (West 2000 & Supp. 2009; COLO. REV. STAT. §§ 12-6-118(2)(g), -120(1)(e), (j)(I) (2009); CONN. GEN. STAT. ANN. §§ 42-133cc(1)(A), -133v(f)(4) (West 2004); DEL. CODE ANN. tit. 6, § 4913(b)(1) (2005); FLA. STAT. ANN. § 320.64(18)–(19), (22) (West 2003); GA. CODE ANN. § 10-1-662 (a)(1), (11) (2009); HAW. REV. STAT. § 437-28(a)(21)(D) (1993 & Supp. 2008); IDAHO CODE ANN. § 49-1613(3)(a) (2008); 815 ILL. COMP. STAT. ANN. 710/4(d)(1), (3), (4) (West 2008); KAN. STAT. ANN. § 8-2410(a)(15) (2001 & Supp. 2008); KY. REV. STAT. ANN. § 190.070(2)(a), (3)(c) (LexisNexis 1997 & Supp. 2008); LA. REV. STAT. ANN. § 32:1261(1)(b), (g) (2002 & Supp. 2009); ME. REV. STAT. ANN. tit. 10, § 1174(3)(A) (2009); MD. CODE ANN., TRANSP. § 15-208(a)–(c) (LexisNexis 2009); MASS. ANN. LAWS ch. 93B, § 4(c)(1), (3) (LexisNexis 2005 & Supp. 2009); MICH. COMP. LAWS ANN. § 445.1574(1)(a), (c) (West 2002); MINN. STAT. ANN. § 80E.13(a) (West 2009); MISS. CODE ANN. §§ 63-17-73(1)(d)(1), 61-17-115 (2004 & Supp. 2009); MO. REV. STAT. § 407.825(3) (2000 & Supp. 2008); MONT. CODE ANN. § 61-4-208 (1)(a)(vi)(B) (2009); NEB. REV. STAT. § 60-1437(1) (2004); NEV. REV. STAT. §§ 482.36388, .36395(2) (2007); N.H. REV. STAT. ANN. § 357-C:3(III)(a) (LexisNexis 2008 & Supp. 2009); N.J. STAT. ANN. § 56:10-7.4(h) (West 2001); N.M. STAT. § 57-16-5(D) (1996 & Supp. 2009); N.Y. VEH. & TRAF. LAW § 463(2)(a), (w) (McKinney 1996 & Supp. 2009); N.C. GEN. STAT. ANN. § 20-305(14), (36) (2007 & Supp. 2009); OHIO REV. CODE ANN. § 4517.59(F) (LexisNexis 2003); OKLA. STAT. ANN. tit. 47, § 565(A)(8)(b), (9)(c), (10) (West 2000 & Supp. 2009); OR. REV. STAT. ANN. § 650.130(3), (10) (West 2003); 63 PA. CONS. STAT. ANN. § 818.12(b)(1), (12) (West Supp. 2009); R.I. GEN. LAWS § 31-5.1-4(c)(1)(i) (2002 & Supp. 2009); S.C. CODE ANN. § 56-15-40(3)(a) (2006); TENN. CODE ANN. § 55-17-114(c)(1) (2008); TEX. OCC. CODE ANN. § 2301.452 (Vernon 2004); UTAH CODE ANN. § 13-14-201(1)(i), (m), (x) (2009); VT. STAT. ANN. tit. 9, § 4097(1) (2004 & Supp. 2009); VA. CODE ANN. § 46.2-1569(7) (2005); WASH. REV. CODE §§ 46.70.180(14)(e), 46.96.185(1)(d), (e) (2001 & Supp. 2009); W. VA. CODE § 17A-6A-10(2)(a) (2009); WIS. STAT. ANN. §§ 218.0116(1)(v), 218.0123 (West 2009); WYO. STAT. ANN. § 31-16-108(c)(i) (2009).

80. *See, e.g.*, George Lussier Enters., Inc. v. Subaru of New England, Inc., 286 F. Supp. 2d 86, 90-91 (D.N.H. 2003) (describing Subaru's allocation formula); Coady Corp. v. Toyota Motor Distrib., 346 F. Supp. 2d 225, 230 (D. Mass. 2003) (describing Toyota's allocation system).

81. *See, e.g.*, FLA. STAT. ANN. § 320.64(18)–(19), (22) (West 2003).

82. *Id.* § 320.64(18).

account. Is every dealer entitled to receive the exact same number of vehicles in each model and in each color, regardless of the supply of vehicles or the supply requirements of individual dealer? These questions remain unanswered at this time.

6. Forum and Applicable Law

Not only is virtually every aspect of the manufacturer-dealer relationship regulated, but in many states, special forums—usually administrative agencies or boards—have been set up to hear these manufacturer-dealer disputes and consider violations of the state dealer act.[83] These dealer boards are in addition to state and federal courts, which generally have concurrent jurisdiction.[84] But at least one state requires that the dealer board action proceed before any litigation in the state or federal courts by mandating a stay of any other proceeding if the dealer elects to file a protest with the board.[85] These administrative boards are often comprised of dealers and manufacturer representatives.[86]

Manufacturers have sometimes successfully challenged the composition of these boards on due process grounds to the extent that they are comprised of dealers or primarily of dealers.[87] The Supreme Court has explained that a tribunal is constitutionally infirm if its members have a pecuniary interest in the outcome of the

83. *See e.g.*, ARK. CODE ANN. § 23-112-201(a) (2004); CAL. VEH. CODE § 3050(c) (West 2000); CONN. GEN. STAT. ANN. § 14-8(b) (West 2004); FLA. STAT. ANN. § 320.699 (West 2005); GA. CODE ANN. § 10-1-667 (2009); 815 ILL. COMP. STAT. ANN. 710/12(a) (West 2009); IOWA CODE ANN. § 322A.17 (West 2005); KAN. STAT. ANN. § 8-2414(b), (d) (2001); KY. REV. STAT. ANN. § 190.058 (LexisNexis 1997 & Supp. 2009); LA. REV. STAT. ANN. § 32:1253 (2002 & Supp. 2009); ME. REV. STAT. ANN. tit. 10, § 1188 (2009); MD. CODE ANN., TRANSP. § 12-104(a)–(b) (LexisNexis 2009); MISS. CODE ANN. § 63-17-91 (2000); MO. REV. STAT. § 407.822(3) (2000 & SUPP. 2008); MONT. CODE ANN. § 61-4-206(2) (2009); N.H. REV. STAT. ANN. § 357-C:12(I) (LexisNexis 2008 & Supp. 2009); N.J. STAT. ANN. § 56:10-19 (West 2001); N.M. STAT. § 66-2-17(C)–(G) (2005); N.C. GEN. STAT. ANN. § 20-301(b) (2007 & Supp. 2009); OHIO REV. CODE ANN. § 4517.57 (LexisNexis 2003); OKLA. ADMIN. CODE § 465:1-7-2(c) (2009); OKLA. STAT. ANN. tit. 47, § 565.2(D) (West 2000 & Supp. 2009); 63 PA. CONS. STAT. ANN. § 818.4(a)(3) (West Supp. 2009); 01-100-041 R.I. CODE R. § III (Weil 2008); TENN. CODE ANN. § 55-17-114(c) (2008 & Supp. 2009); TEX. OCC. CODE ANN. § 2301.151 (Vernon 2004); UTAH CODE ANN. § 13-14-107 (2005 & Supp. 2009)); VA. CODE ANN. § 46.2-1504 (2005 & Supp. 2009); WASH. REV. CODE §§ 46.96.040, .150(1) (2001 & Supp. 2009); W. VA. CODE R. § 91-1-3.9.3 (2009); WYO. STAT. ANN. §§ 31-16-109(e)–(h), -111(a) (2009).

84. *See, e.g.*, Forehand & Forehand, *supra* note 3, at 1066 (describing jurisdiction of Florida Department of Motor Vehicles and private right of action for any person injured by violation of statute).

85. ME. REV. STAT. ANN. tit. 10, § 1190-A (2009).

86. In addition, under the 2002 amendment to the federal Automobile Dealer's Day in Court Act, manufacturers are precluded from enforcing arbitration provisions in dealer agreements entered into after November 1, 2002. *See supra* note 19 and accompanying text.

87. *See infra* note 89.

litigation.[88] Because dealer boards construe and apply state dealer acts that apply to all dealers and their decisions affect dealer-manufacturer relationships within the state, some courts have held that dealers on these boards have a pecuniary interest in the outcome and have required a reconfiguration of the board or the creation of a special non-dealer board to handle dealer-manufacturer disputes.[89] However, some board challenges have been rejected.[90]

Not only do state dealer acts govern the forum for resolving manufacturer-dealer disputes, they also often dictate the law that is applied.[91] Despite choice of law provisions in many dealer agreements, requiring the law of the state where the manufacturer is headquartered to apply, state dealer acts often make it illegal to include or enforce those contractual choice of law provisions.[92] Under these statutes, even if the contract is construed under the choice of law provision, the dealers located

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88. *See* Gibson v. Berryhill, 411 U.S. 564, 578 (1973) (optometry board did not constitute an impartial tribunal for adjudicating charges against other optometrists where result of adjudication could "possibly redound to the personal benefit" of board members in the form of increased business).

89. *See, e.g.*, Yamaha Motor Corp., U.S.A. v. Riney, 21 F.3d 793, 798 (8th Cir. 1994) (bias of a single member rendered Arkansas Motor Vehicle Commission incompetent to decide dispute between motorcycle dealer and manufacturer); Jaguar Cars v. Cottrell, 896 F. Supp. 691, 694 (E.D. Ky. 1995) (finding new car dealers have a "pecuniary stake" in termination cases and recognizing that termination affects "very livelihoods" of dealers); Nissan Motor Corp. v. Royal Nissan, Inc., 757 F. Supp. 736, 740 (E.D. La. 1991) (enjoining Louisiana commission from adjudicating dispute between Nissan and two dealers on grounds that indirect and institutional financial interest raised a question as to the impartiality of dealer commissioners); American Motor Sales Corp. v. New Motor Vehicle Bd., 138 Cal. Rptr. 594, 599 (Cal. Ct. App. 1977) (motor vehicle dealer members of board charged with adjudicating termination disputes had "a 'substantial pecuniary interest' in franchise termination cases," rendering them biased for constitutional purposes) (citation omitted); General Motors Corp. v. Stan Olsen Pontiac GMC-Trucks, Inc., 2003 WL 23921745, at *4 (Neb. Dist. Ct. Dec. 9, 2003) ("As noted above, the Board, by its very composition, is a board of dealers, and by any fair analysis, cannot be deemed to be an impartial fact finding body."); *see generally* New Motor Vehicle Bd. of Cal. v. Orrin W. Fox Co., 439 U.S. 96, 107-08 (1978) ("California Legislature had the authority to protect the conflicting rights of the motor vehicle franchisees . . . by providing existing dealers with notice and an opportunity to be heard by an impartial tribunal….").

90. *See* Alliance of Auto. Mfrs. v. Gwadosky, 353 F. Supp. 2d 97, 99, 101-03 (D. Me. 2005) (rejecting facial challenge to make-up of Maine Motor Vehicle Franchise Board).

91. *See infra* note 92.

92. *See, e.g.*, ALASKA STAT. § 45.25.020 (2008); COLO. REV. STAT. § 12-6-122.5 (2009); DEL. CODE ANN. tit. 6, § 4917 (2005); FLA. STAT. ANN. § 320.64(31) (West 2005); GA. CODE ANN. § 10-1-624 (2009); IDAHO CODE ANN. § 49-1632 (2008); LA. REV. STAT. ANN. § 32:1269 (2002 & Supp. 2009); MASS. ANN. LAWS ch. 93B, § 15(e) (LexisNexis 2005); MICH. COMP. LAWS ANN. § 445.1573(h) (West 2002); N.Y. VEH. & TRAF. LAW § 463(2)(t) (McKinney 1996 & Supp. 2009); N.C. GEN. STAT. ANN. § 20-308.2 (2007); W. VA. CODE R. §§ 17A-6A-2, 17A-6A-18 (2009); WYO. STAT. ANN. § 31-16-124 (2009).

in the state will fall under the protection of the state dealer act, and generally the state dealer act will override the provisions of the dealer agreement.[93]

III. THE AUTOMOBILE MANUFACTURER-DEALER RELATIONSHIP

Virtually every aspect of the manufacturer-dealer relationship—from the purchase of the dealership to termination—is now regulated by the state dealer acts and, to a lesser extent, ADDICA. The supposed unfair bargaining power that manufacturers have over dealers has spawned the proliferation of these regulations.[94] Despite these claims, economists have failed to find substantial evidence of opportunistic behavior by manufacturers in the United States before or after the wave of pro-dealer legislation in the 1950s.[95] Instead of solving the problem of unwarranted manufacturer power over dealers, this uneven patchwork of varying state regulations has created perverse incentives, leading to an over-dealered, inefficient market that, at the end of the day, is detrimental to dealers, manufacturers and consumers alike.

In this Part, I will first review and analyze from an economic perspective why franchising has arisen as a business model as opposed to, or in some cases, in conjunction with, vertical integration. I will also consider what incentives are required to make the relationship work and how parties to the franchise relationship have been able to negotiate the terms of the relationship. Second, this Part will examine how the state dealer acts have reduced the efficiency of franchising as a model to distribute vehicles and created adverse incentives resulting in an over-dealered, inefficient market. Third, this Part will explore some practical business impediments created by these statutes.

A. *Why Franchising?*

Absent statutes prohibiting direct sales to customers, manufacturers and franchisors have the option of vertically integrating.[96] The business owner can choose to invest in her business and open more outlets to sell her products, hopefully increasing profits at the same time. But capital is required, and the business owner

93. *See* sources cited *supra* note 92.

94. *See* Forehand & Forehand, *supra* note 3, at 1063-64.

95. *See* Smith, *supra* note 28, at 154 ("The analysis suggests that state regulation of manufacturer-dealer relations in automobile franchising has tended to strengthen the locational market power of dealers and to deprive manufacturers of feasible means of disciplining dealers.").

96. Automotive dealers are generally not considered franchises because dealers do not have to pay a franchise fee or royalties to the manufacturer, but they possess similar economic attributes to franchisees such that the literature examining franchising should apply. *See supra* text accompanying note 11.

must increasingly rely on managers to operate these additional outlets.[97] Unlike the business owner, these managers as employees of the enterprise may not have the motivation to invest the time and effort needed to expand the business.

Franchising can solve some of these problems. Franchisees are local entrepreneurs who are required to make significant investments in their businesses and facilities, which in turn provide the motivation to make their businesses succeed.[98] They are also knowledgeable about their communities and can use that knowledge about the local markets to target and sell products and services to consumers more effectively than out-of-state franchisors and manufacturers.[99] Franchisors benefit from this local presence and can focus on improving product quality, reducing the cost of manufacturing, improving their business model and increasing the value of their trademarks in general.[100] This efficient distribution of roles benefits everyone involved.

Yet, the franchisor and franchisee will often have differing and sometimes contradictory incentives. Franchisees have an incentive to reduce quality and increase prices to maximize their own profits, rather than concern themselves with the quality and profits of the franchisor or even the franchise system as a whole.[101] A franchisee that skimps on service or quality products not only alienates customers for the particular location but from the franchise system as a whole as customers expect products and services to be uniform across the system.[102] Every McDonald's is expected to serve the same Big Mac; every Molly Maid franchisee is expected to provide the same type of service. But because the individual franchisee does not bear the cost of reduced sales at other locations, the franchisee may not take that into account as it seeks to maximize its profits.[103]

Because franchisors must give up directly running local stores, they must put sufficient controls in place to maintain quality of service and facilities so the brand is not diminished by individual franchisees seeking to maximize the individual franchisee's profits.[104] Historically in the United States, and in many other countries

97. *See* Roger D. Blair & Francine LaFontaine, *Understanding the Economics of Franchising and the Laws That Regulate It*, 26 FRANCHISE L.J. 55, 55 (2006) ("Of course, franchisees also have alternatives. They can start independent businesses, or they can be employee managers.") [hereinafter Blair & LaFontaine I].

98. Blair and LaFontaine have identified this "shirking or moral hazard problem" as a reason for franchising in the first place. ROGER D. BLAIR & FRANCINE LAFONTAINE, THE ECONOMICS OF FRANCHISING 133 (2005) [hereinafter BLAIR & LAFONTAINE II].

99. *See* Blair & LaFontaine I, *supra* note 97, at 55 (lauding "the independent entrepreneur's drive and knowledge of the local market").

100. *Id.* (recognizing the franchisor's "comparative advantages in creating brand recognition and capturing economies of scale in production, product development, and advertising").

101. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 133.

102. *Id.* at 268.

103. *Id.*

104. *See* Smith, *supra* note 28, at 126-27 (describing economics of franchise system).

today, these controls are spelled out in the franchise agreements and in the policies and manuals incorporated into the agreements.[105] Ray Kroc, the founder of McDonald's, developed and revolutionized such quality control procedures with his QSV&C program (Quality, Service, Value, and Cleanliness).[106]

The franchise or dealer agreement is generally a form contract.[107] That is often-cited evidence for the unfair treatment of franchisees—that the agreement is a take-it-or-leave-it contract of adhesion.[108] But economists view the franchise agreement as permitting negotiation of efficient contract terms between the parties because less sophisticated franchisees may dovetail on more powerful franchisees and benefit from the form contracts they negotiate.[109] Some of these more powerful franchisees own multiple units in the same system.[110] The power of the franchisees is enhanced even further through franchisee associations that often negotiate the terms of these contracts on behalf of large groups of franchisees.[111] Or in some cases, the franchisee association will challenge the terms through litigation.[112] Within the automobile industry, the large manufacturers, such as Ford, General Motors, Chrysler and Toyota, have strong dealer councils that they regularly work with on issues affecting dealers across the country, and often policies are changed only after consent by the respective dealer council.[113]

Franchisors also face franchisee concerns about geographical encroachment.[114] Again, the reason for this concern is the different incentives of franchisors and

105. *See* Joellen Riley, *Regulating Unequal Work Relationships for Fairness and Efficiency: A Study of Business Format Franchising*, *in* LABOUR LAW AND LABOUR MARKET REGULATION: ESSAYS ON THE CONSTRUCTION, CONSTITUTION AND REGULATION OF LABOUR MARKETS AND WORK RELATIONSHIPS 564-65 (Christopher Arup et al. eds., 2006) (describing McDonald's franchise operations in Australia).

106. William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 25 (2008).

107. James A. Brickley, Sanjog Misra & R. Lawrence Van Horn, *Contract Duration: Evidence from Franchising*, 49 J.L. & ECON. 173, 173 (2006) [hereinafter Brickley et al. I] (describing these contracts, which are often offered on a "take–it-or-leave-it basis").

108. *See id.*

109. *See id.* at 193-94; *see also* Killion, *supra* note 106, at 30.

110. Killion, *supra* note 106, at 30 (quoting BLAIR & LAFONTAINE II, supra note 98, at 50).

111. Andrew Selden, Lee Abrams & Rupert Barkoff, *Thirty Years of Franchising*, 27 FRANCHISE L.J. 85, 92 (2007).

112. *See, e.g.*, Indep. Ass'n of Mailbox Ctr. Owners, Inc. v. Superior Court, 34 Cal. Rptr.3d 659, 662 (Cal. Ct. App. 2005) (challenging franchisor's conversion of stores to new format).

113. *See, e.g.*, Coady Corp. v. Toyota Motor Distribs., 346 F. Supp. 2d 225, 244 (D. Mass. 2003) (referencing role of Toyota Dealer Council in representing dealers); Danvers Motor Co. v. Ford Motor Co., 186 F. Supp. 2d 530, 532 n.2 (D.N.J. 2002) ("The National Ford Dealer Council, elected by dealers nationwide, advises Ford as to matters of general interest and concern to the dealers.").

114. *See, e.g.*, Camp Creek Hospital Inns, Inc. v. Sheraton Franchise Corp., 139 F.3d 1396, 1403 (11th Cir. 1998) (claim of encroachment by franchisee); *see also* Blair & LaFontaine I, *supra*

franchisees.[115] The franchisor may have the incentive to maximize sales revenue by increasing the number of outlets to sell their products, perhaps above the optimal number.[116] In contrast, the franchisee has the incentive to maximize its profits at the particular location and may perceive that having less intra-brand competition within the area will increase individual franchisee profits.[117] If franchisees believe that they will not be protected from encroachment, it may be difficult to recruit new franchisees into the system.

To address these encroachment issues, the majority of franchisors offer territorial protection in their contracts.[118] Protection may include exclusive territories or a more flexible arrangement permitting the franchisor to establish additional outlets if the existing franchisees fail to meet a certain level of performance or if the franchisor can show that the impact to the existing franchisees would be minimal.[119]

Along with quality control procedures and territorial restrictions, manufacturers and franchisors must establish the right incentives to reward the performing franchisees and discipline the nonconforming franchisees. They can include: (1) bonuses, trips or other rewards for meeting sales, service, and customer satisfaction goals; (2) probationary and cure periods; (3) training programs; (4) counseling; (5) options to purchase/buy-outs; (6) refusals to award additional outlets to the nonconforming franchisee; (7) withholding of product or requiring dealers or franchisees to accept additional product;[120] and (8) termination.[121]

Termination—the equivalent of starting a nuclear war for the franchisee or dealer—is the event that could cause the greatest loss of economic rents and profits; therefore, it is the ultimate weapon with which to discipline a franchisee.[122] Professors Blair and LaFontaine, for example, have noted that the termination of a McDonald's franchise in 1982 would cost the average franchisee $600,000.[123] Because automobile dealerships are more capital intensive, termination would generally result in even greater losses. The threat and ability to follow through with termination is an effective tool for manufacturers to use to require conformity and weed out underperforming franchisees.

But do franchisors abuse the power to terminate? Economists have found that they do not.[124] Instead, termination and the threat of termination are generally used to

note 97, at 63-64 (describing franchisee concerns about encroachment).

115. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 214.

116. *See id.* at 214.

117. *Id.* at 210, 214.

118. *Id.* at 223.

119. *Id.* at 225, 227.

120. *See* Smith, *supra* note 28, at 137.

121. *Id.* at 129 (describing options for manufacturers to discipline dealers).

122. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 269.

123. *Id.* at 129.

124. *See id.* at 271.

enforce performance standards and reduce the number of poor performing outlets.[125] If franchisor opportunism were a problem, one would expect the targets of this opportunism to be the *best performing* outlets, which the franchisor could take over directly or sell to another potential franchisee. But this is simply not the case.[126]

In addition to little evidence of targeting the better performing franchisees for termination, the cost of termination often outweighs that benefit.[127] Franchisors simply have no incentive to terminate without due cause.[128] First, the franchisor would lose representation at the particular location, if the franchisor does not have the right to acquire possession or control over the site.[129] The location may be desirable, and, particularly in heavily populated urban markets, there may not be other suitable sites.[130] Second, abusing termination powers would deter the recruitment of new franchisees who may not want to make the significant investment of time and money into an enterprise that can too easily be taken away.[131] Third, the franchisor would lose the time and effort spent in placing, training and supporting the terminated franchisee and would need to start over again with a new franchisee or else take over the outlet itself.[132]

To counterbalance the potential abuse of termination powers, franchisors and franchisees have been able to negotiate and include "good cause" provisions in franchise agreements.[133] These provisions continue to allow franchisors to terminate the seriously underperforming or nonconforming franchisees while giving franchisees a measure of protection for their investment in the franchise.[134]

125. *Id.*

126. *Id.*

127. *See* Smith, *supra* note 28, at 130.

128. *Id.* at 129-30.

129. In the automobile industry, manufacturers have attempted to gain site control through contract, but in many states, site control agreements cannot be enforced. *See, e.g.*, Manhattan Motorcars, Inc. v. Automobili Lamborghini, 244 F.R.D. 204, 216 (S.D.N.Y. 2007) (setting out New York's restrictions on site control agreements).

130. *See id.* at 211 (describing efforts by a high-end automobile dealer to obtain exclusive territory in Long Island); Donna Harris, *Chrysler's Offer: More Franchises, Tough Rules*, AUTOMOTIVE NEWS, June 22, 2009, at 18, *available at* 2009 WLNR 12142193 (describing Chrysler's efforts to require 30 year site control agreement).

131. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 266-67 ("[F]ranchisees will be willing to invest more in their franchise…the lower the per-period probability of termination…. Conversely, the more franchisors want franchisees to invest, the more they will need to offer long-term contracts with high renewal probability and a low likelihood of termination.").

132. *See* James A. Brickley, Frederick H. Dark & Michael S. Weisbach, *The Economic Effects of Franchise Termination Laws*, 34 J.L. & ECON. 101, 113-14 (1991) [hereinafter Brickley et al. II] (concluding that franchise termination laws increase cost of franchising, resulting in franchisors taking over more franchises).

133. *See id.*

134. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 276 ("As a result, most – if not all – franchise agreements contain some provisions related to duration, termination, and non-renewal.").

In short, in examining incentives in franchise agreements, economists have found that parties to the agreements are able to rationally create incentives that take into account the risks and benefits of entering the relationship, setting up an efficient economic relationship, which is equivalent for the franchisor to vertical integration.[135] All other things being equal, when the economic profits from the franchise network are equal to the economic profits from a vertically integrated company, a manufacturer will turn to franchising. Franchisees are rational individuals, which over time have been able to adjust terms in contracts, even with franchisors that seem to have substantially more bargaining power.[136]

B. *State Dealer Acts and the Economics of the Manufacturer-Dealer Relationship*

The agreed upon incentives that govern the manufacturer-dealer relationship have been undone by a regulatory overlay, which varies in each state.[137] For franchises, franchise relationship laws, like the state dealer acts, govern when a franchisor may terminate, disapprove a transfer or fail to renew.[138] Yet, franchise relationship laws are not as prevalent as the state dealer acts with only sixteen states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands currently having such statutes.[139] But like state dealer acts, the franchise relationship laws were passed because of perceived opportunistic behavior by franchisors.[140]

The problem with these assumptions is that economists have not found that automobile manufacturers engaged in the opportunistic behavior that seemed to drive the passage of these statutes.[141] Would it be in the interest of the manufacturer to treat its dealers unfairly and terminate their relationships? No. As described by Professor Smith: "The manufacturer has sufficient incentives to establish the number and kind of dealerships that will promote the public interest. He has no incentive to treat existing dealers inequitably."[142] Even the *perception* that a manufacturer is unfair could lead to reduction of the value of the brand as a whole and the value of future

135. *See* Blair & LaFontaine I, *supra* note 97, at 64 ("Franchising and vertical integration are fundamentally substitute organizational forms for chains.").

136. Brickley et al. I, *supra* note 107, at 174.

137. Forehand & Forehand, *supra* note 3, at 1064 ("Today every state has some form of regulation, and the states regularly amend their statutes.").

138. *See* Brickley et al. II, *supra* note 132, at 112-13 (describing franchise relationship laws as they relate to terminations); Killion, *supra* note 106, at 27-28 (describing evolution of franchise relationship laws).

139. Robert B. Hughes, 1 Legal Compliance Checkups § 8:17 (2008).

140. *See* Crivelli v. Gen. Motors Corp., 215 F.3d 386, 390 (3d Cir. 2000).

141. *See* Smith, *supra* note 28, at 130.

142. *Id.* at 138; *see also id.* at 139 ("It is true that, under the original franchise provisions, appropriation of the dealer's investment by the manufacturer was possible, but such appropriation was extremely unlikely given the manufacturer's interest in maintaining an effective distribution network.").

and existing dealerships.[143] As a result, dealers would not continue to invest in dealerships and give poor service to customers, outcomes that manufacturers certainly do not want.[144] The fact that there was no shortage of dealer applicants before the passage of the state dealer acts supports that manufacturers were not acting opportunistically towards dealers; otherwise, it would be expected that would-be dealer applicants would be wary of investing in a dealership if it could be taken away on a whim.[145]

Since the enactment of ADDICA, there have also been significant changes in the size and resources available to dealers, further reducing the ability of manufacturers to behave opportunistically.[146] Dealers in the automobile industry have acquired more bargaining power through manufacturer-specific dealer associations.[147] Each of the Big Three automakers has dealer councils that are elected by dealers.[148] These dealer councils meet regularly with each automaker to discuss issues of importance for dealers in the network.[149] Often, the dealer councils present and approve changes to the dealer agreement or manufacturer policies before implementation across the country.[150]

In recent years, dealers themselves have become larger and more sophisticated.[151] An example is AutoNation, Inc., a publicly traded corporation,

143. *See id.* at 130.

144. *Id.*

145. *Id.* at 131.

146. *See* Killion, *supra* note 106, at 30 ("Although franchisees collectively have more bargaining power than their counterparts did in 1970, franchisors have no more economic power today than they did forty years ago."); Chiappa & Stoelting, *supra* note 20, at 220 ("First, dealers are sophisticated business persons managing complex business operations and are represented by counsel in their negotiations with manufacturers. Courts have uniformly rejected arguments by dealers that their purported lack of bargaining power vis-à-vis manufacturers warrants disregarding mandatory arbitration clauses.").

147. For example, Ford dealers can join the Ford Dealers' Alliance, which describes its goals as follows: "The aim of this association is not ***revolution***; it is ***resolution***. We are totally committed to resolve the injustices, burdens, and disadvantages that plague every Ford dealer in his relations with Ford Motor Company." Ford Dealers Alliance, http://www.dealersalliance.org/ (last visited Mar. 10, 2009).

148. *See supra* note 113 and accompanying text.

149. *See supra* note 113 and accompanying text.

150. *See supra* note 113 and accompanying text.

151. Publicly traded corporations that each own a large number of dealerships have developed in recent years. Donna Harris, *Big Public Retailers Brace for Tough 2009*, AUTOMOTIVE NEWS, Jan. 19, 2009, at 38, *available at* 2009 WLNR 1364089 (describing strategy of six largest dealer groups in United States); Donna Harris, *Five Public Retailers Post Lower Net Earnings in 1st Quarter*, AUTOMOTIVE NEWS, May 14, 2007, at 69, *available at* 2007 WLNR 9386042 (describing earnings of publicly traded dealer groups). Sophisticated and wealthy investors continue to look to these companies as providing opportunities. Jim Henry, *Tycoons Remain Cautiously Bullish on Auto Dealerships*, AUTOMOTIVE NEWS, Jan. 26, 2009, at 46, *available at* 2009 WLNR 1960392.

which, as of 2008, boasted ownership of 239 dealerships in 15 states, representing 37 different manufacturer brands.[152] In 2008, AutoNation dealerships sold $7.8 billion in new vehicles.[153] Multi-franchise dealers are also more common. With more dealerships, larger portfolios and more experience with a variety of manufacturers, these dealers and dealer groups are better positioned to negotiate terms with manufacturers than the smaller "mom and pop" dealers that were prevalent fifty years ago.[154] Smaller dealers can also benefit from the concessions gained by the larger dealers as manufacturer policies, procedures and contracts are generally the same throughout the country.[155]

What has been the economic effect of the state dealer acts? Economists have found that generally these laws have transferred wealth from manufacturers and consumers to dealers.[156] Specifically, these laws have stripped manufacturers of the ability to discipline and ultimately purge underperforming or nonconforming dealers, at least without significant time and cost.[157] These underperforming dealers are also free riders, taking advantage of the reputation that the trademarks bring and the work of other dealers in the network. By overriding the terms of the dealer agreement, state dealer acts create perverse incentives within the automobile manufacturer-dealer relationship, including increasing prices for goods and services and increasing the number of dealers over an optimal number over time.[158]

152. AutoNation, Driven To Be The Best – Investor Relations, Profile: A Speciality Retail Busniess, http://corp.autonation.com/investors/profile.asp (last visited Mar. 10, 2009).

153. *Id.*

154. *See* Chiappa & Stoelting, *supra* note 20, at 220.

155. *See* Killion, *supra* note 106, at 30 ("Although franchisees collectively have more bargaining power than their counterparts did in 1970, franchisors have no more economic power today than they did forty years ago.").

156. *See* Smith, *supra* note 28, at 154 ("The analysis suggests that state regulation of manufacturer-dealer relations in automobile franchising has tended to strengthen the locational market power of dealers and to deprive manufacturers of feasible means of disciplining dealers. The result has been a significant increase in vehicle prices—resulting in a large wealth transfer from consumers to dealers and a reduction in the volume of new-vehicle sales.").

157. *See* Brickley et al. II, *supra* note 132, at 130 (concluding that termination laws make franchising more expensive).

158. *See* Smith, *supra* note 28, at 150 ("To recapitulate, this analysis has demonstrated that state regulation has served effectively to entrench existing automobile dealers. They appear to be protected from entry of new dealerships, from discipline by the manufacturer, and from involuntary termination. The net effect is fewer dealerships and increased market power resulting in higher prices."). Although Professor Smith found fewer dealerships than optimal in 1982 given the barriers to entry, in the thirty years since then the number of dealers in the United States has grown incrementally, resulting in an overdealered market. *See* Daniel Duggan & Nancy Kaffer, *Detroit Dealers Buy Out Al Long Ford*, Automotive News, Dec. 22, 2008, at 1, *available at* 2008 WLNR 25067245 (reporting that in the United States there were 20,328 car dealerships as of Oct. 31, 2008, and that "[n]ationally, there need to be 3,800 fewer car dealerships in 2009 for dealers to make the same amount of money they made in 2007").

Economists have found that the inability to discipline or terminate dealers for below-quality service and poor sales has resulted in dealers increasing prices for vehicles and service work above market prices.[159] This results because the state dealer acts have created a near-monopoly power for dealers in the local market, and this increase in the market power of existing dealers permits them to increase prices.[160] Not only does this monopoly power increase the price of the vehicle but it incentivizes dealers to sell unneeded and unwanted equipment, contracts or services, such as etching, undercoating, and various insurance products.[161]

State dealer statutes that provide protection for dealers against encroachment also increase prices of new vehicles and reduce service for customers through reduced hours of operation and less convenient outlets or outlets of the wrong size.[162] Consumers are not the only ones that suffer when new entry is made more difficult. Manufacturers also make less profit and lose a way to incentivize existing dealers to perform better.[163] Dealer applicants find it difficult to enter the business.[164] The only constituency that benefits is existing dealers.[165]

From an economic standpoint, protection against new entry into the market increases prices by suppressing the supply of new vehicles to an area.[166] Assuming that there are an optimum number of dealers in a market, as demand increases the prices of new cars will be driven up in the area.[167] These price increases should be temporary, existing only until new dealers are added to the market, but state dealer acts preventing or at least making it difficult to relocate or add new dealers to a market causes these price increases to become more or less permanent.[168] That is because the time, money and effort that it takes for a manufacturer to relocate or add a new dealer to the market will deter manufacturers from making the attempt until it is fairly certain given the demand in the market that another dealer is needed and the

159. *See* Smith, *supra* note 28, at 150.

160. *See generally id.*at 139-50.

161. *Id.* at 151.

162. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 212; Smith, *supra* note 28, at 136.

163. *See* BLAIR & LAFONTAINE II, *supra* note 98, at 234.

164. *Id.*

165. *Id.*

166. *See* Smith, *supra* note 28, at 154 ("The result has been a significant increase in vehicle prices. . . .").

167. The rise of the Internet and the wealth of pricing information now available to consumers may mitigate the ability of dealers to raise prices in a particular area, as the cost of searching for lower priced vehicles is decreased. John T. Delacourt, *New Cars and Old Laws: An Examination of Anticompetitive Regulatory Barriers to Internet Auto Sales*, 3 J.L. ECON. & POL'Y 155, 177 (2007).

168. *See* Eckard, *supra* note 21, at 227.

new dealer would be approved.[169] This could lead to long periods of under-representation of dealers in a particular market and increased prices for consumers.[170]

State dealer acts have created other incentives that have spurred on the addition of an over-optimal number of dealers in the market.[171] In addition to creating barriers to entry for new dealerships, they have established even greater costs and disincentives to terminate poor performing existing dealers.[172] In the wake of new state dealer act legislation in the 1970s, Professor Smith found that in 1982, the number of automobile dealers in the United States market was *less than* the optimal number because of these barriers. Barriers which included protest rights when a manufacturer seeks to add or relocate a dealer to an existing market.[173]

Twenty-five years later, times have changed. The effect of both barriers to entry and more restrictive termination provisions has resulted in an over-dealered market. The barriers to entry are not absolute, and manufacturers, when faced with poor performing or even mediocre dealers in a market, will be incentivized to add or relocate dealers in an attempt to sell more vehicles and services in the market. Adding or relocating dealers does nothing but spread the expected number of sales over more dealerships than necessary, resulting in less profitable dealerships with less ability to invest in facilities, customer satisfaction, or the community[174] This results in over-dealered markets, particularly in metropolitan areas where the expected vehicle sales are higher due to the population.[175]

169. *See id.* at 229.

170. *See* Smith, *supra* note 28, at 150.

171. I make this assertion based on Professor Smith's examination of the incentives created by state dealer acts in 1982 and the current state of the dealer networks, with its over-abundance of dealers. According to Professor Smith, state regulation has entrenched existing automobile dealers, protecting them from involuntary termination, among other things. *See* Smith, *supra* note 28, at 150. Professor Smith, however, does not specifically examine the tensions created by the incentives that he identifies as created by state dealer acts – protection from involuntary termination and protection from entry of new dealerships. If manufacturers cannot terminate poorly performing existing dealers, how are they to increase vehicle sales in a particular market? One answer is to keep adding more dealers to cover that market. *See Hundreds of Car Dealerships to Close in Coming Years, Analyst Predicts*, GUELPH MERCURY, Jan. 29, 2009, at A6, *available at* 2009 WLNR 1701828 ("Their model traditionally was to put a dealer on every corner. They're over-dealered not just because of loss of market share, but because of their preference to have multiple dealers competing with each other in the same marketplace.").

172. *See* Smith, *supra* note 28, at 150.

173. *Id.*

174. Margaret Harding, '*Perfect Storm' Batters Auto Dealers*, COLUMBUS DISPATCH, Oct. 3, 2008, at C8, *available at* 2008 WLNR 18815726 ("As an example of how crowded the market is given the low sales numbers this year, about 3,800 dealerships would need to close this year to maintain the average dealership sales levels of 2007, said Paul Melville, a partner at Grant Thornton LLP.").

175. This analysis assumes that the commentators are correct that the United States automobile market is over-dealered. Recent dealer resignations and bankruptcies suggest that the

State dealer acts also incentivize dealers to charge more for "back end" service operations.[176] In many states, warranty reimbursement statutes tie the amount that a manufacturer reimburses a dealer for warranty work to what the dealer charges its retail customers, which the dealer controls.[177] Although market forces are theoretically supposed to curb the amount that dealers can charge their retail customers, some states such as Florida and New Jersey, have defined "retail" in such a way as to exempt discounts provided by dealers to their best customers, so in effect manufacturers are required to reimburse dealers at the highest rates charged by dealers.[178]

Setting aside those states that define "retail" to be the highest paying retail customers, the so-called market for service work does not mean that manufacturers are paying "market" for warranty work. That is because those customers who choose to have repair work done at a dealership may be motivated by factors other than price.[179] For example, they may feel more comfortable with the manufacturer-trained technicians or may have loyalty to a particular brand or dealership. Because their demand is more inelastic than the average service customer, dealers have more opportunity to raise prices for these services without the risk of losing them.[180] Dealers also may not fear losing retail customers because they make up a smaller percentage of the service work.[181] Warranty work also benefits dealers because they do not need to advertise for it and they are guaranteed payment from the manufacturer, often overnight after the claim is submitted.[182] Because dealer profit from warranty work is tied by state statute to this small population of retail customers with relatively inelastic demands, dealers may be incentivized to maximize the amount of profit from warranty work by increasing the prices charged to retail

United States is over-dealered as dealers fail to compete in a faltering economy. It is estimated that 900 dealers closed their doors in 2008 and expected that over 1,000 more dealers will close in 2009. Linebaugh, *supra* note 1, at A2.

176. *See* Eckard, *supra* note 21, at 226 n.10 (noting that "after-sales service, including warranty work and specialized repair, and…insurance of parts-availability" increase cost to customers).

177. *See supra* note 73.

178. *See supra* note 75.

179. *See J.D. Power and Associates, 2004 Customer Service Index Study* (J.D. Power & Assocs., Westlake Village, CA), July 2004, at I-11 (noting consumer choice is motivated by initial quality of experience at dealership); Ben McNamara, *Dealerships Compete for Independents' Customers*, AUTOINC. MAGAZINE, April 1998 at 5, *available at* http://www.asashop.org/autoinc/april98/ind.htm (noting consumer choice is motivated by proximity).

180. *See* Brief *Amicus Curiae* of the Alliance of Automobile Manufacturers in Support of Defendant-Appellee and for Affirmance at 9, Tom Rice Buick-Pontiac, GMC Truck, Inc. v. General Motors Corp., 551 F.3d 149 (2d Cir. 2008) (No. 06-5247-CV), 2008 WL 6099302.

181. *See id.*

182. *Id.* at 5-7.

customers and recouping that "loss" through increased warranty reimbursement from manufacturers.[183]

In addition to incentivizing manufacturers to over-dealer markets, state dealer acts also create a free rider problem within dealer networks.[184] Using the goodwill created by other dealers and the manufacturer trade name, mediocre and poorly performing dealers may not be incentivized to invest in their facilities, customer service, or training for their sales people and technicians, unless the manufacturers pay for them to do so.[185]

But many state dealer acts prohibit discrimination among dealers and financial incentives offered to one must be offered to all.[186] For example, Maine prohibits manufacturers from selling or offering to sell vehicles or parts to dealers at a price that is less than the actual price offered to any other dealer.[187] Florida has gone even further, requiring manufacturers to offer the same bonuses, incentives and other benefits to Florida dealers that they offer "nationally" or in the manufacturer-defined zone or region in which Florida is included. Manufacturers are prohibited "[f]or purposes of this chapter" from establishing Florida as its own zone, region or territory.[188] Practically speaking, making sure that Florida dealers are offered any benefit offered to any other dealer may be nearly impossible for dealer networks with thousands of dealers across the country.[189] Absent paying for these improvements or advocating a change in these statutes, manufacturers do not have much in their arsenal to discipline these mediocre dealers who can benefit from the use of the manufacturer's trade name and service marks as well as the reputations of other dealers who invest more in their facilities and communities.[190]

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183. *Id.*

184. *See* Blair & LaFontaine I, *supra* note 97, at 59 ("Although the franchisor benefits from the franchisee's entrepreneurial spirit and drive, that spirit can result in problems as well. These arise because of incompatible incentives. For example, some franchisees' efforts at improving their own unit's profits can lead to reduced profits for the franchisor and for other franchisees in the system.").

185. *See id.*

186. *See, e.g.*, ME. REV. STAT. ANN. tit. 10, § 1174(3)(E), (G) (1997 & Supp. 2008); FLA. STAT. ANN. § 320.64(A)(10)(d) (West Supp. 2009).

187. ME. REV. STAT. ANN. tit. 10, § 1174(3)(E), (G) (1997 & Supp. 2008).

188. FLA. STAT. ANN. § 320.64(A)(10)(d) (West Supp. 2009).

189. For example, after bankruptcy and the rejection of 789 dealer agreements, Chrysler has about 2400 dealers left in the United States. *See* Neil Roland, *Axed Dealers' Best Bet: U.S. Aid*, AUTOMOTIVE NEWS, July 20, 2009, at 1, *available at* 2009 WLNR 14267589. General Motors expects its 6000 stores to be reduced to between 3600 and 3800. *Id.*

190. *See* Smith, *supra* note 28, at 154 ("The only avenue remaining to manufacturers is the same political process that dealers appear to have used with so much success.").

C. *Practical Considerations*

The case has been made in the media and before Congress that the automotive industry is of national interest, justifying a bailout.[191] Economists and industry analysts have estimated that the Big Three going out of business will affect millions of workers, suppliers and consumers who depend on their warranty backing.[192] But for years, the economic protectionism of the states—protecting local dealers to the detriment of out-of-state manufacturers and ultimately consumers—has reigned supreme.[193] Although manufacturers have become more sophisticated about dealer markets as the analytical tools for manufacturers to study their markets have developed, the state dealer acts have often prevented manufacturers from taking steps to reconfigure and improve their dealer networks, or, at the very least, they have imposed significant costs as a deterrent to making the attempt.[194]

Not only does the imposition of significant costs act as a deterrent to improving dealer networks, but it also contributes to the lack of flexibility that manufacturers have in the face of changes to the economy.[195] Domestic manufacturers have known for years that they are over-dealered in certain markets, primarily in metropolitan areas, and there have been some attempts to reduce the number of dealers, primarily through buying out unproductive dealers or facilitating consolidations among dealers.[196] But facilitating such buyouts takes time and money, and, under current state statutes, it can take years to effectuate a termination of an underperforming

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191. *See* David Sedgwick, *The Options: Bailout Now or Collapse; Auto Bankruptcy Would Spread Pain Deep into Economy*, AUTOMOTIVE NEWS, Nov. 10, 2008, at 1, *available at* 2008 WLNR 22178276 (discussing the appearance of the Big Three CEO's before congressional leaders asking for $25 billion in bailout money).

192. *See id.* (quoting industry experts noting that if GM were to file for bankruptcy, "the impact would be…catastrophic" across the automobile industry).

193. *See* Smith, *supra* note 28, at 154 ("A question beyond the scope of this paper is why dealers have been so politically effective and manufacturers have not."). Recently, dealers continue to prove their political clout by initiating legislation that would reverse the terminations of GM and Chrysler dealers that were approved by the bankruptcy court. Roland, *supra* note 189, at 1 ("It has been an impressive show of power. But probably the best that rejected General Motors and Chrysler dealers can hope to gain from all the congressional maneuvering on their behalf is federal compensation for lost franchises.").

194. It has been estimated that it cost General Motors $1 billion to buy out and litigate with Oldsmobile dealers upon withdrawal of the Oldsmobile brand from the United States. Richard Gibson, *Auto Dealerships Prepare for Major Shakeout*, WALL ST. J., Jan. 27, 2009, at B4.

195. James Brickley, *University of Rochester Roundtable on Bankruptcy and Bailouts: The Case of the US Auto Industry*, 18 J. of Applied Fin. 97, 105 (2008) [hereinafter *Roundtable on Bankruptcy and Bailouts*] ("I have studied the effects of franchise and dealer protection laws across a broad range of industries. My research indicates that such laws lead to less efficient distribution systems and the destruction of corporate values.").

196. Duggan & Kaffer, *supra* note 158, at 1 ("The notion of dealers coming together to buy out a competitor isn't unheard of, analysts say, but it's not common.").

dealer.[197] Instead, the economic crisis of 2008 and 2009 has shown that the fastest way to reduce the number of dealers is to let the poor performing dealers fail and voluntarily go out of business.[198]

Given that the economy seems to be righting itself in terms of reducing the number of dealers, why can't the economy be counted upon to make these adjustments, even within the restrictions of the state dealer acts? First, allowing dealers to fail may not result in the optimal number of dealers in a market in the best locations.[199] The dealers that are failing may not necessarily be the poorest performers as the freezing of the credit markets have affected all small businesses by making loans less available even to those in solid financial standing before the economic crisis.[200] A number of banks and other institutions have decided to stop offering wholesale floor plan financing, giving dealers a limited period of time to find new financing at a time when credit is generally unavailable.[201] In addition, automotive finance companies, such as Chrysler Credit and GMAC, had problems obtaining funds in 2008 to sustain their operations.[202]

Second, state dealer acts continue to impede manufacturers from re-configuring the market even when a dealer goes out of business.[203] If the dealer wants to sell the dealership interest, manufacturers in many states are required to consent to the transfer absent a pre-published reason not to.[204] Manufacturers still face protest statutes if they desire to add a point or relocate an existing dealer.[205] It is even more difficult for manufacturers to deny a transfer to the heir of a deceased or incapacitated

197. *See id.* For example, in Lanham Ford, Inc. v. Ford Motor Co., Case No. MDOT-MVA-12-03-10560 (Md. MVA Aug 10, 2005), it took Ford Motor Company over ten years to perfect a termination based on deficient performance.

198. *See* Gibson, *supra* note 194, at B4.

199. *See Roundtable on Bankruptcy and Bailouts*, *supra* note 195, at 105 ("The number of American car dealerships has been falling almost daily as these businesses fail. But relying on local business failures to reduce the number of dealers—thanks to all their legal recourse to and demands on the Big Three for life support—is a very protracted and costly way of addressing the basic problem. What is needed instead are systematic and coordinated changes in these companies' product lines and dealership systems.").

200. *See* Linebaugh, *supra* note 1, at A1-2 ("Even some dealers who had been among the most successful were battered in 2008.").

201. Harry Stoffer, *Floorplan Financing Squeeze Takes its Toll on Dealerships*, AUTOMOTIVE NEWS, Mar. 2, 2009, at 4, *available at* 2009 WLNR 4355622.

202. John D. Stoll, *With U.S. Help, GMAC Revs Up Car Loans*, WALL ST. J., Dec. 31, 2008, at B1.

203. *See Roundtable on Bankruptcy and Bailouts*, *supra* note 195, at 105 ("Inefficient franchise laws are but one example of how political considerations often trump economics in legislative or regulatory solutions.").

204. *See supra* note 55.

205. *See supra* note 48.

dealer.[206] The manufacturers' market representation problems are thus prolonged in generation after generation of dealers.

In recent years, state legislatures have passed statutes that are becoming more onerous as dealers and dealer associations consider and implement new ways for dealers to stay in business, protect their profits, and maintain their territories.[207] Under the state dealer acts, dealer agreements are essentially in existence until the manufacturer has good cause to terminate, notwithstanding the terms of the contract.[208] That is because state dealer acts require the renewal of dealer agreements unless there is good cause not to renew.[209] Because the state dealer acts also generally require that manufacturers approve the transfer of dealerships to family members of the dealer-principal or upper level managers of the dealership, these dealer agreements are extended even longer.[210] These long-term, multi-generational dealer agreements greatly restrict the manufacturers' ability to respond to market changes.[211]

Because manufacturers only have one market for their products–dealers–allowing dealers through the political process to direct and often change the agreed upon terms of the relationship does not make business or common sense as the manufacturers are the ones with the knowledge of the market as a whole and are charged with creating a market strategy.[212] Manufacturers need more control over their distribution channels instead of letting the individual dealers direct where they want to be.

Giving manufacturers more control and flexibility to manage their dealer networks and reducing the cost of doing so will also help dealers and customers.[213] The newer, less saturated dealer networks in the United States, such as Toyota and Honda, have shown that manufacturers can sell just as many vehicles with fewer dealers.[214] For example, Toyota has approximately 1,500 dealers in the United

206. *See* GA. CODE ANN. § 10-1-652(c), (d), (f), (g) (2009).

207. *See* Smith, *supra* note 28, at 140 ("As previously noted, state regulation of manufacturer-dealer relations was not a significant factor until after the 1956 Dealers' Day in Court Act. Subsequently, most regulatory changes have tended to increase the stringency of restrictions on manufacturer behavior."); *see also* Forehand & Forehand, *supra* note 3, at 1064 (describing evolution of state regulatory statutes and noting that "states regularly amend their statutes").

208. *See supra* note 33.

209. *See supra* note 33.

210. *See supra* note 64 and accompanying text.

211. *See* Brickley et al. I, *supra* note 107, at 177.

212. *See Roundtable on Bankruptcy and Bailouts*, *supra* note 195, at 105 ("In the long run, the industry will be much stronger if we allow economics rather than politics to drive the outcome.").

213. *See* Smith, *supra* note 28, at 154 ("As to why consumers have tacitly permitted themselves to be taxed for the benefit of dealers, the answer must lie in the cost of learning about the transfer, and then organizing an effective political coalition to deal with it.").

214. *See* Linebaugh, *supra* note 1, at A2.

States[215] while General Motors has over 6,000.[216] In 2007, Toyota became the number one selling manufacturer worldwide with General Motors a close second.[217] With increased throughput per dealer, profits per dealer will increase, allowing the dealers to provide better service and facilities for customers.[218] Analysts have estimated that there will need to be 3,800 fewer dealerships in 2009 for dealers to make the same level of profits as in 2007.[219]

In addition to affecting the configuration of dealer networks, the state dealer acts also affect the day-to-day relations between manufacturers and dealers.[220] Because dealer networks are national, manufacturers must often comply with the most stringent state statute because it may be difficult to have different processes and systems in place in different states, and one of the hallmarks of franchising is that customers expect the same quality products and level of service at each outlet.[221] An example of this is allocation or the distribution of new vehicles among dealers, which often is done through a nationwide formula based on the selling rate of the individual dealer.[222] It would be difficult, if not impossible, to have different systems in different states even though state statutes on allocation vary.[223] Also, as a matter of dealer relations, manufacturers generally want to treat their dealers in different states consistently. To do so under varying state dealer statutes often requires manufacturers to comply with the most stringent state statute.[224] This lowest common denominator problem binds manufacturers in these day-to-day operations as a matter of course.

215. *Id.*

216. *Id.*

217. James Treece, *Same Old Global Rankings? Wait 'til Next Year: GM Restructuring is Biggest Factor in Changing Landscape*, Automotive News, July 13, 2009, at 9, *available at* 2009 WLNR 13586505 (reporting that Toyota is first in global sales and General Motors a close second).

218. *See In re* Old Carco LLC, 406 B.R. 180, 193 (Bankr. S.D.N.Y. 2009) ("The transplant OEMs established much smaller dealership networks with new and better locations and facilities in growing markets, and recently they have sold considerably more vehicles annually than the Debtors. As a result, the Debtors' dealers' 'throughput' (*i.e.,* annual sales of vehicles) was but a fraction of some of the transplant OEMs' throughput."); *see also* Duggan & Kaffer, *supra* note 161, at 1 (explaining how a smaller dealer network will provide better service to customers).

219. There were 20,328 automobile dealerships in the United State as of October 31, 2008. *See* Duggan & Kaffer, *supra* note 158, at 1.

220. *See* Smith, *supra* note 28, at 136-39 (outlining state restrictions on new vehicle allocations, pricing, and warranty reimbursement, among other things).

221. *See* Blair & LaFontaine I, *supra* note 97, at 60 ("Franchisors are, of course, well aware of the importance of consistent quality to their customers.").

222. This is called "turn and earn." *See* Colonial Dodge, Inc. v. Chrysler Corp., 11 F. Supp. 2d 737, 744, 746 (D. Md. 1996).

223. *See supra* note 79 (setting out allocation statutes).

224. *See* Brief *Amicus Curiae* of the Alliance of Automobile Manufacturers in Support of Defendant-Appellee and for Affirmance at 7, Tom Rice Buick-Pontiac, GMC Truck, Inc. v. General Motors Corp., 551 F.3d 149 (2d Cir. 2008) (No. 06-5247-CV) (explaining that manufacturers prefer to treat dealers equally for warranty reimbursement purposes); *Roundtable on Bankruptcy and*

The restrictions manufacturers face in attempting to use the Internet more effectively to sell vehicles is a recent example of the inability of manufacturers to more effectively manage their dealer networks and benefit consumers.[225] Attempts to directly market new and used vehicles to consumers, to give special Internet prices to certain customers, or even to refer dealers to interested customers, have been rebuffed as being in violation of the state dealer acts.[226] Manufacturers have also been restricted in the parts, service and aftermarket equipment it can sell directly to consumers.[227] As a result, consumers have higher search costs, less bargaining power and pay higher new vehicle prices than they would otherwise.[228] The inability to use the Internet to effectively market and sell new vehicles to consumers hurts both manufacturers and dealers alike as it restricts a new avenue to increase new vehicle sales and forces consumers to turn to alternatives such as used vehicle auction sites.[229]

IV. A PROPOSED FEDERAL AUTOMOTIVE DEALER ACT: BACK TO CONTRACT

From an economist's perspective, the current regime of state dealer acts creates an inefficient market for the sale of new vehicles, and from a business perspective, it makes it extremely difficult for manufacturers to manage their dealer networks and sell new vehicles.[230] On the other hand, generations of dealers have relied upon the state dealer acts as they have entered into their dealer agreements with manufacturers.[231] These dealers have structured their businesses in such a way, for

Bailouts, *supra* note 200, at 105 ("State laws not only make it expensive to alter dealership contracts, they also prevent manufacturers from owning their own dealerships in many states and prohibit direct marketing to consumers through other media such as the Internet. In fact, a number of attempts by the Big Three to introduce new marketing channels have been blocked by dealer-initiated lawsuits or regulatory actions.").

225. Delacourt, *supra* note 167, at 164-65.

226. *Id.*

227. *Id.* at 174-75.

228. *Id.* at 177-79. It is estimated that consumers could save as much as eighteen to forty-four billion dollars per year if Internet vehicle sales were permitted. *Id.* at 187. *See also* David J. Urban & George E. Hoffer, *The Virtual Automotive Dealership Revisited*, 20 J. CONSUMER MARKETING 570, 571 (2003) (reporting that distribution costs constitute an estimated 30% of manufacturer suggested retail price).

229. Delacourt, *supra* note 167, at 168-69 (explaining how used car auction sites have flourished online).

230. *See* Smith, *supra* note 28, at 150 ("To recapitulate, this analysis has demonstrated that state regulation has served effectively to entrench existing automobile dealers….The net effect is fewer dealerships and increased market power resulting in higher prices.").

231. State dealer acts have been in existence since the mid-1930s. *See* Eckard, *supra* note 21, at 223.

bad or good depending on your perspective, to be consistent with the protections provided by these statutes.[232]

After fifty years , the shortcomings of state dealer acts are clear and justify an overhaul of the entire regulatory scheme. The primary lesson learned is that the myriad of regulations governing automotive manufacturers have benefited one constituency—dealers—to the detriment of consumers and manufacturers.[233] These state dealer acts also create a patchwork of often-changing regulations, which are difficult to follow and impede the manufacturers' ability to manage their dealer relationships.[234] They also create rigidity in the dealer networks such that manufacturers cannot timely respond to changes in the market.[235] Examples include the rise of the Internet and the current economic crisis.[236] The state dealer acts appear to attempt to keep dealers in the status quo vis-à-vis the manufacturers no matter what changes in the market, often to the detriment of consumers.[237]

In my view, the goals of this new federal automotive dealer act ought to be fairly straightforward: (1) enhance consumer welfare; (2) allow dealers and the manufacturer to jointly create a system that incentivizes both parties to maximize profits for both the manufacturer and dealers in the network as a whole; and (3) create a sustainable manufacturer-dealer regime particularly in light of changes in the market. These goals may appear to be in tension, but, in actuality, maximizing profits for the manufacturer and dealers should benefit consumers as well since free riding would be minimized.[238] Single dealers would no longer be incentivized to cheat the

232. *See In re* Old Carco LLC, 406 B.R. 180, 188 (Bankr. S.D.N.Y. 2009) (describing objections by terminated dealers to rejection of dealer contracts, including that state dealer statutes were designed to protect dealers).

233. *See* Smith, *supra* note 28, at 139 ("[T]he preceding analysis suggests that the regulations, in some cases, go beyond paternalism to the point of creating monopoly power for the dealers. The expected result, if this is true, is a wealth transfer which benefits dealers.").

234. *See Roundtable on Bankruptcy and Bailouts*, *supra* note 195, at 105 ("It is unrealistic to expect 50 state legislatures to reform these laws in the face of opposition from the local car dealers.").

235. *See id.* (suggesting that bankruptcy would provide auto companies "much more flexibility to reconfigure their brands and dealership systems in a quick and efficient way").

236. *See id.* ("State laws not only make it expensive to alter dealership contracts, they also prevent manufacturers from owning their own dealerships in many states and prohibit direct marketing to consumers through other media such as the Internet.").

237. *See id.*

238. *See* Blair & LaFontaine I, *supra* note 97, at 60. As stated by Blair & LaFontaine:

> Franchisees will complain to the franchisor about underperforming outlets and request that the franchisor intervene because they know how a bad experience by a customer in one location can have an adverse impact throughout the entire franchise system and ultimately on them. In other words, quality and service variations have external effects that damage other franchisees as well as the franchisor, and this creates a tension between the franchisor and individual franchisees.

Id.

system and provide inferior service or charge higher prices to consumers in order to maximize their own profits to the detriment of the dealer network as a whole.[239]

But how do you create these incentives and maximize consumer welfare? From an economist's perspective, there is no reason why the manufacturer and dealer cannot come to their own terms defining the dealer relationship. As explained earlier, despite the purported justification for state dealer acts, there has been little empirical evidence supporting the notion that manufacturers abuse their power and need to be regulated as heavily as they are.[240] Instead, given the bargaining power of the dealer associations within the manufacturer's networks, dealers are often on par with manufacturers in terms of dictating the terms of their contractual relationship.[241] Also, dealers are not artless individuals; they are businesspersons that are often represented by specialized counsel in negotiations with manufacturers.[242]

One solution is to rely on these contractual terms, forged based on experience with the market, to govern the dealer relationship rather than the special interest state legislation that has become dominant. Manufacturers need to have the ability to create incentives and methods of discipline to ensure that dealers are adequately representing the manufacturers in the market. Dealers ought to have the ability to negotiate terms that protect themselves from undue encroachment and from unjustified terminations that would unfairly deprive them of the investments that they have made in their dealerships. Going back to the basics of the franchisor relationship—the contract—should help resolve some of the problems that we have seen with the state dealer acts.

Returning to the terms of the dealer agreements is easier said than done. Some options are: (1) amending each state's dealer act; (2) enacting a new federal statute; or (3) amending ADDICA. Obviously, because each state has its own dealer act, it would be difficult to go through the legislative process in each state to make the dealer acts consistent with the notion that the terms of the dealer agreement should control.[243] Even more difficult would be to achieve a consensus in each of the states. Many states have also given regulatory power to administrative agencies, which may be loathe to give up that power (or the fees that can be assessed for violations). This "state legislative problem" will be a significant barrier to reforming the manufacturer-dealer relationship.

An even more fundamental issue is whether dealer agreements currently in place reflect terms that have been considered by both sides and truly negotiated. Because dealers and manufacturers have relied on the state dealer acts, the ADDICA and case law in negotiating their dealer agreements, the dealer agreements in place today may not include the terms that dealers and manufacturers would have negotiated to protect

239. *See id.*

240. *See supra* notes 124-126 and accompanying text.

241. *See supra* notes 109-113 and accompanying text.

242. *See supra* note 147.

243. *See supra* note 234.

both parties.[244] Terms may be missing.[245] The parties may also have included terms that would be unenforceable because of existing statutes or case law, relying on severability provisions common in dealer agreements that any provision in the dealer agreement that is found to be in violation of state or federal law is deemed stricken from the agreement.[246] I call this the "reliance problem."

Because of the state legislative and reliance problems, a federal legislative solution that keeps in place certain protections against bad faith violations of contract seems to be the most in line with our goals, and does not unnecessarily disturb the manufacturer-dealer relationship. The current ADDICA requires manufacturers to act in good faith in enforcing the terms of the dealer agreement; therefore, it is the ideal vehicle to go back to contract.[247] No new federal statute is necessary. For these reasons, I submit a two part proposal: (1) amend ADDICA to preempt existing state dealer statutes while keeping in place ADDICA's good faith provision; and (2) repeal ADDICA's anti-arbitration provision.

First, an express preemption provision would be required to be added to ADDICA.[248] A federal statute preempting state franchise statutes is not without precedent.[249] The Petroleum Marketing Practices Act ("PMPA") expressly preempts any state statute or regulation that purports to affect the termination or non-renewal of a petroleum distribution franchisee unless the state statute or regulation is the same as the applicable provision of the PMPA.[250] Courts have held that not only does PMPA

244. There is no way to test this hypothesis, but reviewing franchise systems in other countries or in those states without a franchise relationship law suggests that more franchisor quality controls and less restrictions on encroachment may be negotiated in the absence of laws prohibiting such provisions. *See* Riley *supra* note 105, at 564-65 (describing franchise contract terms in Australia); Camp Creek Hospitality Inns, Inc. v. Sheraton Franchise Corp., 139 F.3d 1396, 1403 (11th Cir. 1998) (because there was not a specific contractual provision against encroachment, plaintiff resorted to breach of implied covenant of good faith and fair dealing).

245. *See infra* note 249.

246. For example, dealer agreements may contain provisions permitting manufacturers to terminate upon the insolvency or bankruptcy of the dealer, but such provisions are generally unenforceable if the dealer actually files for bankruptcy. *See In re* Old Carco LLC, 406 B.R. 180, 206 n.33 (Bankr. S.D.N.Y. 2009) ("'Termination procedures and related obligations frustrate § 365's purpose of giving a bankruptcy court the authority to determine whether a contract may be assumed or rejected while also frustrating § 365's purpose to free a debtor of obligations once the debtor has rejected the contract. Section 366 is specifically designed for utilities, and it is not relevant to this case that courts have found that state and local regulations regarding procedures for termination are not preempted.").

247. 15 U.S.C. § 1222 (2006).

248. When Congress legislates in an area historically occupied by the states, there must be a "clear and manifest purpose" by Congress to preempt state law. Wyeth v. Levine, 129 S.Ct. 1187, 1194-95 (2009) (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).

249. *See, e.g.*, Petroleum Marketing Practices Act, 15 U.S.C. § 2801 (2006).

250. 15 U.S.C. § 2806(a) provides:

(1) To the extent that any provision of this subchapter applies to the termination (or

preempt state franchise statutes that directly address termination,[251] but it also preempts those that restrict a franchisor's ability to place conditions on franchisees, the violation of which could lead to termination.[252] I propose that ADDICA be amended to add a similar provision but without the limitation to terminations or non-renewals. Instead, I propose that the express preemption provision provide for the preemption of all state dealer laws from the appointment of a new dealer through termination, while permitting the parties to pursue state common law causes of action.

Starting with a clean slate, essentially wiping out the state dealer acts in each state is critical to reforming the system. Most of ADDICA's provisions could remain intact, however, continuing to require manufacturers to act in good faith in connection with terminations and enforcing their dealer agreements. This overlay simply reflects the policy enunciated in the Uniform Commercial Code and present in the common law of most states, that parties to a contract must act in a way consistent with the terms and spirit of the contract.[253] Also, keeping ADDICA's good faith provision in place will not upset existing case law relied upon by manufacturers and dealers,

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> the furnishing of notification with respect thereto) of any franchise, or to the nonrenewal (or the furnishing of notification with respect thereto) of any franchise relationship, no State or any political subdivision thereof may adopt, enforce, or continue in effect any provision of any law or regulation (including any remedy or penalty applicable to any violation thereof) with respect to termination (or the furnishing of notification with respect thereto) of any such franchise or to the nonrenewal (or the furnishing of notification with respect thereto) of any such franchise relationship unless such provision of such law or regulation is the same as the applicable provision of this subchapter.
>
> (2) No State or political subdivision of a State may adopt, enforce, or continue in effect any provision of law (including a regulation) that requires a payment for the goodwill of a franchisee on the termination of a franchise or nonrenewal of a franchise relationship authorized by this subchapter.

251. *See, e.g.*, Lyons v. Mobil Oil Corp., 884 F.2d 1546, 1549 (2d Cir. 1989) (holding that Connecticut Gasoline Dealers Act provision prohibiting termination for failure to comply with 24-hour operating requirement preempted upon passage of PMPA); Veracka v. Shell Oil Co., 655 F.2d 445, 450 (1st Cir. 1981) (noting that Massachusetts termination provision must conform to requirements of PMPA).

252. *See, e.g.*, Mobil Oil Corp. v. Virginia Gasoline Marketers & Auto. Repair Ass'n, Inc., 34 F.3d 220, 226 (4th Cir. 1994) (holding that PMPA preempts the Virginia Petroleum Products Franchise Act provisions prohibiting quotas, minimum hours, minimum renewals, maximum number of stations, and rent controls are preempted by PMPA); O'Shea v. Amoco Oil Co., 886 F.2d 584, 589-90, 594 (3d Cir. 1989) (holding that PMPA preempts the New Jersey Franchise Practices Act, resulting in the termination of a franchisee who did not comply with a 24-hour operations requirement).

253. U.C.C. § 1-304 (2008) ("Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement."); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

which prevents manufacturers from unfairly coercing or terminating dealers despite the terms of the contract.[254]

Second, in the interest of promoting contractual terms considered and agreed to by the parties, I propose that ADDICA's anti-arbitration provisions be repealed. There is simply no reason that sophisticated parties to the dealer agreement cannot agree at the outset to arbitration if they so desire. In almost every other context, courts have found that the policy underlying the Federal Arbitration Act has encouraged and enforced agreements to arbitrate controls and has directed parties to arbitration.[255] The contexts in which arbitration provisions have been enforced include consumer transactions, employment contracts, broker agreements, franchise contracts and even medical malpractice claims.[256] There is no reason for automobile dealers to have greater protections from arbitration than consumers, employees or medical patients.

Those dealers that truly have been forced into arbitration clauses under circumstances in which duress is suspected will still have the avenue of challenging the enforcement of these clauses as unconscionable under state common law.[257] Franchisees in other contexts have succeeded in some of these challenges, which are considered on a case-by-case basis.[258]

By preempting and essentially repealing state dealer acts and repealing the anti-arbitration provision of ADDICA, automotive dealers will then be put in the same position as franchisees in states with no franchise relationship laws.[259] These franchisees are generally smaller businesses rather than dealers with less capital investment, and, therefore, more of a case can be made that they are in need of special protection.[260] But franchise systems continue to flourish in states without franchise

254. *See* E. Auto Distribs., Inc. v. Peugeot Motors of Am., Inc., 795 F.2d 329, 336 (4th Cir. 1986) ("Actual or threatened coercion or intimidation is an essential element to a claim under the ADDICA."); Globe Motors, Inc. v. Studebaker-Packard Corp., 328 F.2d 645 (3d Cir. 1964).

255. *See Developments in the Law*, 122 HARV. L. REV. 1170, 1173 (2009) (describing contexts in which arbitration agreements have been upheld).

256. *See id.*; *see generally* Stanley A. Leasure & Kent P. Ragan, *Arbitration of Medical Malpractice Claims: Patient's Dilemma and Doctor's Delight?*, 28 MISS. C. L. REV. 51, 51 (2009).

257. *See, e.g.*, *Independ. Ass'n of Mailbox Ctr. Owners, Inc. v. Superior Court*, 34 Cal. Rptr. 3d 659, 676 (Cal. Ct. App. 2005) (striking as unconscionable arbitration provisions that prohibit class actions and restrict relief that could be awarded by arbitrator).

258. *See id.* ("The superior court is directed to enter new and different orders (1) striking as unconscionable those provisions of the subject franchise agreements' arbitration clauses (a) that prohibit representative or class actions from being handled in the arbitration forum; and (b) that limit the arbitrators from granting otherwise authorized relief under statute . . . .").

259. The majority of states do not have franchise relationship laws. *See* Killion, *supra* note 106, at 28 (2008) ("Eighteen states have legislation governing the franchise relationship.").

260. *See id.* at 27 ("Without franchising, thousands of small businessmen would never have had the opportunity of owning their own businesses. Similarly, franchising has enabled many entrepreneurs with little capital to take an idea and from it build a large multi-unit organization.") (quoting URBAN B. OZANNE & SHELBY D. HUNT, THE ECONOMIC EFFECTS OF FRANCHISING 63

relationship laws (and indeed, more franchises are present than in states with such laws).[261]

Preempting the state dealer acts, while keeping in place ADDICA's good faith provision, resolves at least part of the reliance problem. The parties will be governed by the terms of the dealer agreement, which contemplated the state dealer acts that were in place at the time.[262] Until each of these agreements expires, the parties will continue to operate under the terms of the dealer agreements they reached under the state dealer acts. Such an orderly transition is possible because the dealer agreements already in place are generally multi-year, long-term contracts.[263] These agreements will expire and be up for renewal at various times, permitting both manufacturers and dealers to plan for the change-over.[264] Manufacturers and new dealers will also be able to implement the terms of the new dealer agreements.

V. A BOLD NEW WORLD: A NEW AUTOMOBILE DISTRIBUTION SYSTEM

With preemption of state dealer acts, a new, more flexible and consumer friendly automobile distribution system could arise in the United States. But major changes will need to occur in manufacturer-dealer relationships. First, manufacturers and dealers will need to more carefully consider and negotiate the terms of the dealer agreement at the outset of the relationship and at renewals instead of assuming that the state dealer act will fill in or override the terms.[265] Hopefully, these negotiations will more explicitly delineate the expectations of each party to the agreement such that when issues arise, the contract will be sufficient to resolve the issues. Or the parties may be able to resolve them with further negotiation.

(1971)); Thomas J. Collin, *State Franchise Laws and the Small Business Franchise Act of 1999: Barriers to Efficient Distribution*, 55 BUS. LAW. 1699, 1702-03 (2000) (explaining automobile dealers' concerns with manufacturer's Internet car sales).

261. One difference is that these franchisees lack the organized lobbying efforts of automotive dealers and thus have been unable to pass this type of legislation throughout the states. The Small Business Franchise Act of 1999, which would have essentially become a federal franchise relationship law, also failed to pass, demonstrating the lack of organized lobbying power by franchisees generally.

262. *See* Smith, *supra* note 28, at 140 (explaining that unless manufacturer and dealer renegotiate the contract, effects of state regulation will continue).

263. *See* Brickley et al. I, *supra* note 107, at 184 (examining duration of franchise contracts in various industries).

264. *Id.* at 177 ("However, upon renewal, the old contract is replaced with the contract that the franchisor is using for new franchisees….The typical renewal provision gives the franchisor the flexibility to alter the contract in response to environmental changes but offers the franchisee some protection by limiting the changes to provisions that are used in other contracts.").

265. *See id.*; Smith, *supra* note 28, at 140 (explaining that manufacturers' "bilateral bargaining problem" as a result of state dealer acts prevents the negotiation of efficient terms).

Second, to the extent controversies escalate to litigation, they will be decided by the terms of the dealer agreement.[266] Given our federalism, there will still be differences in how contractual terms are construed state by state.[267] I am not proposing a federal common law of contract to govern disputes between manufacturers and dealers as there is no true federal interest in creating a common law of contract to interpret dealer agreements.[268] Dealer agreements are contracts between private parties.[269] The courts will be well suited to interpret and enforce the meaning of these contracts using the appropriate choice of law principles and the applicable common law of contract.[270] With the preemption of state dealer act provisions that prevent enforcement of contractual choice of law provisions, the use of such choice of law principles will be possible.[271]

Dealers will also be able to assert the same types of claims that other similarly positioned contractual parties and franchisees regularly assert. Commonly asserted claims include fraud and negligent misrepresentation claims for misleading prospective dealers, breach of the implied covenant of good faith and faith dealing and claims of discrimination under 42 U.S.C. § 1981.[272] Manufacturers likewise will retain contractual, tort and other statutory claims that they had previously.

Also, this proposed preemption is not intended to take away a state's ability to license and otherwise regulate corporations that do business in the state. New vehicle dealers, and often salespersons, need to be licensed before they can sell vehicles in a state.[273] Some states also require that manufacturers and their representatives be licensed to do business.[274] These licensing requirements should not be affected by the ADDICA preemption as licensing does not affect the relationship between dealers and manufacturers.[275]

266. *See* Arruñada et al., *supra* note 2, at 280-81.

267. As the Supreme Court famously stated in Erie R. Co. v. Tompkins: "There is no federal general common law." 304 U.S. 64, 78 (1938).

268. *In re* Bank of New England Corp., 364 F.3d 355, 363 (1st Cir. 2004) ("But resort to a federal common law of contract enforcement ordinarily is justified only when required by a distinct national policy or interest. . . . The interpretation and enforcement of financial arrangements between private parties does not fill that bill.") (internal citations omitted).

269. *See* Smith, *supra* note 28, at 130 (describing terms of dealer agreements prior to passage of state dealer acts).

270. *See supra* note 92 and accompanying text.

271 . *See supra* note 92 and accompanying text.

272. *See* Carla Wong McMillian & Kelly J. Baker, *Discrimination Claims and Diversity Initiatives: What's a Franchisor To Do?*, 28 FRANCHISE L.J. 71, 72 (2008) (describing various claims for discrimination that may be brought by franchisees).

273. *See* Smith, *supra* note 28, at 134 (describing licensing requirements); Forehand & Forehand, *supra* note 3, at 1058-60 (describing Florida's licensing requirements).

274. *See* Forehand & Forehand, *supra* note 3, at 1059-60 (describing Florida's licensure requirements for manufacturers).

275. Licensing is done by state agencies, not federal authorities. *See infra* note 280.

Third, the relationship between dealers and manufacturers would fall more in line with other franchisor-franchisee relationships where there is no franchise relationship law.[276] Manufacturers would again have the ability to use termination and the threat of termination—albeit in good faith and under the terms of the dealer agreement—to discipline underperforming dealers and get rid of the bad ones.[277]

Manufacturers, like other franchisors, could also choose to sell vehicles directly to customers from their own dealerships or through the Internet. Although dealers fear encroachment, if the dealer agreement is negotiated such that dealers are provided territorial protection, there is no reason not to allow manufacturers to own and operate dealerships. This would permit manufacturers to fill open points more quickly and take over dealerships that are failing instead of simply letting them close their doors.[278] Also, the day-to-day points of contact between the manufacturer and dealers—such as on allocation, warranty and service incentives--would be governed by contract instead of various state laws.[279]

Over time, under the proposed new federal dealer act, and as dealer agreements are re-negotiated and manufacturers take the opportunity to start selling vehicles directly to consumers, a new distribution network could arise that would be more pro-consumer and more balanced in power as between the manufacturer and dealer. A consumer could choose to purchase a new vehicle from her local dealer or directly from the manufacturer through the Internet or in manufacturer-operated dealerships.[280] Dealerships—whether owned by the manufacturer or dealer—could offer customers test-drives and other services that certain consumers want before making an investment in a vehicle. Customers willing to forgo the support offered by

276. As explained *supra* note 259, most states do not have franchise relationship laws.

277. As Professor Smith has concluded, "If recontracting does not occur (and there is no evidence to suggest that it has), the expected result is increased retail prices and reduced output." Smith, *supra* note 28, at 140. These outcomes may be resolved by negotiation in the absence of state dealer statutes. *Id.*

278. *See* Delacourt, *supra* note 167, at 167 (explaining that restrictions on direct-to-consumer sales by manufacturers prevents "manufacturers from actively taking the same, retail-level financial risks that they are supposedly imposing on dealers").

279. *See* Tom Rice Buick-Pontiac, GMC Truck, Inc. v. General Motors Corp., 551 F.3d 149, 151 n.1 (2d Cir. 2008) (describing warranty reimbursement provisions of General Motors dealer agreement).

280. Under this scenario, states would still have the ability to license dealers located in the state and could impose requirements such as having a facility in the state. Manufacturers could presumably have a small facility to accept delivery of vehicles while still conducting the majority of the sale through the Internet. *See* Delacourt, *supra* note 167, at 181 ("A further possibility is that specialty test drive services will emerge to fill the gap, operating either in conjunction with, or independently of, Internet sellers. Rather than following the traditional dealership model, one would imagine that such services would have fewer locations and a significantly smaller inventory."); Urban & Hoffer, *supra* note 228, at 577 (proposing model for Internet-based distribution system).

local dealerships could choose to buy directly from manufacturers, presumably at lower prices due to lower overhead.[281]

Not only could consumers have a choice of where to purchase vehicles, but they also may have the opportunity to choose between service centers as well.[282] Presumably, dealers would continue to offer retail and warranty repair services, yet manufacturers could offer these services in their own dealerships or by contracting such work to independent repair shops.[283] Again, prices for services should be lower with increased competition.[284] But certain segments of consumers should be willing to continue to pay a premium, as they do today, for dealership technicians and expertise.[285]

Subject to the antitrust laws and the terms of their dealer agreements, manufacturers could also competitively price vehicles and parts to dealers, providing incentives and bonus payments in those regions where additional incentives are needed to sell vehicles without the fear that the incentives would need to be offered to all dealers across the country. Dealers would also have competition with other warranty providers, which should provide for fairer pricing for manufacturers to pay dealers for warranty work. [286]

VI. Conclusion

The primary barrier to enacting a new federal Automobile Dealers' Day in Court Act is resistance by highly organized and politically savvy dealer associations.[287]

281. *See* Delacourt, *supra* note 167, at 178-79 (estimating that a customer could save up to 6% of vehicle cost, for an average of around $1500 per vehicle, or by some estimates up to $2600 per vehicle, through direct manufacturer sales).

282. *See* Urban & Hoffer, *supra* note 228, at 577 ("As we envisioned the virtual dealership, vehicle delivery, warranty work, after-market parts and service, and customer trade-in services would be performed by existing firms in the automotive infrastructure.").

283. *Id.*

284. *Id.*

285. *See supra* note 179.

286. As explained supra, manufacturers are currently required to use dealers to perform warranty work and many dealer statutes require manufacturers to reimburse dealers for that work at the same prices and rates charged by these dealers to their retail customers. *See supra* notes 71-78 and accompanying text (explaining warranty reimbursement under many dealer statutes). Presumably, if manufacturers are no longer required to use dealers to perform warranty work, the reimbursement rates can be renegotiated with an expected decrease in the price due to cost savings. *See* Delacourt, *supra* note 167, at 185 (explaining that a "more sensible and pro-competitive approach would be to ensure the quality of service through a system of technician and service center certifications").

287. This lobbying power has been demonstrated recently in the wake of the terminations of hundreds of dealer agreements by Chrysler and General Motors through their respective bankruptcy actions. Within six weeks, legislation seeking to reverse the terminations was passed by the House of Representatives. *See* Roland, *supra* note 189, at 1. *See also* Smith, *supra* note 28, at 154

Case in point: state dealer lobbying groups have pointed to the current economic downturn and dealer resignations as an indication that manufacturers should have *more* restrictions in managing their dealer networks and provide *more* compensation when a dealer goes out of business.[288]

Another barrier, described above, is that manufacturers and dealers have relied on the state dealer acts in negotiating the terms of the dealer agreement (to the extent that there is any negotiation given that the state dealer acts provide the protections dealers need).[289] Policies and procedures governing the day-to-day operations of the dealership such as allocation formulas, procedures and warranty reimbursement also have been compiled in reliance on the state dealer acts.[290]

While it is certain that dealers will not like losing ground to the manufacturers, manufacturers also may be hesitant to change the present system, which, with its imperfections, at least provides a known quantity in their relationships with dealers.[291] Manufacturers would need to pay closer attention to negotiating dealer agreements and formulating their policies and procedures. Manufacturers would also need to carefully weigh entering into the retail dealership business and the investment that would be required to operate a dealership, not to mention hiring the right managers to operate the dealerships.

Despite the expected resistance to changes to the current system, it is clear that reforms are needed in order to create a healthy and sustainable automobile distribution network in the United States. I hope that the proposals that I have outlined will at the very least spur some new and creative thinking about the purpose of the state dealer acts, the relationship between manufacturers, dealers and consumers, and how to establish a system that would provide incentives that would maximize benefits to all.

(hypothesizing as to why dealers have been better able to take advantage of the political process to pass dealer-protection statutes).

288. In 2009, eight states will likely pass statutes that provide manufacturers will pay additional compensation to dealers that go out of business or if the manufacturer determines to stop selling a vehicle line. Donna Harris, *Dealers Lobby Statehouses for Beefier Franchise Laws*, AUTOMOTIVE NEWS, Feb. 23, 2009, at 1, *available at* 2009 WLNR 3723885.

289. *See supra* notes 245-247 and accompanying text.

290. These policies are often incorporated by reference in the dealer agreement. *See* Blair & LaFontaine I, *supra* note 97, at 60 ("In fact, most franchise contracts incorporate by reference the whole set of directives contained in a very detailed operations manual.").

291. *See generally* Delacourt, *supra* note 167, at 179-86 (outlining potential obstacles if manufacturers were permitted to sell vehicles directly to consumers).