

Mitigating Risk Under The ADDCA

Law360, New York (February 3, 2011) -- It is no secret that auto distributors and dealers do not always see eye to eye when it comes to allocation of vehicles. Dealers want a limitless supply of the fastest-selling and most profitable models. Distributors want to sell the largest volume of vehicles in the most efficient manner possible.

When dealers feel they are not being allocated their fair share of desirable vehicles, they may sue distributors under federal or state law or both. This article generally describes the laws under which dealers may sue for perceived improper allocation as well as what steps distributors can take to ensure compliance with those laws and to avoid liability.

Automobile Dealers' Day in Court Act[1]

Since 1956, the Automobile Dealers' Day in Court Act (the ADDCA) has allowed dealers to sue manufacturers/distributors for any damages resulting from "the failure of said automobile manufacturer ... to act in good faith in performing or complying with" the franchise agreement or in severing its relationship with the dealer.[2]

The ADDCA was enacted by Congress to "level the playing field" between manufacturers/distributors and dealers in response to a perceived imbalance in bargaining power between them.[3] Despite the seemingly broad language of the ADDCA, however, it is difficult to sustain a lawsuit brought under the act for unfair or otherwise improper allocation of vehicles.

The duty to act in "good faith" under the ADDCA has been interpreted narrowly in favor of distributors. A distributor must be shown to have coerced or intimidated a dealer in order to achieve some wrongful end.[4] Thus merely demonstrating that a distributor acted arbitrarily or unfairly, with nothing more, will not support a claim under the ADDCA.[5]

Because this is a high standard, it is unusual for a vehicle allocation scheme to be found to have violated the ADDCA. However, this does not mean that distributors need not concern themselves with the act in deciding how to allocate vehicles. In particular, distributors should not use vehicle allocation as a means to attempt to terminate their relationships with particular dealers or for any other improper purpose.

In one such case, an appellate court upheld a jury verdict finding that a distributor violated the act by discriminating in the allocation of a popular model in order to try to compel the termination of certain under-performing dealers.[6] In another case, a verdict was upheld where the distributor withheld vehicles to coerce a dealer to cooperate with an illegal price-fixing scheme.[7] Reducing allocation in retaliation for a dealer's refusal to add a new line of cars[8] and for refusing to sell another dealership[9] have also been found sufficient to support an ADDCA claim.

Conversely, allocation practices that are not discriminatory and not applied to achieve an improper purpose will not be found to violate the ADDCA. Thus, in cases where allocation was based on a dealer's prior sales, ADDCA claims based on allocation have failed.

In one such case, the court found that a distributor's use of a "turn and earn" system of allocation did not violate the ADDCA.[10] Under that system, a dealer must sell a certain number of a particular model of car in order to receive an increased allocation of that model. If a dealer requires more vehicles than it receives under its allocation, it must obtain those vehicles from other dealers.

In finding the "turn and earn" system not to be coercive, the court quoted a previous case, which explained "the allocation of scarce vehicles based upon prior sales performance is generally permissible as a legitimate means of promoting competition through efficient distribution." [11]

State Allocation Laws

Every state except for Alaska has a law governing automobile dealer franchises, and nearly every one of these state laws contains a provision governing the allocation of vehicles. Unlike the ADDCA, these laws explicitly address allocation. Generally, these state laws require the distributors to employ fair allocation systems, although they may use different language to reach that result.

For instance, some statutes require allocation systems to be "fair and equitable" or use some variation of that phrase.[12] Others prohibit "arbitrary and capricious" allocation systems.[13] Still others prohibit distributors generally from withholding vehicles or from failing to provide all models of a particular line that they provide to other dealers carrying that line.[14]

Additionally, many state statutes require that a distributor disclose its allocation system to dealers.[15] Despite the fact that many of the state statutes contain similar language and appear to establish similar standards, each state may interpret its statute differently. Therefore, it is important to thoroughly review each state's laws and any cases interpreting them in determining how best to proceed in that state.

Because state allocation laws generally prohibit unfair or arbitrary allocation systems, the use of discretion in allocation schemes can lead to suits under the statutes. Such suits have had varying results. For instance, in one Illinois case, a court found that where a franchise agreement granted a distributor discretion over allocation and there was no evidence that the distributor exercised its discretion in bad faith, the dealer's claim under the statute failed.[16]

In another Illinois case however, a verdict under the statute was upheld where the evidence at trial showed the distributor maintained a great deal of discretion over allocation.[17] In that case, the distributor told dealers it was using a "turn and earn" system, but actually used a complex system that took many adjustable parameters into account.

The plaintiff argued that the system was put together that way to give managers the ability to manipulate allocation. Furthermore, regional managers were given a pool of vehicles to allocate at their discretion, within certain guidelines. The evidence also showed the regional managers did not always follow the guidelines. The court found that this evidence was sufficient to support the jury's finding that the distributor violated the statute by employing an arbitrary and capricious allocation system.[18]

While the pool of vehicles to be distributed at the discretion of regional managers contributed to the upholding of that claim, a Massachusetts court found in a different case that a distributor's allocation system was not "arbitrary or unfair" where the plaintiff failed to show that a pool of vehicles distributed at the discretion of regional managers were distributed arbitrarily.[19]

Using allocation to retaliate against dealers, as well as failing to allocate according to the system that is in place, may lead to liability under state statutes. Such was the situation in a New Hampshire case where a distributor retaliated against a dealer by cutting its allocation.[20]

The dealership's owner was president of an alliance of dealers that was unhappy with the distributor and was formed to bargain with the distributor. The dealer presented evidence that, after the alliance presented the distributor with a list of demands, the distributor went against its own allocation formula and allocated fewer cars to the dealer than it did to other comparable dealers. Based on this evidence, the court upheld a jury verdict finding that the distributor violated New Hampshire's franchise law prohibiting distributors from failing to provide reasonable quantities of vehicles to dealers.

Because it is typically left to juries to determine whether state allocation statutes have been violated, it is difficult to discern where the line is drawn between permissible and prohibited conduct.[21] Therefore, to mitigate risk, distributors should design and implement allocation systems that studiously avoid that line.

Allocation systems that are predictable, transparent, and that limit discretion are the most likely to withstand scrutiny. Additionally, allocation should generally not be used as a coercive tool. While every case, and every state law, is different, following these basic precepts should limit distributors' liability under both state franchise laws and the ADDCA.

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[1] 15 U.S.C. §§ 1221-25.

[2] 15 U.S.C. § 1222.

[3] See *Bronx Chrysler Plymouth Inc. v. Chrysler Corp.*, 212 F. Supp. 2d 233, 239 (S.D.N.Y. 2002).

[4] *Id.* at 245; *Coady Corp. v. Toyota Motor Distributors Inc.*, 346 F. Supp. 2d 225, 234 (D. Mass. 2003).

[5] *Fox Motors Inc. v. Mazda Distributors (Gulf) Inc.*, 806 F.2d 953, 959-60 (10th Cir. 1986).

[6] *Fox Motors*, 806 F.2d at 960.

[7] *Randy's Studebaker Sales Inc. v. Nissan Motor Corp in U.S.A.*, 533 F.2d 510, 516 (10th Cir. 1976).

[8] See, e.g., *Speed Auto Sales Inc. v. Am. Motors Corp.*, 477 F. Supp. 1193, 1198 (E.D.N.Y. 1979).

[9] *Rea v. Ford Motor Co.*, 497 F.2d 577, 582-83 (3d Cir. 1974).

[10] *Bronx Chrysler Plymouth*, 212 F. Supp. 2d at 246.

[11] *Bronx Chrysler*, 212 F. Supp. 2d at 246 (quoting *Fox Motors*, 806 F.2d at 959-60).

[12] See, e.g., Fl. Stat. § 320.64(18); Me. Rev. Stat. § 10-1174(3)(A); N.C. Gen Stat. § 20-305(14).

[13] See, e.g., § 815 Ill. Comp. Stat. 710/4(d)(1); Mass. Gen. Law, ch. 93B § 4(c)(1).

[14] See, e.g., Colo. Rev. Stat. Ann. § 12-6-120(1)(e); N.J. Stat. Ann. § 56:10-7.4(h).

[15] See, e.g., § 815 Ill. Comp. Stat. 710/4(d)(2); N.C. Gen. Stat. § 20-305(14).

[16] *Olympic Chevrolet Inc. v. Gen. Motors Corp.*, 959 F. Supp. 918, 927 (N.D. Ill. 1997).

[17] *Belleville Toyota Inc. v. Toyota Motor Sales U.S.A. Inc.*, 738 N.E.2d 938, 947 (Ill. App. Ct. 2000).

[18] See *id.*

[19] See *Coady Corp. v. Toyota Motor Distributors Inc.*, 346 F. Supp. 2d 225 (D. Mass. 2003).

[20] *Jay Edwards Inc. v. N.E. Toyota Distributor Inc.*, 708 F.2d 814 (1st Cir. 1983).

[21] See, e.g., *Belleville Toyota*, 738 N.E.2d at 947-48 (finding that jury need not receive instruction as to the meaning of “arbitrary an capricious” in determining whether statute prohibiting such conduct has been violated).

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