Arbitration Guide for Terminated Auto Dealers

Purpose and Authorization of Arbitration

The auto industry, at the end of 2008 and in early 2009, faced a crisis. Sales had plummeted to post-WWII lows, General Motors and Chrysler faced imminent bankruptcy, and dealers and suppliers were similarly facing bleak prospects. Ultimately, both Chrysler and General Motors declared bankruptcy, and the federal government became both the financier and the major stockholder of the surviving enterprises. During this time, GM and Chrysler—following significantly different policies—terminated, or did not renew, thousands of dealership franchise agreements across the country.

Concerns about these terminations, many of which were made in haste and with tremendous political and financial pressure, resulted in the introduction in Congress of legislation to provide a procedure for the review of termination decisions in an orderly fashion. In mid-December, the proposal was adopted into an omnibus budget bill (H.R. 3288). This was signed into law by President Obama on December 16, 2009.

This guide is for dealers that are considering the arbitration process established by the bill. It reviews the timeline, the process, and the criteria that will be considered by the arbitrator. It concludes with some practical steps dealers should take as they consider whether to participate in the arbitration process.

Timeline and Process

The bill establishes a timeline for action by both the dealer and the manufacturer. By January 15, 2010 (30 days from the law's enactment) Chrysler and General Motors must provide terminated dealers with a summary of their rights and terms for arbitration, and the specific criteria used in reaching the decision to terminate. Dealers will then have a short window of time, until January 25, 2010, to decide if they want to participate in arbitration. However, a dealer can elect arbitration at any time, even before receiving materials from the factory.

After a dealer elects arbitration, the process will begin immediately. An independent arbitrator will be selected by mutual agreement of the dealership and manufacturer. Arbitration proceedings will take place in the state that the dealer is located. Prior to the start of arbitration, dealers will be allowed to a limited amount of discovery. This will be limited to requests for documents specific to the dealership. All arbitrations must be completed by June 14, 2010 (180 days from the law's enactment), though some may extend an additional 30 days if the arbitrator finds good cause for an extension to be granted.

When the arbitration hearing is complete, the arbitrator will make a determination regarding reinstatement of the dealership. If the arbitrator finds in favor of the dealer, the manufacturer will then have 7 business days to provide the dealer with a letter of intent to reinstate and the customary sales and services agreements. The arbitrator cannot award monetary damages to a dealer, and reinstated dealers will have to refund any wind-down payments to the factory.

Criteria for the Arbitration

Under the bill, an arbitrator is required to consider whether the dealership was terminated properly based on specific criteria. The criteria we consider to be the most important are listed below, along with our expectation about the practical interpretation that arbitrators will bring to them:

1. Dealership Profitability—Was the terminated dealer profitable enough over the last 4 years to establish a reasonable expectation that they could continue in operation and meet minimum requirements for an automobile franchise in that area? This provision addresses concerns that some terminated dealerships were financially viable until their termination, and some were terminated based on losses in 2008 without regard for factors that might explain a 1-year decline.
2. Ability to Support Manufacturer's Overall Business Plan—Could the dealership, if re-instated, operate in a manner that is consistent with the manufacturer's post-bankruptcy viability plans? It is probable that the manufacturers will present business plans that require fewer dealerships than in the past, given their lower expected sales volume in the future.
3. Dealership's Current Economic Viability—Was the dealership viable in terms of its capitalization at the time of their termination, and can it be viable upon reinstatement? Note that this criteria is listed separately from profitability.
4. Dealership Performance in Relation to Manufacturer's Performance Criteria—Did the dealership perform adequately in relation to the manufacturer's customary and regular business objectives? Such objectives are likely to include retail vehicle sales, particularly sales in the designated market area for the dealer, and customer service and satisfaction scores.
5. Local Conditions—Did local demographic, geographic, economic conditions, or natural disasters and other disturbances, cause or contribute to poor dealership sales performance or profitability?

Other criteria that an arbitrator will consider are the length of experience of the dealer, and the dealer's demonstrated record of satisfying objectives of the applicable franchise agreement. More broadly, the bill states that "the arbitrator shall balance the economic interest of the covered dealership, the economic interest of the covered manufacturer, and the economic interest of the public at large." Each arbitrator will interpret this "balancing test" differently. Some may weigh the interests of the public in convenience and competition in the local market more heavily, others the financial commitment and track record of the dealer, and others the specific criteria the manufacturer established for performance.

Advice to Dealers

Anderson Economic Group LLC has been involved in numerous market studies, feasibility studies, arbitration hearings, and court proceedings for automobile dealers and their associations. Based on our experience, we suggest dealers consider the following:

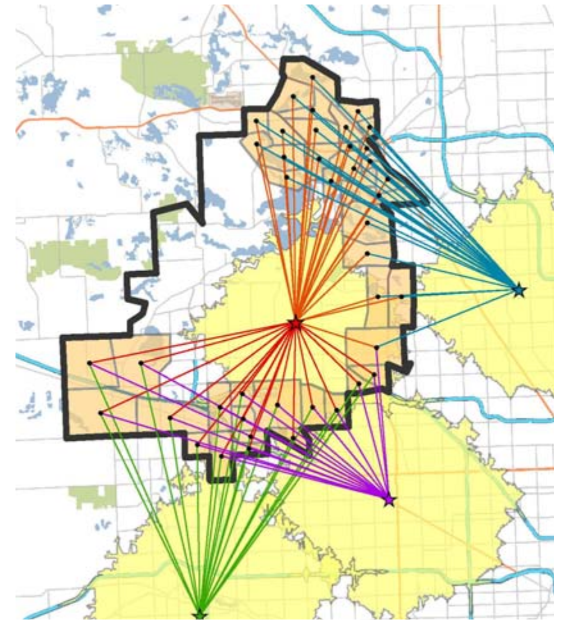
Individual Circumstances. A dealer should consider his or her own financial circumstances, business objectives, and expectations about the future health of the automobile industry before pursuing arbitration under the federal law. Pursuing arbitration will require time and money.

Dealers will have to pay any legal and expert fees that they elect to incur, as well as one-half of the costs for arbitration (split with the manufacturer). Additional risk is involved in re-opening a dealership, or re-establishing a franchise agreement, and re-established dealers will have to repay any wind-down monies received. Regardless of whether the termination decision was "correct," each dealer should consider his or her own circumstances carefully before moving forward.

A dealer should also be mindful that manufacturers have legitimate business interests that are protected by both franchise agreements and state laws, and that arbitrators are legally bound to observe valid business criteria as bases for both termination and possible re-instatement. Although each case is different, some termination decisions will undoubtedly prove to be well-founded and irreversible under those criteria.

Representation at Arbitration. The law does not require a dealer to be represented by legal counsel or retain an expert to testify at the arbitration proceeding. However, we advise dealers to consult an attorney familiar with arbitration proceedings, and have one or more capable and independent experts review the available information relevant to the termination criteria. Your expert should be able to evaluate:

1. The geographic and demographic characteristics of your market area.
2. The specific business performance standards stated in your franchise agreement.
3. The financial viability and profitability of your dealership at the time of the termination and the 3 years before.
4. The manufacturer's performance metrics used in the termination process, and the sources of data used in the calculations.



A "desire line" analysis, performed using GIS, measures the drive-times from population centers to four competing automobile dealerships.

Evaluating the factors for automobile dealers requires special knowledge of the industry, and particular skills in evaluating sales, demographic and economic data. Qualified experts will likely make use of a Geographical Information System (GIS) to model and illustrate the pattern of sales in the market, and may find that the market area designated by the manufacturer deviated from the standard business practices in the industry.

In some cases, a capable expert could discover that errors were made in the assessment made by the manufacturer (or their market analyst) that was the basis for the termination. In other cases, an expert may need to confirm that the dealership's performance under the factory's stated performance criteria did not meet a reasonable business standard, or demonstrate how the factory's criteria provides an unreasonable measure of performance.

When seeking an expert, a dealer should ensure that the individual or firm is knowledgeable about the automobile industry; has the capability to perform the necessary market and business analyses; has the necessary GIS software and data; and can testify at an arbitration hearing, if necessary. Dealers should avoid experts that lack specific industry knowledge; promise to find a result favorable to their client regardless of the facts; or do not have the necessary skills and facility.

In general, a dealer's accountant, sales manager, or attorney will not have the independence or expertise necessary to perform these tasks. However, information from these individuals, as well as from the dealer principal and the key documents listed below, will be helpful in both evaluating the dealer's ability to meet the balancing test and to prepare information that demonstrates this to the arbitrator.

Next Steps. A dealer considering arbitration should be aware of the strict timelines in the law. In particular, an interested dealer should promptly take the following steps:

1. Secure a copy of his or her franchise agreement, any written statements designating a market area or evaluating sales performance or customer satisfaction, recent sales performance reports from the factory, and any correspondence related to the termination.
2. Read the text of the law, in particular the criteria and possible remedies established by the law. Review the statements of the manufacturer outlining the arbitration process they intend to follow. Ask an attorney familiar with the industry to provide advice on the process.
3. Consider all the factors listed in this guide and the applicable law.
4. If you wish to proceed, confirm that your dealership is eligible, and within 10 days of receiving notice from the factory, provide notice that you intend to pursue arbitration.
5. If you wish to go to the arbitration proceeding, consider retaining a qualified, independent expert to conduct a review of the criteria to be covered by the arbitrator.

Limitations

As noted above, this is preliminary information provided to dealers for whom the authors have no contractual relationship. The authors have not examined any business, market or other records for any individual dealership, and do not intend this guide to be either legal or financial advice. The authors advise dealers to confirm the details of the actual law and arbitration process, retain professional legal advice, and retain professional market and economic professionals, before going to arbitration.

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Additional Resources

For additional information, we recommend:

- Anderson Economic Group, LLC - http://www.andersoneconomicgroup.com/Expertise/Automotive.aspx
- American Arbitration Association - http://www.adr.org/
- Committee to Restore Dealer Rights - http://www.hometownautodealers.org/
- National Auto Dealers Association - http://www.nada.org/
- H.R. 3288, Sec. 747 - http://thomas.loc.gov/