

Tip of the Iceberg? New Law Exempts Car Dealers from Federal Arbitration Act

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On November 2, 2002, President Bush signed into law the Motor Vehicle Franchise Contract Arbitration Fairness Act (Act).¹ Designed to redress an alleged disparity in bargaining power between motor vehicle dealers and manufacturers, the Act makes predispute arbitration clauses in motor vehicle franchise contracts unenforceable under the Federal Arbitration Act (FAA) unless both parties consent after the dispute arises.

The three-paragraph Act is a landmark. For the first time, a special-interest exemption to the FAA has become law.² Moreover, the loophole benefits relatively sophisticated business interests rather than individual consumers or employees who have also sought exemptions. Although the Act appears to reflect the considerable political clout of the motor vehicle dealer lobby rather than a broad congressional consensus to roll back arbitration, the Act will almost certainly encourage other groups to seek similar carve-outs. In the long run, as the chief Senate sponsor of the Act predicts, the Act may prove to be the first salvo in a legislative strategy to ban “mandatory, binding arbitration provisions . . . altogether.”³

Description of the Act

The Act makes arbitration clauses in motor vehicle franchise contracts⁴ unenforceable unless all parties consent in writing “after the dispute arises.” The consent requirement applies to motor vehicle franchise contracts “entered into, amended, altered, modified, renewed or extended” after November 2, 2002.⁵ The Act also requires any arbitrator to provide “a written explanation of the factual and legal basis for the award.”⁶

Introduced in a slightly different form in 1999 and the subject of congressional hearings in 2000,⁷ the Act was the top legislative priority of the National Automobile Dealers Association (NADA).⁸ The Act appeared stalled, however, until automobile dealers nationwide, at NADA’s urging, began contacting their legislators directly.⁹ In September 2002, the Act was inserted in an omnibus spending authorization bill for the Department of Justice that Congress approved by an overwhelming majority.¹⁰ Following the President’s signature, NADA issued a press release hailing the Act as “the biggest legislative victory for NADA in at least 50 years.”¹¹

The Act was necessary, according to the Committee Report, because of the disparity in bargaining power between motor vehicle dealers and manufacturers. In addition, the report found that motor vehicle franchise agreements between dealers and manufacturers are inherently coercive and one-sided contracts of adhesion.¹² The Act also seeks to protect dealers’ ability to bring claims before specialized state administrative agencies,

which are perceived as more hospitable to dealer interests.¹³

The Act Breaks New Ground

As Senator Sessions states in the minority views section of the Committee Report, the Act “reverses a long-standing congressional policy favoring arbitration.”¹⁴ This policy had emphasized the importance of enforcing contractual promises to arbitrate and the benefits that can arise from arbitration. The U.S. Supreme Court, in applying “the FAA’s proarbitration purposes,”¹⁵ has enforced a wide range of arbitration clauses. Most recently, the Court has held that arbitration clauses in employment contracts are enforceable.¹⁶ For motor vehicle dealers, the applicable Court precedent meant that mandatory arbitration clauses in franchise contracts with manufacturers were generally enforced.¹⁷

The Act effectively overrules a line of state and federal cases invalidating state laws that exempt motor vehicle dealers from mandatory arbitration. Courts had almost uniformly held that the FAA preempted these provisions. In *Saturn Distribution Corp. v. Williams*,¹⁸ for example, the U.S. Court of Appeals for the Fourth Circuit criticized a Virginia statute that prohibited mandatory arbitration provisions in motor vehicle franchise contracts: “Requiring arbitration provisions in dealership agreements to be optional rather than nonnegotiable unreasonably burdens the formation of arbitration agreements. . . . The Federal Arbitration Act does not allow such singular hostility to the formation of arbitration agreements.” Similarly, in *Cornhusker International Trucks v. Thomas Built Buses*,¹⁹ the Nebraska Supreme Court held that the FAA’s “liberal federal policy favoring arbitration agreements” preempted a statute purporting to invalidate arbitration clauses in motor vehicle franchise agreements. In *Bondy’s Ford v. Sterling Truck Corp.*,²⁰ an Alabama federal court held that a state statute precluding mandatory arbitration clauses in motor vehicle franchise contracts was void.

Ironically, the Act closely resembles the preempted state statutes at issue in *Saturn*, *Cornhusker*, and *Bondy’s*. Indeed, the Act almost certainly would have been invalidated had a state legislature, not the federal government, adopted it.

Do Motor Vehicle Dealers Merit Relief from the FAA?

Motor vehicle dealers are one of many business, consumer, and employee interest groups that have sought carve-outs from the FAA. These groups’ arguments for exemptions have been similar: mandatory predispute arbitration clauses are coercive and unjust, and result from a lack of bargaining power. For a number of reasons, however, motor vehicle dealers are quite unlike other groups that have sought relief from the FAA. First, dealers are sophisticated business persons managing complex business operations and are represented by counsel in

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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.²¹

Motor vehicle dealers also frequently insist on mandatory arbitration clauses in their own contracts with retail car buyers and rely on the FAA to enforce those provisions.²² Even Senator Feingold, one of the Act's original sponsors, was troubled by the fact that "auto dealers . . . themselves put mandatory arbitration in their contracts with consumers."²³ This has led consumer groups like Public Citizen that oppose mandatory arbitration under the FAA to criticize motor vehicle dealers for seeking relief from the FAA while at the same time being "at the forefront of a trend to impose mandatory predispute requirements on the consumers who purchase their cars."²⁴

In addition, relatively few motor vehicle franchise contracts include mandatory predispute arbitration clauses. As Senator Sessions noted in his Minority Views, "only a small fraction of motor vehicle franchise contracts contain arbitration clauses."²⁵ One industry poll estimated that under seven percent of these contracts have a now-prohibited mandatory arbitration clause.²⁶ That statistic makes this unprecedented legislation appear all the more remarkable.

Finally, no evidence exists that arbitral panels are inherently less hospitable to motor vehicle dealers than are courts.²⁷ All states have enacted laws "specifically designed to level the playing field between manufacturers and dealers."²⁸ These statutes provide substantive protections to dealers; for example, they generally prohibit dealer termination without cause, restrict manufacturers' ability to appoint additional dealers, and prohibit manufacturers from selling motor vehicles over the Internet.²⁹ These substantive protections apply whether the dispute is heard in court or by arbitrators.³⁰

Conclusion

Congress, of course, may restrict the scope of the FAA.³¹ As the U.S. Supreme Court observed in *Circuit City*, it is for Congress "to consult political forces and decide how best to resolve conflicts."³² The Act, however, signals a retreat from the strong federal policy in favor of arbitration. By creating an exemption for motor vehicle dealers, Congress has raised expectations among other groups that seek similar treatment. If motor vehicle dealers merit protection from mandatory arbitration, why not contracts involving consumers and employees that may well result from disparate bargaining power? Congress is now likely to come under pressure to create more exemptions from the FAA and to curtail long-standing U.S. Supreme Court precedent that broadly construes the FAA. Additional carve-outs would weaken the FAA and create greater uncertainty in contractual dispute resolution. As the U.S. Chamber of Commerce has cautioned, the Act threatens to "cause serious damage to the use and availability of alternative dispute resolutions . . . [and] establish a dangerous anti-contract and anti-arbitration precedent."³³

Endnote

1. 15 U.S.C. § 1226(a)(2).

2. The Report of the Senate Committee on the Judiciary refers to the Act as a "targeted amendment to the Federal Arbitration Act" although the Act is included in the Automobile Dealers' Day in Court Act, 15 U.S.C. §§ 1221 *et seq.*, and not in the FAA itself. See Motor Vehicle Franchise Contract Arbitration Fairness Act Report, S. REP. 107-266 at 2 (Sept. 10, 2002), available at <ftp://ftp.loc.gov/pub/thomas/cp107/sr266.txt>.

3. Statement of Senator Russ Feingold on S.1020, the Motor Vehicle Franchise Contract Fairness Act (Oct. 5, 2000), available at http://judiciary.senate.gov/oldsite/1052000_rf.htm.

4. The Act defines "motor vehicle franchise contract" as "a contract under which a motor vehicle manufacturer, importer, or distributor sells motor vehicles to any other person for resale to an ultimate purchaser and authorizes such other person to repair and service the manufacturer's motor vehicles." 15 U.S.C. § 1226(a)(1)(B).

5. 15 U.S.C. § 1226(b).

6. 15 U.S.C. § 1226(a)(3).

7. *Fairness and Voluntary Arbitration Act of 2000, Hearings on H.R. 534 Before the House Judiciary Committee Subcommittee on Commercial and Administrative Law*, 106th Cong., 2d Sess. (Mar. 1, 2000, and June 8, 2000), available at www.house.gov/judiciary/cal0608.htm.

8. Press Release, President Signs NADA Voluntary Arbitration Bill (Nov. 4, 2002), available at www.nada.org.

9. Harry Stoffer, *A Lesson in Sausage Making, or How NADA Got Congress to Ban Mandatory Binding Arbitration*, AUTOMOTIVE NEWS (Jan. 27, 2003).

10. See COMMITTEE REPORT, *supra* note 2, at 2 n.1 (noting "exceptionally strong bipartisan support" for the Act).

11. Press Release, *supra* note 8.

12. Committee Report, *supra* note 2, at pt. I (Background) ("Motor vehicle manufacturers have historically, and do currently, require dealers to execute standard contracts of adhesion defining the manufacturer-dealer contract on a 'take it or leave it' basis."). See also Hearings on H.R. 534, *supra* note 7 (Testimony of Gene Fondren, President, Texas Automobile Dealers Association).

13. Committee Report, *supra* note 2, at 5 ("State motor vehicle administrative forums were specifically established for the public policy purpose of providing alternative dispute resolution mechanisms, but with the added features of important legal safeguards, particularly that of a right to appeal.") Some courts have found these administrative bodies to provide inadequate due process protections. *E.g.*, *Jaguar Cars v. Cottrell*, 896 F. Supp. 691, 696 (E.D.Ky. 1995) (finding "evident bias" in state motor vehicle commission because a "majority of the Commission's members have a direct pecuniary interest in the matter at bar").

14. Committee Report, *supra* note 2, at 11, (Minority Views of Senator Sessions).

15. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 122 (2001).

16. *Id.* at 109 (holding that exemption in FAA § 1 should be narrowly confined to transportation workers, not employees in general).

17. *E.g.*, *Bondy's Ford, Inc. v. Sterling Truck Corp.*, 147 F. Supp.2d 1283, 1291 (M.D.Ala. 2001) (granting motion to stay case filed by motor vehicle dealer because mandatory arbitration clause in dealer agreement enforceable under FAA); *Gaston Andrey of Framingham v. Ferrari N. Am., Inc.*, 983 F.Supp. 18, 21 (D. Mass. 1997) (granting motion to stay action filed by motor vehicle dealer against manufacturer, alleging lack of good cause to terminate franchise agreement, pending arbitration pursuant to mandatory arbitration clause).

18. 905 F.2d 719, 726 (4th Cir. 1990). See also *Seacoast Motors of Salisbury v. DaimlerChrysler Motors Corp.*, 271 F.3d 6, 10 (1st Cir. 2001) (holding that antitrust claim by car dealer against manufacturer was arbitrable under dealer agreement).

19. 637 N.W.2d 876, 884 (Neb. 2002).

20. 147 F. Supp. 2d 1283, 1289 (M.D. Ala. 2001).

21. See *Saturn Distrib. Corp.*, 905 F.2d at 726 ("The use of a standard form contract between two parties of admittedly unequal bargain-

ing power does not invalidate an otherwise valid contractual provision. To be invalid, the provision at issue must be unconscionable.’ ”); *Bondy’s Ford*, 147 F. Supp. 2d at 1291 (“the inherent imbalance of bargaining power between automobile dealers and manufacturers . . . is insufficient” to warrant invalidating mandatory arbitration provision).

22. *E.g.*, *Jacobson v. J.K. Pontiac GMC Truck, Inc.*, No. 01-C-4312, 2001 U.S. Dist. LEXIS 20393 (N.D. Ill. Dec. 7, 2001) (granting car dealers’ motion to compel arbitration in dispute with customer based on “strong presumption” in FAA of validity of arbitration clauses); *Stout v. Byrider*, 50 F. Supp. 2d 733, 740 (N.D. Ohio 1999) (enforcing arbitration clause under FAA in dispute between car dealer and consumer; consumers were given opportunity to read the arbitration clause and had “an opportunity to ask questions,” the clause “was clear and unambiguous,” and consumers presented no evidence of fraud).

23. Sen. Feingold Statement, *supra* note 3.

24. *See also* Hearings on H.R. 534, *supra* note 7 (Statement of Joan Claybrook, president, Public Citizen), available at www.citizen.org (arguing that the Act, which exempts car dealers only from the FAA, “is fundamentally flawed”); Public Citizen, H.R. 534/S. 1020 Should Protect Consumers—Not Just Auto Dealers—from Mandatory Arbitration, available at www.citizen.org (“At a minimum, auto dealer protections from mandatory arbitration with the big auto makers should be contingent upon the auto dealers not forcing their customers into arbitration.”).

25. Committee Report, *supra* note 2, at pt. IX (minority views of Senator Sessions noting “the limited applicability in practice of arbitration clauses to motor vehicle franchise contracts” and criticizing “piecemeal exemption approach” of the Act).

26. James T. Riley, *Citizens for a Sound Economy, Issue Analysis No. 106: Protecting the Trial Lawyer Monopoly: The Assault on State and Federal Binding Arbitration* (July 12, 2000), available at www.csc.org (citing poll of Alliance of Automobile Manufacturers and Association of International Automobile Manufacturers).

27. *E.g.*, Eric Freedman, *Truck Franchisor Can’t Force Dealers to Sign New Contracts*, AUTOMOTIVE NEWS (Jan. 29, 2001) (describing ruling by arbitrator applying state law in favor of group of dealers in suit against manufacturer). *Cf.*, In the Matter of Arbitration between Trans Am. Brokerage, Inc. and Mrs. Smith’s Bakeries, Inc., Bus. Franchise Guide (CCH) ¶ 12,512 (AAA 2003), confirmed by *Trans Am. Brokerage v. Mrs. Smith’s Bakeries*, Case No. 02-3810 (E.D. Pa. Jan. 21, 2003) (arbitrator awarded \$9.8 million to distributor in suit against pie manufacturer arising from breach of distributor agreement).

28. Committee Report, *supra* note 2, at pt. IV (Background).

29. *See Ford Motor Co. v. Texas Dep’t of Transp.*, 264 F.3d 493, 511 (5th Cir. 2001) (affirming ruling that Ford Motor Company’s sale of preowned motor vehicles through its website violated Texas Motor Vehicle Commission Code).

30. *See, e.g.*, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985) (“By agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.”); *Ferrari N. Am., Inc. v. Crown Auto Dealerships*, No. 94 Civ. 8541 (KMW), 1995 U.S. Dist. LEXIS 15356 (S.D.N.Y. 1995), *aff’d without op.*, 101 F.3d 686 (2d Cir. 1996) (holding that enforcement of mandatory arbitration clause was consistent with application of dealer’s remedies under Florida state law).

31. For example, § 1 of the FAA excludes “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.” 9 U.S.C. § 1.

32. *Circuit City Stores, Inc. v. Adams*, 523 U.S. 105, 119 (2001).

33. Tom Donohue, President and CEO, U.S. Chamber of Commerce, *The Donohue Letter* (Apr. 25, 2001), available at www.chamberbiz.com/government/Donohue/archive (commenting on an earlier version of the Act). *See also* Press Release, *Anti-Arbitration Bill Sets Dangerous Precedent, Warns U.S. Chamber of Commerce* (June 8, 2000), available at www.uschamber.com (criticizing early version of the Act).