NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL

DEFENDER

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In this Issue:

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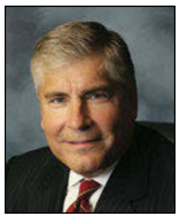

Factory Incentive Programs - Illegal Price Discrimination?

By Leonard A. Bellavia
Bellavia Blatt & Crossett, PC

This article analyzes possible federal and state law challenges to volume discount incentives offered by automobile manufacturers to their dealers.

One hypothetical volume discount offers dealers a $200 incentive per vehicle sold each month if the dealer exceeds its previous year's sales performance by twenty percent. Another hypothetical volume discount offers dealers an $800 incentive per vehicle sold each month that the dealer sells more than 150 of the manufacturer's vehicles. The first hypothetical is not illegal price discrimination, while the second hypothetical is illegal price discrimination. The first volume discount is proportionately available to competing dealers, while the second volume discount is not proportionately available to competing dealers, but only to a high volume "mega-dealer".

In yet a third hypothetical, suggested by a February 8, 2016 Automotive News article, "Cash for Nissan's Preferred Dealers", by Neal Boudette and Jamie LaReau, an automobile manufacturer offers a small number of favored dealers quarterly installment payments in cash totaling $4.44 million over an eight year period, subsidizing the growth of those dealers into high-volume mega-dealers. Such subsidies are indirect price discrimination in violation of Section 2(a) of the Robinson-Patman Act.

In a civil action for damages brought by disfavored dealers against a manufacturer under Section 2(a) the Robinson-Patman Act, the plaintiffs would have the burden of proving injury and damages.

1. <u>Section 2(a) of the Robinson-Patman Act</u>

Section 2(a) of the Robinson-Patman Act, an amendment to the Clayton Act enacted in 1936, generally provides that a seller cannot discriminate in price between purchasers of goods of like grade and quality, where substantial competitive injury may result. In pertinent part, section 2(a) provides:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them.

Although the Robinson-Patman Act's purpose is simple to state, its interpretation and application are not; indeed, because of imprecise drafting, numerous courts and commentators have noted that Robinson-Patman is one of the most difficult, if not inscrutable antitrust laws in existence. As one commentator has written:

> The Robinson-Patman Act of 1936 is the most awkwardly drafted of all antitrust legislation. This statute was a roughly hewn, unfinished block of legislative phraseology when it left Congress, and has required much interpretive refinement by the [Federal Trade] Commission and the courts to reveal the contours of its meaning and application. Indeed, so confusing is some of this language that experience in applying its provisions is the only reliable guide for the wise practitioner.

Jerrold G. Van Cise, Understanding the Antitrust Laws, 56 (9th ed. 1986); *see Automatic Canteen Co. v. Federal Trade Commission*, 346 U.S. 61, 65 (1953) ("[P]recision of expression is not an outstanding characteristic of the Robinson-Patman Act.").

The Robinson-Patman Act has been assailed on policy grounds as well, the most frequent criticism being that its prohibitions on price discrimination protect inefficient competitors at the expense of consumer welfare, placing it in tension with the remainder of antitrust law. Indeed, the federal government, which has responsibility for enforcing the Robinson-Patman Act's provisions, has largely ignored it in recent times. One federal judge, noting these criticisms of the Robinson-Patman Act, stated: "[F]or purposes of adjudicating this case, of course, such criticism carries no weight; this court's task–and its only task absent unconstitutionality–is faithfully to apply any statute that Congress has enacted." *Precision Printing Co., Inc. v. Unisource Worldwide, Inc.*, 993 F. Supp. 338, 345 n.5 (W.D. Pa. 1998).

The Second Circuit, in *George Haug Co. v. Rolls Royce Motor Cars*, 148 F.3d 136, 143-44 (2d Cir. 1998), set forth the elements of a "secondary-line" Robinson-Patman Act claim (injury to disfavored purchaser, as opposed to "primary-line" injury to competitor of seller):

> In order to establish secondary-line price discrimination under section 2(a), a plaintiff has the burden of establishing four facts: (1) that seller's sales were made in interstate commerce; (2) that the seller discriminated in price as between the two purchasers; (3) that the product or commodity sold to the competing purchasers was of the same grade and quality; and (4) that the price discrimination had a prohibited effect on competition. A private plaintiff who has proved a violation of section 2(a) must, in order to recover damages under §4 of the Clayton Act, demonstrate that it suffered actual injury to its business or property as a result of the price discrimination. Moreover, section 2(a) affords defendants two defenses based on certain cost justifications and/or changing conditions, respectively. [citations omitted].

A claim of "secondary-line" injury under Section 2(a) of the Robinson-Patman Act, unlike most other antitrust claims, does not require proof of actual injury to competition, only that the effect of price discrimination "may be to substantially lessen competition . . . or to injure destroy or prevent competition." *Federal Trade Commission v. Morton Salt Co.*, 334 U.S. 37, 46 (1948). In *Morton Salt*, the Supreme Court noted that the Robinson-Patman Act adopted a liability standard designed to reach incipient as well as actual anticompetitive effects of price discrimination.

Overturning earlier precedent, the Supreme Court has held that for "primary-line" Robinson-Patman Act claims, competitive injury must measure up to more exacting standards of competitive injury under the Sherman Act. *Brooke Group v. Brown & Williamson Corp.*, 509 U.S. 209, 221 (1993). There is a split in the federal courts on whether *Brooke Group* should be extended to require injury to competition on "secondary-line" Robinson-Patman Act claims to measure up to more exacting standards of competitive injury under the Sherman Act. *See George Haug,* 148 F.3d at 143-44 (adhering to *Morton Salt* rule); *Chroma Lighting v. GTE Products Corp.*, 111 F.3d 653, 657 (9th Cir. 1997) (same); *Coastal Fuels of Puerto Rico, Inc., v. Caribbean Petroleum Corp.*, 79 F.3d 182, 192 (1st Cir. 1996) (same); *Stelwagon Mfg. Co. v. Tarmac Roofing Sys., Inc.*, 63 F.3d 1267, 1271 (3d Cir. 1995) (same). *But see Bob Nicholson Appliance, Inc. v. Maytag Co.,* 883 F. Supp. 321, 326 (S.D. Ind. 1994) (holding that "we are persuaded that the Seventh Circuit would extend the reasoning of *Brooke Group* and require actual injury to competition"); *Volvo Trucks North America, Inc., v. Reeder-Simco GMC, Inc.*, 546 U.S.164, 177 (2006) (noting in dicta in a secondary-line injury case that the Robinson-Patman Act "signals no large departure" from the antitrust law's general focus on inter-brand competition, citing *Brooke Group*).

The Second Circuit, in *Cash & Henderson Drugs, Inc. v. Johnson & Johnson*, 799 F.3d 202, 210 (2d Cir. 2015), noted that plaintiffs attempting to establish "secondary-line" competitive injury under Section 2(a) of the Robinson-Patman Act generally have two routes available to them: (1) showing substantial discounts to a competitor over a significant period of time, known as the *Morton Salt* inference, or (2) showing proof of sales lost to favored purchasers. *Falls City Indus., Inc. v. Vanco Beverage, Inc.,* 460 U.S. 428, 435 (1983). The Eleventh Circuit Court of Appeals found a successful claim of second line injury under the Robinson-Patman Act in *Alan's of Atlanta, Inc. v. Minolta Corp.*, 903 F.2d 1414, 1417 (11th Cir. 1990), holding that secret discriminatory discounts in the range of four to seven cents per purchase dollar generally, with occasional instances of ten percent not quantified until after extensive pre-trial discovery, were sufficient to justify a viable claim of price discrimination. While the Second Circuit in *Cash & Henderson Drugs*, 799 F.3d at 207-13, concluded that the plaintiffs had not proven the required second line injury after a closely-supervised matching process under which plaintiffs attempted to isolate more than *de minimis* sales to identified customers lost to identified favored competitors, that conclusion was drawn on summary judgment only after a full opportunity for plaintiffs to muster proof through discovery from defendants and third parties.

Volume discounts offered by automobile manufacturers to their dealers come within the Robinson-Patman Act's definitions of similar goods sold by persons in commerce to different purchasers at different prices, *Federal Trade Commission v. Anheuser-Busch, Inc.*, 363 U.S. 536, 547-51 (1969) (the term "price discrimination" is defined as merely a difference in price), provided that the favored and disfavored dealers are in actual competition with one another. *Best Brands Beverages v. Falstaff Brewing*, 842 F.2d 578 (2d Cir. 1987). However, these volume discounts offered by automobile manufacturers do not qualify for the cost-justification defense, because the relative cost of manufacturing and transporting vehicles from the factory to competing dealers is the same. *Texaco, Inc. v. Hasbrouck*, 496 U.S. 543, 561 n.18 (1990) (recognizing that cost justification seldom prevails as a defense to discounts).

The volume discounts posited by the hypotheticals stated at the beginning of this article do not qualify for the "changing conditions" defense, as might temporary promotions of outdated models or seasonal clearance sales. *Valley Plymouth v. Studebaker-Packard Corp.*, 219 F. Supp. 608, 613 (S.D. Cal. 1963). Volume discounts offered by automobile manufacturers may qualify for the functional availability "defense". Although this "defense" is not expressed in the language of the Robinson-Patman Act, courts have held that if discounts are available to the allegedly favored and disfavored purchasers alike, a claim of illegal price discrimination is negated. *Morton Salt*, 334 U.S. at 42. In several reported decisions, courts have found discounts offered by automobile manufacturers to be legal because they were functionally available to the favored and disfavored dealer alike. *See, e.g., Capital Ford v. Ford Motor Co.*, 819 F. Supp. 1555, 1571 (N.D. Ga. 1992); *Metro Ford Truck v. Ford Motor Co.*, 145 F.3d 320, 326 (5th Cir. 1998); *Rod Baxter Imports v. Saab-Scania of America, Inc.*, 489 F. Supp. 245, 249 (D. Minn. 1980). In these and other cases, federal courts have tested discounts for the functional availability "defense" by posing the question, "Are the conditions of the discounts well within the means of the average dealer?" *Bouldis v. U.S. Suzuki Motor Corp.*, 711 F.2d 1319, 1326 (6th Cir. 1983); *D.S. America, Inc. v. Chromagrafx Imaging Sys.*, 873 F. Supp. 786 (E.D.N.Y. 1995) (functional availability requires showing of "proportionately equal terms").

The first hypothetical stated above satisfies the functional availability "defense", as offering discounts well within the means of the average dealer. The second hypothetical does not satisfy the functional availability "defense", as it disproportionately favors a mega-dealer who sells a large multiple of the number of cars sold by the average dealer. The second hypothetical, with discounts of hundreds of dollars per car sold each month, available only in quantities sold by a mega-dealer, violates the underlying aim of the Robinson-Patman Act, which is "to prevent a large buyer from gaining discriminatory preferences over the small buyer solely because of the large buyer's greater purchasing power." *Morton Salt,* 334 U.S. at 43.

Under the third hypothetical above, a substantial cash payments from an automobile manufacturer to a favored dealer, made without the expectation of any services from the dealer other than reselling a high volume of automobiles, may be challenged as indirect price discrimination under Section 2(a) of the Robinson-Patman Act. Indirect price discrimination occurs when a seller grants something of value to one or more favored purchasers, but not to disfavored purchasers. *Fred Meyer, Inc. v. Federal Trade Comm'n*, 359 F.2d 351, 362 (9th Cir. 1966), *rev'd in part on other grounds*, 390 U.S. 341 (1968) (discriminatory cash payments from seller to buyer were not for promotional services, but instead "outright price concessions"); *American Booksellers Ass'n v. Barnes & Noble, Inc.*, 135 F. Supp. 2d 1031, 1068 (N.D. Cal. 2001); *Intimate Bookshop, Inc. v. Barnes & Noble, Inc.*, 88 F. Supp. 2d 133, 137-38 (S.D.N.Y. 2000); *see also* Financial Accounting Standards Board, Accounting Standards Codification 605-50-S99-1 (March 2016) (cash paid from vendor to buyer, to the extent not requiring buyer to perform services, is a price reduction that should be accounted for by the vendor as a reduction in revenue, not as an expense).

2. <u>State Price Discrimination Statutes</u>

Robinson-Patman Act claims may only be asserted in federal court, due to the exclusive jurisdiction of the federal courts over federal antitrust claims. In addition, there are approximately twenty-seven states with laws generally proscribing price discrimination, generally along the same lines as the Robinson-Patman Act. These are Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas, Utah, Wisconsin, and Wyoming. There may be significant variations in the language and the interpretation of these state statutes. Therefore, unlike in Connecticut, where its price discrimination statute, Conn. Gen. Stat. § 35-45(a), has been explicitly interpreted as substantially identical in meaning to Section 2(a) of the Robinson-Patman Act, *Retail Service Assoc. v. Conagra Pet Products Co.*, 759 F. Supp. 976, 983 (D. Conn. 1991), it cannot be assumed that claims under the state price discrimination statutes would have the same results as Robinson-Patman Act claims, or that the same damages and or other remedies would be available.

3. <u>State Motor Vehicle Dealer Statutes</u>

In addition to states laws of general application proscribing price discrimination, twelve of the fifty states in their motor vehicle dealer laws have provisions prohibiting motor vehicle manufacturers from discriminating in price between dealers. For example, New York Vehicle and Traffic Law Section 463(2)(g) provides that among unfair business practices by automobile manufacturers for which dealers have a private right of action for damages and injunctive relief, it is illegal for automobile manufacturers:

> (g) To sell or offer to sell any new motor vehicle to any franchised motor vehicle dealer at a lower actual price therefor than the actual price offered to any other franchised motor vehicle dealer

> for the same model vehicle similarly equipped or to utilize any device including, but not limited to, sales promotion plans or programs which result in such lesser actual price. . . . This paragraph shall not be construed to prevent the offering of incentive programs or other discounts if such discounts are available to all franchised motor vehicle dealers in this state on a proportionately equal basis.

This price discrimination section of the New York Vehicle and Traffic Law, applicable specifically to wholesale automobile pricing, has no comparable statutory prohibition of general application in New York. The New York statute does explicitly recognize the functional availability "defense" discussed above under the Robinson-Patman heading. In 2001, the following amendment was added to Section 463(2), making it an unfair business practice for a motor vehicle manufacturer to:

> (aa) (1) sell directly to a franchised motor vehicle dealer or, to or through a franchised motor vehicle dealer in which the franchisor owns any interest or controls the management, directly or indirectly, motor vehicles, parts, warranties, or services at a price that is lower than the price which the franchisor charges to all other franchised motor vehicle dealers.

Section 463(2) of the New York Vehicle and Traffic Law was also amended in 2002 to the effect that:

> (bb) (3) In any action or proceeding instituted pursuant to the provisions of this section, there shall be available to the franchisor all of the defenses provided for under section thirteen-b of title fifteen, United States code, known as the Robinson-Patman Act.

Thus, price discrimination claims by dealers against motor vehicle manufacturers under the New York Vehicle and Traffic Law were made explicitly subject to the statutory defenses to price discrimination claims under the Robinson-Patman Act. In *Audi of Smithtown v. Volkswagen Group of Am., Inc.,* 32 Misc. 3d 409 (Sup. Ct. Suffolk Co. 2011), *aff'd*, 100 A.D. 3d 669 (2d Dep't 2012), a factory's incentive programs were found to violate the prohibition on price discrimination under the New York Vehicle and Traffic Law, because they were not available to all dealers on a proportionally equal basis.

The provisions of the motor vehicle dealer statutes of the fifty states with respect to price discrimination by manufacturers between dealers are set forth below:

Alabama Code § 8-20-4(f), prohibits price discrimination between dealers;

Alaska Stats, Title 45, Ch. 25, §§ 10 – 990, no prohibition on price discrimination;

Arizona Rev. Stat. § 28-1302, no prohibition on price discrimination;

Arkansas Code § 23-112-101, *et seq*., prohibits price discrimination between dealers;

California Veh. Code §§ 3060-3069, no prohibition on price discrimination;

Colorado Rev. Stat. § 12-65-101, *et seq*., no prohibition on price discrimination;

Connecticut Gen. Stat. § 42-133(r), no prohibition on price discrimination;

Delaware Code Ann, tit. 6, §§ 4901-4920, no prohibition on price discrimination;

Florida Stat. § 320.632, *et seq*., no prohibition on price discrimination;

Georgia Code § 10-1-620, *et seq*., no prohibition on price discrimination;

Hawaii Rev. Stat. § 437-28(b), prohibits price discrimination between Hawaii and non-Hawaii dealers, except as cost-justified;

Idaho Code Ann., § 49-2414, prohibits price discrimination between dealers;

Illinois, 815 ILCS § 710/4 (e)(2) and (e)(3), prohibits price discrimination between dealers;

Indiana Code § 9-10-1-1, *et seq*., no prohibition on price discrimination;

Iowa Code§ 322A.1, *et seq*., no prohibition on price discrimination;

Kansas Stat. Ann. § 8-2401, *et seq*., no prohibition on price discrimination;

Kentucky Rev. Stat. Ann. § 190.010, *et seq*., prohibits price discrimination between dealers;

Louisiana Rev. Stat. Ann.§ 1251, *et seq*., no prohibition on price discrimination;

Maine Rev. Stat. Ann. tit. 10, §1171, *et seq*., prohibits price discrimination between dealers;

Maryland Code Ann. Transp. § 15-201, *et seq*., no prohibition on price discrimination;

Massachusetts Gen. Laws, ch. 933, §1, *et seq*., prohibits price discrimination between dealers;

Michigan Comp. Laws §445.1561, *et seq*., no prohibition on price discrimination;

Minnesota Stat. §80E.01, *et seq*., prohibits price discrimination between dealers;

Mississippi Code Ann. § 63-17-51, *et seq*., no prohibition on price discrimination;

Missouri Rev. Stat., § 407.810, *et seq*., no prohibition on price discrimination;

Montana Code Ann. § 61-4-131, *et seq*., no prohibition on price discrimination;

Nebraska Rev. Stat. § 60-1401.01, *et seq*., no prohibition on price discrimination;

Nevada Rev. Stats.§ 483.36311, *et seq*., no prohibition on price discrimination;

New Hampshire Rev. Stat. Ann. §357-C:1, *et seq*., no prohibition on price discrimination;

New Jersey Rev. Stat. § 56:10-16, *et seq*., no prohibition on price discrimination;

New Mexico Stat. Ann. § 57-16–1, *et seq*., prohibits price discrimination between dealers;

New York Vehicle and Traffic Law, Art 17-A, § 460, *et seq*., prohibits price discrimination between dealers;

North Carolina, Gen. Stat. § 20-305, *et seq*., no prohibition on price discrimination;

North Dakota, Cent. Code § 51-07-01, *et seq*., no prohibition on price discrimination;

Ohio Rev. Code Ann. § 4517.49, *et seq*., no prohibition on price discrimination;

Oklahoma Stat. tit. 47§ 561, *et seq*., no prohibition on price discrimination;

Oregon Rev. Stat. § 650.120, *et seq*., no prohibition on price discrimination;

Pennsylvania Board of Vehicles Act, 63 Pa. Stat. Ann. § 818.1, *et seq*., no prohibition on price discrimination;

Rhode Island Gen. Laws, § 31.5.1.1, *et seq*., prohibits price discrimination between dealers;

South Carolina Code Ann., § 56-15-10, *et seq*., no prohibition on price discrimination;

South Dakota Codified Laws, § 32-6B-45, *et seq*., no prohibition on price discrimination;

Tennessee Code Ann. § 55-17-101, *et seq*., no prohibition on price discrimination;

Texas Rev. Civ. Stat. Ann. art. 4413(36), §§ 5.02, 6.01, 7.01, no prohibition on price discrimination;

Utah Code Ann. § 13-14.1 *et seq*., no prohibition on price discrimination;

Vermont Stat. Ann. tit. 9, § 4083, *et seq*., no prohibition on price discrimination;

Virginia Code, Ann. § 59.1-21.8, *et seq*., no prohibition on price discrimination;

Washington Rev. Code, §46.96.010, *et seq*., no prohibition on price discrimination;

West Virginia Code§ 17A-6A-1, *et seq*., no prohibition on price discrimination;

Wisconsin Stat. Ann. § 218.01, no prohibition on price discrimination; and

Wyoming Stat. Ann. § 31-16-101, *et seq*., no prohibition on price discrimination. ■

Leonard A. Bellavia, Esq., is founding partner of the law firm of Bellavia Blatt & Crossett, PC. Mr. Bellavia is a nationally recognized authority in the field of automotive franchise law. Mr. Bellavia represents thousands of automobile dealerships across the country in all aspects of commercial litigation and buy-sell transactions, and has been instrumental in negotiating the sales of hundreds of dealerships.

President's Message

Steve Linzer
Tiffany & Bosco, P.A.
NADC President

It is hard to believe that we are well into 2016 and that the 12th Annual Member Conference (at The Four Seasons Hotel in Palm Beach, Florida) is almost upon us. Between the "happenings" at NADC and the always dynamic auto industry, there never seems to be a dull (or free) moment. With respect to the auto industry, the workshop held by the FTC earlier this year and its fall out has prompted us to supplement our program at the Palm Beach meeting. In addition to the previously scheduled and announced presentations (which include the NADA Update, top issues facing dealers, recent ADA compliance issues, the challenges of market share performance programs, the risk and rewards of dealership participation programs, dealer advertising issues in a digital world, structuring concepts to remove road blocks, proving dealer damages in territory incursions and bank and finance company compliance managements issues), we will have several NADC members who participated in that workshop (Aaron Jacoby, Paul Norman, Joe Roesner, and Richard Sox) speak at our luncheon on Monday. Those members will give us the benefit of their impressions of the workshop and a sense of what they feel the future will hold from the FTC. Obviously, this will be an informative and timely discussion. We hope that you have made your plans to attend the conference. It promises to be another record setter. As this message is written, we are on track to reach or exceed our all-time high attendance level from last year's 185 attendees. On the same note, we have reached our highest amount of conference sponsorship income for any meeting to date. We are currently at $23,500 in sponsorship income, $6,750 over last year's record number. We are truly appreciative of all of our sponsors who help to elevate the quality of the events while keeping the costs low for our members. When you see a sponsor be sure to thank them–they are all special to us.

We will also have some organizational "housekeeping" to do at the Annual Meeting. We will elect four NADC board members. Three board members are finishing their first three year term and are eligible for a second term. Yes, we have term limits. One board member, Tammi McCoy, is going off having served the six years mandated by the term limit policy. We thank Tammi for her service and for giving us her expertise and valuable time. Also, thanks to the Standing Board Membership Committee chaired by Scott Silverman with Eric Baker, Johnnie Brown, Diane Cafritz, and Jonathan Harvey.

If any member is interested in serving on the board in the future, I thought I might share with you some insights from my service on the nomination committee. NADC currently has 23 board members. NADC strives to have a working board. Board members are asked to participate in meetings at each conference and in at least two scheduled telephonic board meetings. Special meetings may be called as needed. Board members are also asked to serve on NADC committees and are encouraged to write articles for *The Defender*. Members who are interested in serving on the board should be aware that, while there is no set policy for board eligibility, factors that have been considered in the past are attendance at NADC meetings, presentations at meetings, submission of articles for *The Defender,* and serving on NADC committees and task forces. If you are interested in submitting an article for *The Defender* please write to Jami Farris; if you are interested in serving on a committee or task force please let me or Erin know. We can always use help.

Thank you to everyone who stopped by the NADC booth at the NADA Convention & Expo in Las Vegas to say hello. NADC debuted a new 10 x 20 foot booth at the Expo this year, and members were able to take advantage of the conference space available at the new booth. A special thanks to the members who joined NADC staff at the booth to help educate prospective members on the many benefits of NADC membership. We hope that everyone who attended NADA had a successful show.

Finally, let me share with you good news regarding our membership numbers. NADC continues to flourish. I am honored to serve as president and witness the continuing growth of this organization. That growth has resulted from the able leadership of my predecessors and the continuing involvement and participation of our founder, Jonathan Harvey. Our membership numbers are on the rise. We currently have 557 members. That is an increase in the number of members we had last year at this time. As our membership continues to grow, we work towards fulfilling our mission of providing education and information for attorneys representing automotive dealers for the purpose of improving and developing their capabilities. See you in Palm Beach. Travel safe. ■

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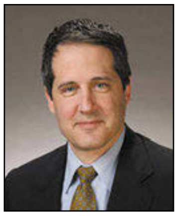


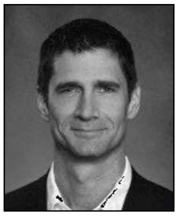
Be Careful About Contractual Damage Waivers

By Oren Tasini
Haile, Shaw & Pfaffenberger, P.A.

Contracts, including asset purchase agreements, commonly seek the waiver by a party of a right to obtain certain kinds of damages, usually, consequential, indirect, special or punitive damages. The waiver of consequential damages particularly should cause a contracting party to pause. A careful analysis of the law of contracts and the parties' rights upon breach reveals that a waiver of consequential damages, in essence waives a party's right to receive the standard measure of damages for a contract breach–all damages that are the natural, probable and reasonable foreseeable consequences of the breach.

Although it may be reasonable to seek a waiver of punitive damages, the concept of consequential damage is fundamental to a party's right to collect damages to which he is normally and rightfully entitled. For example, the standard and typical indemnification provision in an asset purchase agreement provides for the selling party to defend and indemnify the purchasing party from any breach of the seller's representations and warranties. What is the effect of a waiver of consequential damage where a seller misstates its financial statements? Absent the waiver one could easily argue it would be equal to the multiple, times the overstated earnings. This is a natural foreseeable consequence of the breach. Another measure might be the lost profits the seller expected to earn, but will not receive due to the misstatement. A waiver of the right to receive consequential damages may preclude such claims. Consequently, consequential damages and the right to pursue them, go to the essence of the contractual benefit of the bargain and should never be waived in any contractual agreement. ■

Oren Tasini is a Shareholder with Haile, Shaw & Pfaffenberger, P.A. Oren is a Past President of NADC and works with automotive dealerships regarding legal compliance, regulatory and franchise matters, and in the purchase and sale of automotive franchises.



Dealerships Need to Reexamine Their Fair Credit Compliance Policy & Programs

Feature Article

By Michael Maledon
Falbe Law PLLC

Efforts by the Consumer Financial Protection Bureau (CFPB) and other consumer advocates to police the fairness of auto loans have accelerated in recent years. Since 2013 the CFPB has recovered more than $220 million from several large car-financing companies to settle claims of discriminatory lending practices. And even though the CFPB does not have direct enforcement authority over franchised dealers, the CFPB's recent actions could foretell a new wave of attacks by federal and state regulators and private attorneys to sue dealers for the way finance rates are set. Simply put, it is imperative that dealers have policies and processes in place to comply with fair credit laws.

Existing compliance policies provide helpful guidance. Yet, despite the best efforts of many dealerships, written credit compliance policies that call for standardized processes are routinely replaced in the day-to-day operations with subjective decision-making done on a customer-by-customer basis. And while there may be no *intent* to discriminate, the fact that these written policies have been largely overridden by subjective decision-making makes it all the more problematic for a dealer if a statistical evaluation of past credit transactions shows a disparity in finance rates paid by consumers in a protected class. This article examines some continuing areas of exposure for dealerships and offers suggestions for a more comprehensive approach to fair credit compliance.

Existing Compliance Programs

In January 201, the National Automobile Dealers Association (NADA) and the American International Automobile Dealers Association (AIADA) released to their members a Fair Credit Compliance Policy & Program. The NADA/AIADA Program recommends that dealers establish a preset amount for the finance reserve, like a fixed number of basis points over the buy rate. Dealers can then allow for a documented downward adjustment of that amount should a predetermined condition occur. The NADA/AIADA Program does not attempt to address every issue that potentially relates to fair credit compliance at a dealership, and it specifically acknowledges desking procedures as an area that must be considered separately by dealers as part of a broader, comprehensive solution to fair credit compliance.

To address the desking piece, most lawyers and compliance experts advise dealers to establish and use a credit score drive "rate matrix." A typical rate matrix has 50 point credit score tiers (over 700, 650 to 699, 600 to 649, and under 600) and then assigns a rate using the captive finance company's buy rate for each tier while adding a standard mark-up of 100, 150 or 200 basis points. So in practice, every customer who has a 625 credit score should be quoted the same rate. From there, the final transaction becomes a negotiation. If the dealer agrees to lower its standard markup for legitimate business reasons – and if the dealer has implemented the NADA/AIADA Program – then the change will be documented to mitigate any finding of disparate impact discrimination.

The Challenge with Implementing a Credit-Driven Rate Matrix

It may be unrealistic to assume that most franchised dealers would be able to effectively implement a rate matrix. This is because the use of a rate matrix is predicated on the dealer *knowing* the buy rate at the time the dealer makes the offer to the customer. The buy rate, however, is not known until after the deal is typed and submitted to the bank for approval. Prior to that point, the dealer is making a "best guess" at the rate at which the lender will buy the contract. For the prime credit score customer buying a new vehicle, there is little needed guesswork, but in most scenarios, guesswork is more involved. A recent monthly snapshot from one of the captive lenders shows that it approved 97% of its Tier 1 applicants. In contrast, for Tier 2 the approval rate fell to 78%, for Tier 3 the approval rate fell to 63%, and for Tier 4 the approval rate fell to 47%.

The limitation with a credit-based rate matrix is that it omits important variables that factor into lender approvals. The buy rate will be affected by a variety of deal specific variables, such as debt-to-income ratio ("DTI"), payment-to-income ratio ("PTI"), and loan-to-value ("LTV") percentage. For example, a 640 credit score customer with income of $3,000 a month and a LTV of 108% because of a negative equity trade will receive quite different approval options than a 640 credit score customer with income of $7,000 a month and a $5,000 down-payment. Adding to the challenge is that franchised dealers have many different indirect lenders with which to work, and each lender has its own criteria for lending. A 600 credit score first time buyer with less than three years in the bureau will have different approval options than a 600 credit score customer that has a discharged bankruptcy and ten years in the bureau. Credit score is just one of many factors determining the eventual buy rate, and the combination of subjective and objective factors makes it nearly impossible to know before obtaining actual lender approval whether the consumer's loan request will be granted by a given lender.

The Role of Subjectivity and Employee Discretion

An experienced sales or finance manager knows how to read a credit bureau, knows the right interview questions to ask the customer, and has knowledge of a variety of lender programs. She knows to look beyond just the FICO scores and to look at factors such as years in the bureau, number of outstanding trade lines, and employment history. She knows which lenders are most likely to approve her C- credit customer with a recently discharged bankruptcy, and knows when her B+ credit customer with a negative equity trade will fall outside the prime lender's advance guidelines and will need to go to a secondary lender at a higher rate. The fact is that each deal is unique and requires a sophisticated understanding of credit reading and a wide variety of lender programs. It is also the reason dealers are entitled to earn a profit in helping to secure financing for its customers, and why experienced sales and finance managers are in high demand.

But uncertainty still exists with even the most experienced sales and finance managers. When dealing with an uncertain outcome, a capable sales or finance manager may structure a deal with two or three lender programs in mind. For example, given a particular deal structure and customer credit profile, the finance manager might anticipate receiving an approval from Wells Fargo at 11.9% or Capital One at 13.9%. So assuming this dealer's preset standard participation rate is 2%, an approval may come back from one of these lenders with dealer participation falling somewhere between zero and two points depending on how the deal is structured. Alternatively, the lender may turn down the deal as it was structured resulting in an unwind and recontract (if the customer will agree to the new terms). Successful sales and finance managers seek to structure deals in a manner that satisfy the customer, limit unwinds, and provide a fair profit to the dealer. While every manager will have the inevitable unwinds and deals with 0% reserve, those deals will be the exception to an otherwise profitable department with high CSI.

Notice these objectives are no different when it comes to dealing with the A+ credit customer. As the buy rate for the prime customer is known with more certainty, it is less likely that dealer participation will remain at the dealer's preset standard participation rate. It is simply the law of probability: greater uncertainty brings greater statistical variance. Stated differently, disparity in dealer participation – particularly on nonprime deals – is often attributable to the uncertainty of knowing the buy rate before the contract rate is negotiated with the customer.

Thus, while the dealer is not intentionally discriminating against customers with lower credit scores, the fact that it is harder to predict the buy rate of credit-challenged customers leads to a greater disparity between buy rate and the contracted ARP. This statistical variance may give rise to post transaction claims that such disparities are attributable to a customer's background (*i.e.*, the customer's status as a member of a protected class) and therefore are in violation of ECOA.

The Dealer's Dilemma

Existing compliance programs leave the dealer with a choice. Choice A is to demand strict adherence to a rate matrix and disallow employees from considering any factor other than a customer's bureau score in setting the rate. If the deal is turned down or the callback is at a higher rate, then the contract would be unwound and the dealer would attempt to make a new deal with the customer. Notice here that unless the dealer also eliminates spot deliveries, this process would destroy CSI and likely get the dealer in even hotter water for what consumer advocates like to call the "yo-yo" transaction: contracting the customer at a rate that is unlikely to be approved, with the anticipation of recontracting the customer on different terms.

Choice B is for the dealer to allow experienced sales and finance managers to continue relying on their knowledge and judgment to take a "best guess" at the rate at which the customer will be approved. But when one 655 credit score customer is contracted at the dealership's matrix rate and another 655 credit score customer is contracted at a rate that is one or two tiers below, is the dealer in any better position to defend against allegations of discrimination?

In order for a dealer to implement an effective fair lending compliance program, the dealer should not only have a good process for documenting any disparity in *dealer participation rate*, it should have a standardized process than can explain pricing disparities in *wholesale rates, and therefore the contract rate,* that might lead a court, governmental enforcement agency, or indirect auto finance source that is monitoring the dealer's credit contracts to question disparities among customers with similar credit scores. Although recent actions by the CFPB have largely focused on the disparities in participation rate, dealers and indirect lenders would be well advised to ensure that their fair lending policies account for varying wholesale rates among customers of similar credit scores.

The Solution

The ideal complement to the NADA/AIADA Program would be a rate matrix not based solely on credit scores, but one that takes into account the relevant credit history information that may factor into the lender approvals (such as positive trade lines, revolving credit balances, and bankruptcies) as well as the relevant variables of the specific car deal (such as LTV, DTI, and PTI)–in other words, a rate matrix that essentially mimics the knowledge and skill of an experienced sales or finance manager. There is at least one software provider that has recently introduced such a system.

With a more "intelligent" rate matrix, dealers can significantly reduce subjectivity and employee discretion in setting rate. Through technology and the use of well-studied algorithms, dealers can more confidently structure deals at the desk using an objectively calculated and highly predictable rate based on the non-discriminatory credit profile characteristics of each deal. The scoring system can be electronically archived with the deal to access at a late time if necessary to serve as evidence as to the dealer's objective process for determining rate for its customers. ■

Michael Maledon is an attorney with Falbe Law PLLC. Michael has been representing dealerships and related companies for over 16 years, including having served as general counsel of The Van Tuyl Group (now Berkshire Hathaway Automotive). Michael is also CEO of Libra Systems, a provider of software desking solutions for auto dealerships.

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