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DEFENDER

The National Association of Dealer Counsel Newsletter APRIL 2019

The Manufacturer's Duty to Defend and Indemnify Dealers in Product Defect Cases

By Oren Tasini, *Qvale Auto Group*

When a customer files a lawsuit alleging a defect in the vehicle he purchased against a dealer and a manufacturer, the dealer will demand that the manufacturer defend the lawsuit and indemnify the dealer for damages. Manufacturers often push back, claiming that the suit is not one that obligates the manufacturer to provide a defense or indemnity, or requests the dealer to sign an agreement that would remove the defense and indemnity under certain circumstances. Determining whether a manufacturer is required to defend and/or indemnify the dealer requires consideration of several legal doctrines.

The first legal doctrine is that the law governing contractual indemnity is different than the law governing defense and indemnity under an insurance contract. Under an insurance contract, the duty to defend is a distinct and separate obligation from the duty to defend, which is broadly construed in favor of the insured. If any portion of the allegations of the complaint might give rise to liability to the indemnitee, *i.e.*, if the allegations within the "four corners" of the complaint can be reasonably construed to allege a claim for damages that would be covered by the insurance policy, then the insurer has a duty to defend. This broad duty to defend arises due to the fiduciary relationship between an insurer and an insured, because the contract of insurance is generally one of adhesion, and the insured has paid a premium for the very purpose of receiving payment for any loss and the defense of any covered claim.

In contrast, where an obligation to provide indemnity is in a written contract, the rules related to the interpretation of contracts generally are applied to determine the scope of the indemnitor's obligation. Courts considering contractual indemnity will enforce the parties' bargain and give force to the unambiguous terms of the contractual agreements of the parties, including upholding any limitation or exclusions on the duty to defend or indemnify. The provisions relating to indemnity in the sales and service agreement vary by manufacturer, but in general they include exclusions that could negate the manufacturer's duty to defend and indemnify. For example, sales and service agreements provide that the manufacturer will not cover the claim if the dealer has been negligent in the servicing of the vehicle, or the dealer should have discovered the defect during

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a predelivery inspection or upon a reasonable inspection. Some sales and service agreements provide for indemnity but do not specifically mention a duty to defend. Rather, they treat the costs of defense as part of the losses that may be subject to indemnity.[1]

Finally, dealers have an additional protection under the dealer laws of most states, in providing it is a prohibited practice for a manufacturer to fail to indemnify the dealer in connection with product defects. These statutes, however, often fail to impose a duty to defend but rather only a duty to indemnify. For example, Florida's statute makes no mention of the duty to defend, although it does provide that indemnity includes fees incurred by the dealer in defending the suit. Thus, a dealer would be required to pay the cost of defense and only recover upon the successful conclusion of the case. This result leaves the dealer having to pay for the cost of litigation and seeking reimbursement, as opposed to having its cost of defense paid by the manufacturer. New York law also provides for indemnity but does not include a duty to defend and also excludes any portion of the suit which contains "independent allegations" against the dealer. This is in line with the narrow interpretation of contracts of indemnity which are not contracts of insurance. Texas law is similar to New York, as it provides for reimbursement of damages and fees but not if the dealer is found to be negligent.

In analyzing the right of a dealer to receive both defense and indemnity from the manufacturer, it is necessary to determine the terms of the contract of indemnity set forth in the sales and service agreement, how your state's courts have ruled on the interpretation of contractual indemnity clauses, and the effect of the statutory protection afforded dealers which impose an obligation on the manufacturer to defend and indemnify a dealer in the case of a product defect claim. ■

Oren Tasini is the General Counsel for the Qvale Auto Group. He was one of the Founding Members of the National Association of Dealer Counsel.

[1] A handful of states have statutory provisions which define the parameters of agreements to indemnify. The one that effects the greatest number of dealers comes from California, under §2778 of the Civil Code. The California Supreme Court relied on §2778 to find that an implied duty to defend exists whenever there is an agreement to indemnify unless the duty to defend is explicitly disclaimed. *Crawford v. Weather Shield Mfg. Inc.*, 44 Cal. 4th 541 (Cal. 2008). A number of states have not followed *Crawford* and have held that unless the duty to defend is explicit in the contract, a duty to defend cannot be implied just because there is an obligation to indemnify. *See, e.g., Caydon Acquisition Corp. v. Custom Mfg., Inc.*, 301 F. Supp.2d 945 (N.D. Iowa 2004).

Executive Director's Message

Erin H. Murphy
NADC Executive Director

NADC is currently engaged in a strategic planning project to explore potential ways to further enhance the value of the organization and offer maximum benefits to our members. The Board of Directors will meet in Dana Point, CA just prior to the start of the Annual Member Conference to kick of the project with an in-depth SWOT analysis of the organization. In the coming months, NADC members will be asked to participate in a member survey as part of this process. Your responses to the survey will help shape the direction of our activities, ensuring we remain a truly member-driven organization. A finalized version of the strategic plan will be shared with all members once completed. We look forward to this exciting project and thank you all in advance for your participation and assistance.

As always, we rely on our members to help us identify key issues facing dealer counsel. Your input helps us to best serve the quickly changing and diverse needs of our membership. There are many different ways that you can help further educate the NADC community:

- ***The Defender*** – We are always looking for submissions to publish in the *Defender*. Please send your contributions or proposals for articles to Erin Murphy emurphy@dealercounsel.com or Editor Jami Farris jamifarris@parkerpoe.com.
- **Webinars –** Would you like educate your fellow NADC members by presenting a webinar? Please contact Erin Murphy with webinar proposals.
- **Conference Sessions –** If you have an interesting and informative program idea that you would like to present at one of our bi-annual conferences, please submit the following to Erin Murphy:
  - Session Topic
  - Outline and/or short description of session
  - Names and bios of presenters
  - Requested length of time

  The Program Planning Committee will review all proposals.

If you have any other suggestions or comments please do not hesitate to contact me. I look forward to hearing from you all! ■

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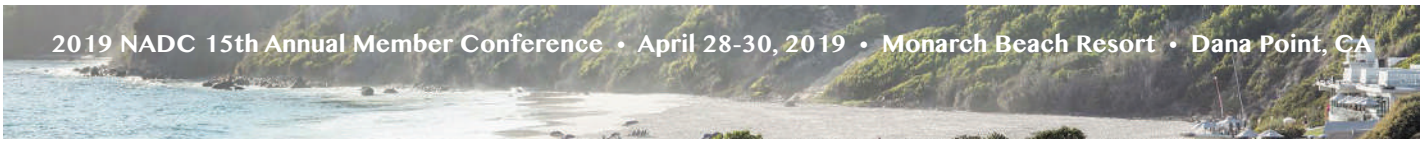

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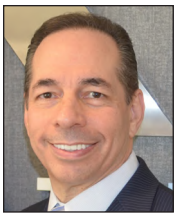

The Best Way to Take Advantage of State Warranty Compensation Laws

By Joe Jankowski, *Armatus Dealer Uplift*

For too many years, dealerships have been at the mercy of their manufacturers, especially in regard to warranty compensation. However, the enactment of laws in this area has helped level the playing field for dealers to earn a fair market rate for their warranty claims. Notably, all fifty states have automotive franchise laws, but they vary in terms of content and strength.

Specifically, forty-five states have laws that require retail compensation for both parts and labor. In thirty-six states, the laws are fairly strong; in nine, they are somewhat favorable; and in five, there is no retail requirement, although two of these remaining states have submitted bills in the most current legislative session. To further complicate matters, no two state laws are exactly alike—some statutes dedicate an entire section to retail compensation, while others might only briefly mention it. Because those factories dedicated to resistance will exploit every nook and cranny in a statute, the "less-is-more" paradox holds no sway here. The superior law will be the product of a thorough knowledge of each factory's present, and a keen anticipation of its future behaviors, and thus will spare no text in plugging the gaps through which such behaviors would otherwise gain traction so as to frustrate the statute's fundamental purpose.

Regardless of whether a state has *statutory* retail labor requirements, a dealer can perform a *factory* submission for an increased labor rate in all fifty states. This does not, however, mean that the latter, hamstrung by definition with self-serving limitations and conditions, will produce a result on a par with that achievable pursuant to a well-crafted statute. Parts, however, are another matter. In the absence of a statutory retail mark-up directive, or the absence of a dealer's availing itself of such a directive, it is relegated to a paltry forty percent on warranty parts (or, in the case of a few factories, MSRP, which is in reality an effective combined mark-up far short of what such factories contend that it is). By contrast, on a national basis, the average retail mark-up is at least double this percentage.

Why the Laws Are Necessary

The relationship between dealership and manufacturer can be uncertain at best and often downright contentious. While dealers envision an equal partnership with their respective manufacturers, many quickly discover that it is a one-way street with lop-sided bargaining power. This is, to be perfectly candid, because the franchise agreement and its off-shoots are basically a contract of adhesion. Distrust justifiably permeates both sides of the relationship—but these state laws seek to balance this power, so dealerships get a fairer shot at receiving market rate compensation on warranty claims, rather than being forced to run this segment of their fixed operations at a loss that must be absorbed internally or subsidized by their retail customers.

Taking Advantage of State Compensation Laws

When you stop to consider the tense relationship between dealer and manufacturer, you may be wondering if it makes sense to jump through the hoops of statutory submissions to experience a more equitable process, or possibly for the chance to earn more money. However, that reasoning is precisely why dealers should seek to take advantage of favorable state laws—there is a great probability that you will achieve a true market rate for your warranty claims.

Consider this: dealerships that perform statutory parts mark-up submissions increase their annual warranty parts gross profits by an average of $100,000. That significant uplift goes directly back to a dealership's bottom line, all with no alteration to the existing process of presenting, and being paid for, individual claims.

However, the complex and frequently evolving state laws pose a significant challenge for dealerships that are not familiar with legal jargon or structure. While a dealer is certainly welcome to attempt to perform a statutory submission without expert assistance, it runs the risk of missing critical aspects of the submission package, which in turn directly affects its compensation rate. And if its submission is approved at a lower rate or rejected altogether by the manufacturer, it almost assuredly will not know how to rebut the decision, or the alleged statutory rationale (genuine or fabricated) behind it.

Regardless of the scenario, a dealer never wants to be in the position where it is guessing at an answer to a question the manufacturer is asking or at a response to a position the manufacturer is taking. A dealer needs the context and framework in which to submit or rebut, which is not always possible unless there is full comprehension of the relevant statute mandating retail warranty compensation, as well as the manufacturer's stated and unstated protocols and their historical behavior.

Outsource Advantages

Thankfully, there is a solution to this challenge: outsourcing the entire submission process to a trusted group of technical and automotive experts who guarantee optimized results, and an approval, in most cases in less than sixty days from start to finish. These teams fundamentally understand what level of retail warranty compensation the dealer is entitled to. In order to optimize this number, they will put together a

quality and timely submission on the dealer's behalf that is submitted at the rate that should be earned, based on the universe of factors to be considered. And if, for whatever reason, the manufacturer rejects the initial submission, they will work closely with the dealer to ensure that a rebuttal is appropriately responsive and statutorily and factually sound.

The key part of this submission process is that the outsourced team does all of this work, so the dealer does not have to prepare it. After all, dealership employees are busy getting business in the door and taking care of customers' needs; every moment they spend away from these critical missions means less revenue. If a dealership allows a trusted third party to complete this complex project on its behalf, the dealer is set up for optimal results and can focus on its own core competencies.

Final Thoughts

In addition to the multiplicity of provisions, and the relative strengths and weaknesses, among the various state statutes, as referenced above, to make matters even more confusing, a manufacturer may approve submissions in certain states requiring retail but not in others. The manufacturers' behavior and protocols are constantly in flux, so it is advisable to consult a professional rather than just look to largely unqualified in-house personnel. Since third parties are constantly engaged in the process of submitting to *all* manufacturers across *all* jurisdictions, they can give dealers expert answers on the spot.

In fact, clients are constantly amazed at how easily and efficiently they can begin to enjoy their newfound profits. And, unlike other revenue-generating initiatives, retail warranty compensation means you do the same work you do today; it does not require an investment in bricks and mortar, inventory, technology, processes, advertising, or personnel. ■

Joe Jankowski is Managing Partner of Armatus Dealer Uplift, a Hunt Valley, Maryland-based firm specializing in retail warranty compensation submissions. Joe has been personally involved in consulting on 10 retail warranty statutes and is widely recognized as an expert in this highly-technical subject matter. Previously, Joe spent more than 20 years as CFO, COO, and CEO of a large automotive group in Maryland.

Updated Member Contact Information

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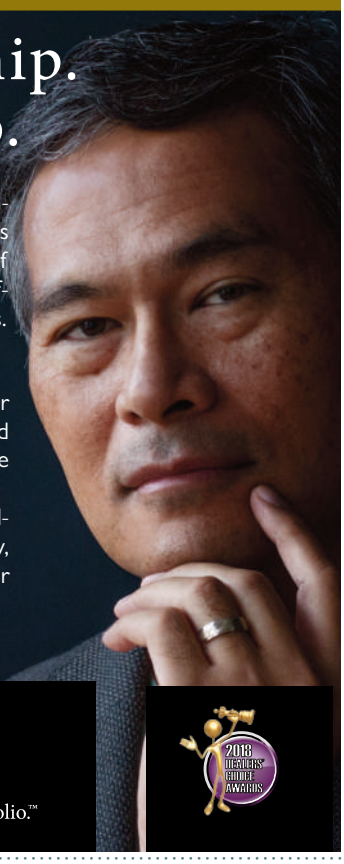

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