The Automobile Industry Special – Binding Arbitration Program:

A Review and Analysis

A look at the arbitration program Congress created, the American Arbitration Association's role in administering the program, and the lessons to be learned from the experience.

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Last July, the American Arbitration Association (AAA) finished administering the Congressionally mandated arbitration program for automobile-dealer terminations. Congress crafted the legislation over a tumultuous six months, and the AAA administered close to 1,600 cases under this program in the following seven months. This article reviews the process and analyzes the lessons we can learn from it.

Congress Creates the Program

The national economic decline beginning around 2007 hit General Motors and Chrysler hard, ultimately threatening their very viability. The federal government responded by enacting the Troubled Asset Relief Program (TARP) and investing $80 billion in TARP funds in both companies.

As part of the investment, the Treasury Department demanded that the companies restructure. The companies submitted voluntary restructuring plans, but the government rejected them as inadequate. This led to the companies' filing for bankruptcy under Chapter 11 of the Bankruptcy Code,[1] Chrysler on April 20, 2009 and GM on June 1, 2009. As part of

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their reorganization plans, GM terminated 2,000 dealerships and Chrysler terminated 789.

The dealer terminations sparked political turmoil. Groups including the Committee to Restore Dealer Rights, the Automobile Trade Association Executives, the National Automobile Dealers Association and the National Association of Minority Auto Dealers demanded that Congress provide dealers with an avenue of redress.[2] Congress, however, also faced countervailing pressure not to interfere: Given the federal government's significant financial stake in GM and Chrysler, Congress didn't want to threaten the manufacturers' opportunity to emerge from bankruptcy as lean, profitable businesses.

Democrats and Republicans worked together to balance these interests by crafting a fair, swift and economical appeal process for the dealers. On Dec. 16, 2009, less than six months after GM's bankruptcy filing, Congress passed legislative provisions authorizing what would eventually be known as the Automobile Industry Special Binding Arbitration Program, in Section 747 of H.R. 3288, the 2010 omnibus spending bill.[3]

One of the bill's leading supporters, Rep. John Conyers (D.MI), chair of the House Judiciary Committee, directly addressed the selection of arbitration as the method of dispute resolution. Speaking to his colleagues in the House, he said that the drafters of the bill selected binding arbitration by a neutral arbitrator because that "is the most appropriate means of resolving the differences between covered dealerships and manufacturers, and to protect the taxpayers, and the broader economy."[4]

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Program Provisions

The bill designated the AAA to administer the program, and set aggressive deadlines for completing the arbitrations. It gave GM and Chrysler 30 days to provide dealers with the criteria used to terminate or not to renew them. The dealers would have 10 days to decide whether to file for arbitration to contest the termination. All arbitrations would have to be completed within six months, or by June 14, 2010, though arbitrators could extend the deadline for 30 days for good cause.

Congress included in the bill provisions to help ensure that the arbitrations would be fair and cost-effective. The bill required the hearing to be held in the dealer's state, and each party to be responsible for its own costs and fees. It also allowed limited discovery in a balanced manner.

The bill also defined the legal standard that would govern the arbitrator's consideration of the case. The arbitrator would have to determine the issue based on specific business or economic criteria. In addition, the arbitrator would have to balance the economic interests of the dealer, the manufacturer, and the public at large. More specifically, the bill required that the arbitrator consider the dealer's profitability and economic viability, the manufacturer's business plan, the dealer's success in meeting performance objectives generally and as compared to the manufacturer's criteria for termination or non-renewal, and the dealer's territory, experience, and length of service. The arbitrator could only determine whether the dealer should be reinstated or not. The arbitrator could not award damages.[5]

The AAA's Role

The AAA promptly responded to the legislation. First, it created a roster of nearly 350 highly qualified arbitrators. It advised the arbitrators of the program's parameters and time limits and the need to commit to being available to accommodate multiple hearings and cases by June 14. The AAA also requested that arbitrators discount their compensation so as to honor Congress' expectation of economy in the context of bankruptcy and financial constraints of some terminated dealerships.

The AAA provided the arbitrators with extensive information via a series of webinars, as well as training in how to use a dedicated Web site containing background materials. The Web site was also the platform for tracking all cases.

The AAA's goal for the auto industry arbitration program was to administer streamlined, user-friendly and consistent arbitrations. Arbitrators were encouraged to ask the parties to decide whether to further streamline the process, for example, by combining their presentations of expert witness testimony and scheduling multiple hearings together.[6]

Facts About the Arbitrations

Of the 2,789 terminated dealers eligible to participate in the program Congress created, 1,575 (about 55%) from 48 states filed for binding arbitration.[7] More than 300 dealers were from three states (Pennsylvania, Ohio and Illinois). The AAA designated one or more major cities in each state as the site for the arbitrations, unless in a particular case the parties agreed to hold the arbitration elsewhere.

The parties selected their arbitrator either by mutual agreement or the traditional "strike-and-rank" method.[8] Some arbitrators were selected to hear multiple cases, in some instances as many as 10 cases. (I was on the panel and served on 10 cases.) The selected arbitrators then prepared for the hearings. At that point there was some apprehension about how the program would fare. But by the time the hearings began—less than 90 days from the initiation of the program—we were all well prepared.

Eight hundred and three cases (more than half of all cases filed) ultimately settled before the arbitration hearing. About one-third of the cases (493) were withdrawn. (Dealers were not required to provide a reason for withdrawal.) In addition, the AAA administratively closed 113 cases for various reasons, including noncompliance with statutory requirements, a missed deadline, or nonpayment of fees.

About 10% of the cases (166) proceeded to be arbitrated, resulting in a final determination. Hearings typically lasted from one to four days, and in most cases pre- and post-hearing briefs were submitted. The arbitrators had seven days after the hearing closed to deliberate, prepare and file their determinations.

The arbitrators found in favor of dealers in 55 cases (about one third), and in favor of manufacturers in 111 cases (about two thirds). By July 23, 2010, the statutory deadline set by Congress, all 1,575 cases had been closed.

Evaluation and Lessons Learned

The AAA Automobile Industry Special Binding Arbitration Program was a tremendous success. Congress, the AAA, and arbitration itself all performed extraordinarily well.

Within six months of Chrysler and GM's bankruptcy filings and dealer terminations, Congress enacted an arbitration procedure that provided some 2,800 terminated automobile dealers the right to promptly appeal their terminations through a fair, fast, and economical process.

Faced with the task of administering this program under aggressive deadlines in a highly charged political atmosphere under Congressional scrutiny, the AAA devised the entire program and made it work, all within seven months.

While harder to categorize, the arbitration process itself also performed well. The combination of well-crafted procedures with tight deadlines forced the dealers and the manufacturers to assess their positions quickly, leading to settlements of over half the cases before a hearing was held.

Dealers who did not settle or withdraw their cases obtained a binding determination in a fair, fast, and economical process within the statutory deadline. It is difficult to imagine how much time and money the terminated auto dealers and the manufacturers would have spent to resolve their disputes if Congress had not authorized this arbitration program and instead designated the courts to resolve these claims, or worse, not addressed the problem at all, leaving the decision to be handled on a state-by-state basis.

Public Policy Implications

The success of the AAA Automobile Industry Special Binding Arbitration Program could have a role in the public policy discussions about arbitration agreements in the business setting. Part of a bill known as the Arbitration Fairness Act[9] would ban mandatory arbitration clauses in franchise agreements on the theory that such clauses are fundamentally unfair. Yet auto dealership agreements are very similar to franchise agreements and Congress chose binding arbitration as the vehicle to guarantee fairness, speed, and efficiency in resolving disputes between auto dealers and manufacturers. These contrary approaches—one that would bar mandatory arbitration, the other imposing it—seem to be irreconcilable, but the apparent conflict can be hurdled by realizing that arbitration itself is not the problem.

Arbitration, when structured properly, can be fair, fast and economical and a tremendous benefit to franchisees who often can't afford to fund the cost of a traditional lawsuit. This means that if Congress does choose to intervene, its focus should not be to bar mandatory franchise arbitration but to require that it be structured fairly. What many critics of mandatory arbitration in franchise agreements perceive as harmful is that the arbitration clause, which is drafted by the franchisor, usually forces the franchisee to arbitrate in the franchisor's home city. Critics also attack one-sided provisions such as those requiring the loser to pay the prevailing party's costs and fees only if the loser is the franchisee.[10]

Congress addressed these issues directly in the special binding arbitration program it created for the auto industry by requiring that the arbitrations be held in the dealer's home state and by providing that each party was responsible for its own costs and fees. Concerns about the fairness of the franchise arbitration process could similarly be handled by remedial legislation regulating franchise arbitration agreements, not by prohibiting them.[11]

Conclusion

The AAA Automobile Industry Special Binding Arbitration Program showcased the power of a well-designed arbitration program to deliver fair and rapid results at an economical cost. Congress should take note of this in pending and future legislation regulating dealer and franchise arbitration. ■

ENDNOTES

[1] Chapter 11 provides for reorganization under the Bankruptcy Code, while Chapter 7 provides for liquidation.

[2] See, e.g., www.hometownautodealers.org.

[3] The Consolidated Appropriations Act, 2010.

[4] Conyer's remarks were recorded in the Congressional Record on Dec. 10, 2010.

[5] The AAA and arbitrators could look for legislative intent in the House and Senate floor debates over the bill.

[6] While this article focuses on how the process worked for the parties, the arbitrator perspective is worth a short comment. Deciding whether to accept the AAA's invitation to serve on the auto dealer panel required a good deal of thought. Even after accepting the invitation, arbitrators would have no idea if they would be selected and, if they were, how many cases they would be selected for. Nor did they know how the process would work, or how much study and hearing time would be required to resolve all the arbitrations through final award in six months. Finally, if selected to serve, disclosure would have to be made under the AAA's rules of relationships with GM, Chrysler, auto dealers generally, and the specific parties and law firms.

[7] Statistics in this section of the article are from A Report to Congress on the Automobile Industry Special Binding Arbitration Program (November 2010), prepared by the American Arbitration Association.

[8] H.R. 1020, introduced Feb. 12, 2009.

[9] Franchisee advocates and proponents of the Arbitration Fairness Act also claim that there is a "repeat-player" bias in the design of franchisee arbitration programs. In my view, this concern seems misplaced in the franchise context when the arbitration clause calls for administration by an arbitration institution, like the AAA, which has neutral commercial arbitration rules that apply to all kinds of business disputes. Further, it is arbitrators, not the administrators, who decide the arbitrations. The remedy for avoiding repeat-player bias in an arbitrator is not to select an arbitrator who has previously been involved in a case regarding the franchisor.

[10] One reform that could help would be to institute a system like the FINRA's [Financial Industry Regulatory Authority] where the arbitration provider discloses certain information regarding past outcomes of arbitrators' franchise arbitrations. This reform would lessen some privacy benefits that arbitration traditionally affords, but that should not be a major problem because franchisors are required to publicly report on the results of arbitration proceedings in their franchise disclosure document.

[11] Congress' choice on how to address those issues in the Automobile Industry Special Binding Arbitration Program may not be the best way to address issues involving franchising generally. Nonetheless, Congress' choice did show one approach to addressing the issues fairly.