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Limitations on Manufacturers' Power to Require Exclusive Use of their Service Contracts

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The general manager of your client, a new car dealership, calls you to discuss a non-factory service contract program that it wants to offer its customers. "Unfortunately," the manager says, "the manufacturer told us we must sell their service contracts exclusively or we will be at risk of losing our franchise." Can the factory really do this?

The answer depends on a careful review of the law of the state in which your client is located. Over the last decade, at least five states have enacted legislation and made it unlawful to coerce a dealer into selling their service contracts by threatening injury to business or engaging in other discriminatory behavior. Other states have anti-discrimination statutes that are more general, and do not provide sections specifically relating to service contracts.

In California, the law was amended in 2011 to specify that it is unlawful to discriminate against a franchise because that franchisee sells a service contract not endorsed by the manufacturer. *See*, Cal. Vehicle Code §11713.3(x)(1). The statute defines behaviors that are discriminatory including: 1) statements of any type that the dealer is obligated to exclusively sell the manufacturer's service contract; 2) statements of any type that a dealer would suffer negative consequences for selling an unapproved or unendorsed service contract; 3) measurement of a dealer's performance based on service contract sales; 4) requirements that a dealer actively promote a manufacturer endorsed service contract; 5) restrictions on access to vehicles, parts, vehicle sale or service incentives that are conditioned upon the sale of endorsed service contracts.

The California statute also sets forth what behavior is permissible for the manufacturer. There are three specific exceptions to what constitutes discrimination. First, the statute states that "[u]nfair discrimination does not include, and nothing shall prohibit a manufacturer from, offering an incentive program to vehicle dealers who voluntarily sell or offer to sell service contracts..."

Second, a dealer may also be required to provide a manufacturer

approved service contract if a used vehicle is part of a manufacturer "certified vehicle" program.

Third, manufacturers may require California dealers to place a service contract disclosure on any service contracts that are not endorsed or approved by the manufacturer. The language for this disclosure is provided by statute and must read: "The service contract you are purchasing is not provided or backed by the manufacturer of the vehicle you are purchasing. The manufacturer of the vehicle is not responsible for claims or repairs under this service contract."

If the manufacturer's conduct runs afoul of subdivision (x)(1), and none of the three exceptions are applicable, a quick call or letter from you to the manufacturer may resolve the issue expeditiously.

Other states have laws that are very similar to California. For example, the Pennsylvania Professions and Occupations title forbids a manufacturer from coercing new vehicle dealers in to exclusively selling a manufacturer endorsed service contract. *See* 63 P.S. 818.12. The Pennsylvania statute defines acts of coercion in terms that are virtually identical to the California anti-discrimination statute.

Despite their similarities, the Pennsylvania and California laws have a distinguishing factor. While California lists three exceptions, Pennsylvania only defines one; in Pennsylvania, it is not coercion if a manufacturer or distributor provides an incentive program to a dealer who makes the voluntary decision to sell a manufacturer endorsed service contract exclusively. *Id.* The Pennsylvania exception to what constitutes coercion or discrimination is followed in Louisiana, Idaho, and Virginia.

On the other hand, Arizona forbids discrimination in the same way that California does –but statute does not include any statutory exceptions to the rule of what manufacturer behavior is not allowed.

Nebraska has a statute specific to service contracts, although it is less detailed. Its statute forbids manufacturers from stating or representing that a dealer is obligated to sell manufacturer sponsored

service contracts. *See*, Neb.Rev.St. 60-1437. However, the Nebraska legislature does not define what type of behavior would constitute a direct or indirect representation.

In Oregon, the statute takes a very general approach and does not specifically mention service contracts. Instead, the statute forbids manufacturers from coercion or unfair competition with its franchise holders. An illustration of this general statute occurs in Oregon, where it is unlawful for a manufacturer to “Coerce or attempt to coerce a dealer to enter any agreement or sales promotion program by threatening to cancel the franchise of a dealer” or “unfairly compete with a dealer in any matters governed by the franchise”. Or.St. 650.130.

Although the specificity varies, in each of the above examples the dealership is protected from coercive or threatening behavior on the part of the manufacturer. The protections afforded by each state have several different remedies which the dealer may seek to prevent further harassment. In states like California, the manufacturers’ behavior is unlawful.¹³ California Code of Regulations 314.00. Your letter to the manufacturer should require that the manufacturer cease and desist or risk monetary penalties for each violation.*Id.* In states like Oregon where the manufacturer’s actions fall under a more general umbrella, a dealer may sue for an injunction and recover damages. O.R.S. 650.170.

While several states are discussed in this article, the list of statutes may not be complete. If you have run into this type of problem in your state, please contact the authors of this article who are maintaining a database for this type of law. ■

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