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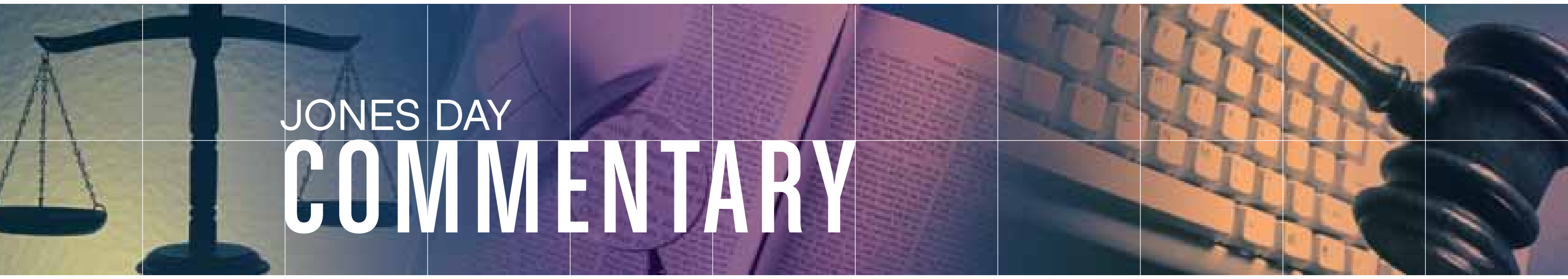

AUTOMOTIVE ALERT: FEDERAL APPELLATE COURT SAYS MANUFACTURER CAN CONTROL INTERNET SALES OF SERVICE CONTRACTS BY DEALERS TO CONSUMERS

The United States Court of Appeals for the First Circuit has ruled that an automobile manufacturer may temporarily preclude its dealers from selling vehicle servicing contracts ("VSCs") over the internet without violating a state dealer statute. *See Saccucci Auto Group, Inc. v. American Honda Motor Co., Inc.*, ____ F.3d ____, 2010 WL 3025536 (1st Cir. 2010). The case is of particular note because the internet was not a widespread commercial medium at the time the contracts between the manufacturer and the plaintiff dealer were formed.

While Honda had allowed its dealers to sell VSCs over the internet for a number of years, it temporarily halted the practice in 2007. *See id.* at *1. A dealer had been free to charge a customer whatever price the dealer chose and was allowed to retain the difference between the price the customer paid and the fee that the dealers paid to Honda for every VSC sold.

The VSC contract is ultimately between the customer and Honda. *See id.* Honda, in turn, pays dealers a performance-based allowance for each VSC sold, which depends on a quotient keyed to vehicle sales. *See id.* at *2. According to the court, the dealers that sold VSCs over the internet sold them at or near cost and relied on the performance-based allowances for their profits.

Honda dealers who did not sell the VSCs over the internet began to complain about the practice, "focusing their complaints on the lower prices charged by the [i]nternet dealers." *Id.* Honda's position eventually began to change. In January 2007, Honda's Dealer Advisory Board ("DAB") recommended that Honda stop the sale of VSCs over the internet. *See id.* Some dealers complained that the internet sales undermined customer satisfaction with the dealers and with Honda, given the different prices that were available. *See id.* Honda subsequently

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formed a committee to consider the issues, a committee that included Honda management and inside and outside counsel. *See id.* at *3. After the committee decided it was necessary to impose restrictions on internet sales, Honda announced a temporary prohibition on internet sales of VSCs in February 2008, which included graduated penalties for noncompliant dealers. *See id.*

The plaintiff dealership filed suit, claiming that Honda had violated three provisions of the Rhode Island Dealership Act.

First, the plaintiff claimed that Honda's actions violated the statute's prohibition on coercion, which has previously been interpreted to mean a "wrongful demand which will result in sanctions if not complied with." *Id.* at *4 (quotation omitted). The court found that the parties' contracts "simply do not address the [i]internet sale of Honda VSCs, much less the [i]nternet sale of Honda VSCs in a manner reasonably susceptible to different interpretations." *Id.* at *5. The court found that at the time the parties entered into the most recent contract in 1995, the internet was not a widespread commercial medium. *See id.* at *6. The court ultimately rejected the coercion claim because the plaintiff failed to argue that Honda's demand that its dealers cease internet sales was wrongful. *See id.* Moreover, the court found that even if the plaintiff had made that argument, the claim would fail because the temporary prohibition "seems fair and equitable, given that Honda imposed the prohibition on all of its dealers equally and that the dealers themselves, through the DAB, sought the prohibition. Moreover, we have said that a distributor acting honestly is entitled to latitude in making commercial judgments." *Id.* (quotation omitted).

Second, the plaintiff claimed that Honda's decision was "arbitrary" in violation of the Dealer Act. The court rejected that argument, stating that "Honda's decision-making process was thorough" and that Honda formed a committee to study the issue after complaints. *See id.* at *7. Although the plaintiff argued that Honda should have consulted customer and sales satisfaction surveys, the court found that Honda had other evidence on which to base a judgment on customer satisfaction: "[t]herefore, although it might be debatable whether Honda exercised the best judgment in failing to consult the customer surveys in addition to [evidence considered], its decision was nevertheless based on 'due cause' and was not 'selected at random and without reason.'" *Id.* As the court explained, perhaps more important was that Honda was concerned that the internet sales might violate other state laws and was leading dealers to promote competing products. *See id.*

The plaintiff also claimed that Honda's decision was "arbitrary" because Honda allows dealers to sell cars over the internet while it controls the sale of power equipment. The court found that Honda's concerns about Honda equipment sales on the internet having a negative impact on brand image and the dealer network were the same concerns about the VSCs. "In contrast, there is nothing in the record indicating that the [i]nternet sale of cars raised brand or dealer network concerns for Honda." *Id.* at *8. The court found that the decision was not arbitrary despite the dealer's claim that it was motivated by a decision to appease a powerful dealer based on the considerable evidence that Honda's decision was based on valid considerations, among other things. *See id.*

Third, the court ruled that the plaintiff's "predatory practice" claim failed. "Nothing in the record suggests that Honda imposed the temporary prohibition on the [i]nternet sale of Honda VSCs to exploit Internet dealers like [plaintiff] for its own benefit. To the contrary, the evidence indicates that Honda enacted the policy to protect brand loyalty and image, something in the best interest of Honda's dealers." *Id.* at *9.

The First Circuit also affirmed summary judgment on an implied covenant of good faith claim because "Honda's actions here did not unfairly interfere with any contractual objectives, nor is there evidence of bad faith." Id.

Saccucci stands for the notion that the business decisions of manufacturers that treat all dealers the same should be entitled to deferential review by courts and administrative agencies.

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