Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Were The GM, Chrysler Dealer Terminations Constitutional?

Law360, New York (May 12, 2014, 2:07 PM ET) -- Readers may remember the dramatic restructuring of the General Motors and Chrysler dealer networks as part of the bankruptcy proceedings for each automaker in 2009. The state auto dealer franchise statutes and their protection against dealer terminations were summarily preempted by the bankruptcy proceedings and the precondition of dealer network reduction for the necessary loans from the federal government to the debtors in possession.

Dealers challenged this action in the Court of Claims, and by an April 7, 2014, decision in A&D Auto Sales Inc. et al. v. U.S., the Court of Appeals for the Federal Circuit upheld the denial of the government's motion to dismiss the complaint and granted the plaintiff dealers leave to amend the complaint.

Although the case is in the early stages of discovery and a number of arguments have yet to be raised, the U.S. Department of Justice was unsuccessful in defeating the claim that the property rights associated with the intangible property represented by the dealer agreements with the manufacturers were entitled to constitutional protection against either "regulatory takings" or "categorical takings" under U.S. Supreme Court decisions dealing with government action affecting real property and tangible personal property.

Citing these cases represented by Lucas v. S.C. Coastal Council, a categorical taking occurs where regulations "compel the property owner to suffer a physical invasion of his property" or "prohibit all economically beneficial or productive use."

A regulatory taking occurs when government action is so unduly burdensome as to be tantamount to a physical invasion or taking. Three factors have "particular significance" in the regulatory taking analysis: (1) "the character of the governmental action," (2) "the extent to which the [action] has interfered with distinct investment-backed expectations," and (3) "[t]he economic impact of the regulation on the claimant."

At the heart of the issue: Was the government loan precondition of dealer network reduction a taking? The court of appeals ruling allows the plaintiff dealers to develop the case in discovery based on the court's findings that the intangible property rights represented by dealer agreements were compensable protected property interests.

The court observed a distinction between inchoate rights of parties that exist at the time the agreements are created, such as the power of a debtor in bankruptcy to reject executor contracts, and government action after the formation of the contract that gives rise to actions adverse to the property rights of the property owner.

The court noted that "government action directed to a third party does not give rise to a taking if its effects on the plaintiff are merely unintended or collateral." The court cited another line of its cases that hold no taking occurs if "the challenged government action was of general application and the plaintiff was but one member of an affected class of persons."

The plaintiffs must amend their complaint to satisfy a number of other criteria, including more detailed economic loss and diminution of value. The theory of liability may turn on whether the plaintiffs can prove some manner of coercion by the federal government against the manufacturers because of their inability to survive bankruptcy without the financing to which the condition was attached.

The fascinating opportunity represented by the decisions in this case is whether the rulings will determine if the recent attempts by state legislatures to enact franchise relationship laws applicable to existing contracts and existing trademarks will pass constitutional muster. The relationship laws serve no public purpose other than to rebalance private property rights between the commercial contract parties, and to limit the discretion reserved by one party and presumably priced into the bargain by both sides.

The initial finding of the court of appeals that the intangible contract rights are compensable property interests to which government action may create either a regulatory taking or a categorical taking is a huge step in advancing the argument that these relationship laws are unconstitutional takings of the property rights associated with the trademarks and other intellectual property licensed as part of the franchise agreement.

In the auto dealer termination case, the government action coerced the manufacturers into termination of valid pre-action contracts between private parties for commercial purposes, an action they may or may not have taken in the bankruptcy case on the economic merits. Is it a stretch to say that the same principles apply to government action coercing franchisors not to terminate pre-action contracts between private parties for commercial purposes?

—By Joel R. Buckberg, Baker Donelson Bearman Caldwell & Berkowitz PC

Joel Buckberg is a shareholder in Baker Donelson's Nashville, Tennessee, office.