

# ARTICLE

## The Reversal Arbitration Board: An ADR Model for Resolving Intra-Corporate Disputes\*

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### I. INTRODUCTION

In this article, we describe the development and implementation of an innovative Alternative Dispute Resolution (ADR) program that uses neutral adjudicators to minimize lawsuits between Toyota Motor Sales, USA and its automobile dealerships. The Toyota Reversal Arbitration Board [hereinafter RAB] has several distinguishing characteristics. First, while many forms of ADR seek to shift the focus of disputes away from formal rules, the Toyota RAB was specifically designed to convey and enforce organizational rules. Second, an aspect of organizational decision making is entrusted to neutral, outside adjudicators trained as specialists in the rules and the context out of which disputes arise. Third, the program involves an asymmetrically binding process: Toyota is bound by the decision of the neutral, while dealer disputants still have recourse to the legal system if they are unhappy with the process or outcome.

We argue that the RAB program produces a more focused and accessible body of decisions than could be obtained from either formal legal adjudication or the "in-house" system of decision making that it replaced. We also argue that the process promotes procedural justice and makes the program attractive to dealer participants. We explore the hypothesis that the program has reduced the frequency of dealer sales credit disputes by the development of a body of organizational "common law" that communicates the rights and responsibilities of involved parties. Finally, we consider how the lessons learned from the program can be applied in other contexts.

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## II. HISTORY OF THE DEVELOPMENT OF THE REVERSAL ARBITRATION BOARD

### *A. Toyota Policy*

Through its retail sales reporting policy, Toyota allots sales credit and certain sales incentives to its dealers. Dealers receive credit for vehicles sold to ultimate retail consumers, but not for vehicles sold to wholesalers or other dealers. An ultimate retail consumer purchases vehicles for use and not for resale. Toyota's sales reporting policy provides information for its vehicle distribution system which has the goal of assuring that future production flows to those dealers who sell to ultimate consumers. The success of the reporting policy depends on adherence by dealers to strict inventory and sales reporting practices.

Prior to its adoption of the "ultimate consumer" test in the 1970s, Toyota had operated under an "initial seller" test, whereby the first-selling dealer received sales credit. Although the initial seller test allowed for perfunctory resolution of sales credit disputes, it resulted in inefficient allocation of new vehicles and was subject to abuse by dealers who would report as "sales" the transfer of vehicles to dealer-owned companies or to brokers who in turn sold to other dealers.

Toyota believes that the "ultimate consumer" test underlying its current sales reporting policy provides the most equitable method of allocating vehicles among its dealers. Yet, implementation of the "ultimate consumer" test also presents problems and abuses in sales reporting. Frequently, two dealers claim sales credit for the sale of the same vehicles and a dispute arises. Toyota's position is that it cannot act as a "policeman" in awarding the sales credit. It contends that the first-selling dealer is in the best position to determine whether customers are genuine retail buyers or simply wholesale outlets.<sup>1</sup>

### *B. Dealer Disputes*

Even though Toyota believed<sup>2</sup> that the "ultimate consumer" test of its sales reporting policy had been straightforward over the years, many disputes arose between dealers over the issue of retail sales credit. These disputes fell into two typical scenarios. Most commonly, an independent broker<sup>3</sup> would purchase vehicles from a dealer (Dealer 1), pretending to purchase for use, and then, in a separate and subsequent transaction, sell the same vehicles to another dealer (Dealer 2). Dealer 1 would request and receive sales credit after the initial sale to the broker, while Dealer 2 would request sales credit on the same vehicles after

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1. While dealers may sell to whomever they choose, any sales to persons who buy from one dealer in order to sell to another are considered wholesale and will not generate sales credit.

2. Toyota Motor Sales continues to maintain that the "ultimate consumer" test is straightforward.

3. Typically, a broker would pose as an automobile leasing or rental company.

it had sold them to ultimate consumers.<sup>4</sup> In other cases, purchases by brokers from Dealer 1 were initiated by Dealer 2.<sup>5</sup>

Prior to the implementation of the RAB in 1985, Toyota regional offices<sup>6</sup> would informally decide sales credit disputes arising in the above situations. The office would gather information from each dealer involved in the transaction, and then use a common sense notion of fairness in applying the "ultimate consumer" test. For example, under the first scenario, sales credit would typically be awarded to Dealer 2, since it had sold the vehicles to the ultimate consumer; any sales credit initially awarded to Dealer 1 by its prior filing for credit would be reversed. The regional office would be less likely to award sales credit under the second fact pattern, if it believed that Dealer 2 induced Dealer 1 into making a nonretail sale.

If either dealer strongly disagreed with the regional office's sales credit award, the sales department of Toyota's headquarters would resolve the dispute. Neither the regional offices nor the sales department issued written decisions. As a consequence, no formalized criteria emerged for establishing what constituted a sale to an ultimate consumer.

Due to dealer dissatisfaction with in-house decisions, the high cost to Toyota of policing reported sales, and recurring abuses in sales reporting, Toyota supplemented the "ultimate consumer" test with other policies designed to reduce the number of dealer disputes. Sales to dealerships, for instance, qualified as sales to "ultimate consumers," earning Dealer 1 retail sales credit only if the purchased vehicles were used to conduct dealership business or to generate revenue for Dealer 2. Additionally, the sale of vehicles to leasing or rental companies constituted sales to an ultimate consumer only if the vehicles were both: (1) placed in legitimate lease or rental service at the time of the sale; and (2) remained in service for at least 120 days.<sup>7</sup> Finally, in 1984, Toyota implemented a policy whereby sales credit was subject to reassignment (reversal) only if it was reported by Dealer 2 as resold within sixty days of the original transaction between the dealers.<sup>8</sup>

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4. Sometimes, the sales credit disputes involved only one vehicle. Other cases involved multi-vehicle sales, in which a dealer could potentially earn significant sums of money, both through the sale itself and incentive awards. For example, one case involved the reversal of sales credit for 20 vehicles and approximately \$30,000 in incentive money.

5. In many cases, it was argued that the sale to the broker was initiated by Dealer 2, but this allegation was not always proven. See *infra* note 26 and accompanying text.

6. In the United States, there are nine Toyota Regions and three Private Distributorships whose primary function is to distribute Toyota vehicles.

7. Prior to 1986, Toyota required the vehicles to remain in service for at least 180 days.

8. Prior to 1984, Toyota allowed dealers to request reversals within 180 days of the last reported retail sales date. Implementation of the 60 day rule helped protect dealers who were unwittingly selling vehicles to brokers.

### C. *Lawsuits Against Toyota*

As explained above, sales by Dealer 1 to Dealer 2 or to a broker would not earn Dealer 1 retail sales credit. However, when Dealer 2 purchased vehicles from a broker and resold them to retail customers, it would receive credit for the sale, and Dealer 1, who sold to the broker, would lose the credit it had previously received. Dealer 1 would frequently object to the loss of its credit, stating that it sold cars to the broker in good faith and without knowledge that its customer was a broker. Dealers requesting reversal also voiced complaints about the unfairness of the decisions of the regional offices and the Toyota Sales Department.

These dealer disputes often resulted in "messy and expensive lawsuits," with the protesting dealer suing both the reversal requesting dealer and Toyota Motor Sales.<sup>9</sup> In many of these lawsuits, the subject of sales credit would be secondary to the larger and more complex issues of antitrust laws and the Racketeer Influenced and Corrupt Organizations Act (RICO).<sup>10</sup> "[D]iscovery of just the allegation challenging the sales credit policy in the prior lawsuits cost Toyota several hundred thousand dollars in legal fees and related expenses."<sup>11</sup> In one lawsuit that dealt specifically with the sales credit policy, Toyota settled out of court for several hundred thousand dollars.<sup>12</sup>

## III. DEVELOPMENT OF THE REVERSAL ARBITRATION BOARD PROGRAM

### A. *Origin of the RAB*

By the Spring of 1985, Toyota was "faced with escalating legal expenses and dealer hostility over an issue in which Toyota obtained no financial benefit, regardless of which dealer received sales credit."<sup>13</sup> In response to this problem, Toyota's Legal Department<sup>14</sup> began to design a nonbinding alternative dispute resolution procedure. Toyota consulted and subsequently hired the Private Adjudication Center, Inc.<sup>15</sup> as the exclusive administrator of the program. Nine

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9. *Toyota Designs New ADR System for Dealers*, ALTERNATIVES TO THE HIGH COST OF LITIG. (Ctr. for Pub. Resources, New York, N.Y.), Dec. 1985, at 14, 14.

10. *Id.*

11. *Id.* at 15.

12. Telephone interview with David Laufer, Toyota's Managing Counsel (Dec. 23, 1992).

13. Ctr. for Pub. Resources, *supra* note 9, at 14.

14. William Plourde, Toyota Vice President and General Counsel for Business Law, and David Laufer, Toyota's Senior Managing Counsel, were the key players in designing a nonbinding ADR procedure.

15. The Private Adjudication Center, Inc. is a nonprofit affiliate of Duke University School of Law that provides research, education, and services in the field of alternative dispute resolution.

neutral adjudicators, who were geographically distributed throughout the country, were selected and met with Toyota to discuss the program.<sup>16</sup>

The group discussed Toyota's sales credit policy and its vehicle allocation system, and then discussed possible structures for the program. After considering other ADR processes, the group decided that an arbitration model would most effectively meet the needs of both the dealers and Toyota. Toyota's original design of the program had contemplated arbitrators awarding sales credit according to state laws governing vehicle registration. During the meeting, however, some of the participants argued that other factors beyond registration laws, such as dealers' intentions in specific sales, should be considered. The final design of the program required that arbitrators consider the good or bad faith of the dealers in a transaction and determine which dealer sold the vehicle to an ultimate consumer. Toyota agreed to comply with all decisions of the RAB, even though the decisions would not bind participating dealers.

### *B. RAB Guidelines*

Toyota adopted three exceptions to the "ultimate consumer" rule of its retail sales credit policy which incorporated considerations of good faith, prudence, and reasonableness. These exceptions are:

- 1.) A dealer protesting a sales reversal will receive sales credit if (a) it can prove by very strong and convincing evidence that it acted prudently and in good faith, and did all it could reasonably be expected to do under the circumstances to establish that the purchaser was, in fact, the ultimate retail customer, AND (b) the requesting dealer did not act in good faith in obtaining the vehicle from the protesting dealer.
- 2.) If a protesting dealer can prove by very strong and convincing evidence that it acted prudently and in good faith, and did all it could reasonably be expected to do under the circumstances to establish that the purchaser was, in fact, the ultimate retail customer AND if the requesting dealer acted in good faith, the reversal request will be granted; but for allocation purposes only, each dealer will receive one-half of the sales credit.
- 3.) Neither the requesting dealer nor the protesting dealer will receive sales credit if neither acted in good faith. The vehicles will be reversed into Toyota inventory.

These exceptions permitted the arbitrators to take into account the dealers' intentions in resolving sales credit disputes. With the adoption of these exceptions,

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16. Toyota organized a meeting in March, 1985, in which the Center, the arbitrators, and Toyota developed the RAB.

arbitrators could resolve sales credit disputes in one of four ways: (1) grant sales credit to the protesting dealer (*i.e.*, Dealer 1); (2) grant sales credit to the requesting dealer (*i.e.*, Dealer 2); (3) split the sales credit evenly between the dealers for allocation purposes only; and (4) refuse to grant credit to either dealer.

### *C. Rules and Procedures*

Dealers, private distributors, Toyota regional offices, and Toyota Motor Sales, USA may initiate reversal requests.<sup>17</sup> Dealers who request a reversal must do so within sixty days of the last recorded retail sales date.<sup>18</sup> The procedure requires that the requesting dealer (Dealer 2) file a "Retail Sales Reversal Request Form," along with supporting documentation, with its private distributor or the distribution manager of its region. The distribution manager first reviews reversal requests for legitimacy and completeness, then notifies Dealer 1 that if it wishes to contest the credit reversal, it must submit a letter of protest, with supporting documentation (including a brief written summary of its position), within fourteen days of this notification. If Toyota receives no protest, it will reverse the sales credit automatically on the fifteenth day.

A dealer may request a hearing before the RAB if it wishes to protest a reversal request. After the protesting dealer provides all required information, the dealer's regional office has seven calendar days within which to negotiate a resolution with the requesting dealer. If the matter cannot be resolved by agreement, the regional office must forward the material to the head office of Toyota by the eighth calendar day. Upon receipt and review of the material, Toyota forwards the protest documentation to the Private Adjudication Center, Inc.<sup>19</sup> The Center assigns a case number and an arbitrator to the case, and then arranges a hearing that is mutually convenient to both dealers.<sup>20</sup>

The RAB is informal and inexpensive. Dealers may participate in a RAB hearing in person, by conference call, or by submission of documents. Most

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17. The vast majority of sales credit disputes are initiated by dealers.

18. The last "retail sales date" is most likely the date Dealer 1 sold vehicles to the broker or to Dealer 2, or the date Dealer 2 sold the vehicles to ultimate consumers.

19. Toyota conducts a review to determine if the protest is frivolous. Regardless of Toyota's determination, if a dealer insists on bringing a dispute to the RAB, it is forwarded to the Private Adjudication Center.

The rules also provide that the arbitrator may order the protesting dealer to pay costs of up to \$1000.00 if the protest is determined to be frivolous. In only one hearing has an arbitrator awarded costs.

20. If the protesting dealer wishes to appear in person before the arbitrator, the Center arranges for the hearing to take place in that dealer's region, as provided in the rules. The Center arranges for hearings to occur within two weeks of receipt of documentation. Hearings typically last one-half hour or less.

dealers have participated by conference call, thus eliminating travel expenses.<sup>21</sup> Attorneys may not assist disputants in the hearings.<sup>22</sup> Each side must present its case within one-half hour, and both the arbitrator and the parties may ask questions. Arbitrators issue written opinions approximately one week following the hearing. The Center reviews each decision for accuracy and then forwards it to the parties and Toyota.<sup>23</sup>

#### IV. THE REVERSAL ARBITRATION BOARD IN OPERATION: RESULTS AND ANALYSIS

##### A. Cases Arbitrated

With the development of the RAB and the adoption by Toyota of good faith exceptions to its sales credit policy, dealers gained a forum that accounted for more facts relevant to the disputed transactions than the prior in-house procedure. Moreover, the dealers gained quick access to the decisions of the arbitrators through oral and written communications from the regional offices. The following discussion explores the hypothesis that RAB arbitrators have issued a consistent body of opinions that has clarified the sales credit policy and educated dealers as to their rights and duties under the policy.

In an effort to track the consistency of arbitrators' decisions, we reviewed 271 opinions rendered under the RAB between 1985 and 1991.<sup>24</sup> The opinions were sorted according to the four possible hearing outcomes.<sup>25</sup> An analysis of what facts led arbitrators to find the good faith or bad faith of disputants was conducted. The review indicates that arbitrators employed a fairly uniform notion of "good faith" and that an intelligible body of private common law arose from the decisions.

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21. Of 320 hearings reviewed for the purpose of determining in what manner dealers participated in the hearings, there were 170 conference calls, seven hearings in which both parties appeared live, 41 hearings in which one party participated by telephone and one relied on documents, 91 hearings in which one person participated by telephone and one appeared in person, six hearings in which one person relied on documents and one person appeared live, and five hearings in which both parties relied on documents only.

22. The assistance of attorneys was considered during the discussion of the design of the RAB. Lawyers were excluded in order to reduce legal fees.

23. A review is conducted by the Center to confirm correct vehicle numbers and other typographical errors. It is not a substantive review.

24. Although 293 decisions were randomly selected for review, in 22 cases the arbitrator failed to make explicit the basis of the decision. The total number of decisions rendered during this period was 402.

25. Possible outcomes are: (1) reversal granted to Dealer 2; (2) reversal denied to Dealer 2; (3) reversal granted, but sales credit evenly divided between dealers for allocation purposes; and (4) sales credit denied to both dealers and the vehicles reversed into Toyota inventory. *See supra* RAB Guidelines Section.

### *1. Classification of Decisions*

Recall from the earlier discussion that at the time a sales credit dispute is brought before an arbitrator, the protesting dealer (Dealer 1) is in possession of sales credit and the requesting dealer (Dealer 2) seeks the reversal of sales credit into its account. The sales credit policy states that the dealer who sells to an ultimate retail consumer gets the credit. There is a presumption in the hearing that credit will be reversed from the protesting dealer and granted to the reversal-requesting dealer who actually sold to an ultimate consumer. If the protesting dealer can convincingly prove all factors under the first exception to the sales credit policy, it will have overcome this presumption and retain the sales credit.

Consistent with the Toyota sales credit policy, which states that the dealer who sells to an ultimate retail consumer will receive sales credit, arbitrators granted a reversal of sales credit in 148 cases, in which it was determined that the requesting dealer acted in good faith and the protesting dealer failed to carry its burden on the issues of its good faith, prudence, and reasonability under the circumstances of the transaction. Of these 148 decisions, arbitrators found that the protesting dealer failed to ensure that the buyer was an ultimate consumer in 134 cases, knew that it was not selling to an ultimate consumer in five cases, failed to act in good faith in three cases, and failed to present sufficient evidence of its good faith in six cases.

Arbitrators awarded sales credit to the protesting dealer in only six of the 271 cases. In each of the six cases, the protesting dealer met its burden of proof under the first exception to the sales credit policy by establishing its good faith, prudence, and reasonableness in the investigation of the buyer. In five of the cases, the requesting dealer was found to be in bad faith, while in the sixth case, there was insufficient evidence of the reversal-requesting dealer's good faith.<sup>26</sup> Following the second exception to the sales credit policy, arbitrators granted reversal, but divided sales credit between protesting and requesting dealers, in 107 of the 271 cases reviewed.<sup>27</sup>

Following the third exception to the sales credit policy, arbitrators denied sales credit to the disputants in ten cases. In eight of the ten cases, the arbitrators

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26. After proving its good faith, prudence, and reasonability, the protesting dealer may put the good faith of the requesting dealer into question. Under appropriate circumstances, the arbitrator may shift the burden of proof to the requesting dealer to prove its good faith.

27. Although the outcomes were the same, to support their opinions, arbitrators emphasized different aspects of the second exception to the sales credit policy in these 107 decisions. In 62 of these cases, arbitrators stated that the protesting dealer acted in good faith; in 41 of the cases, arbitrators emphasized that the protesting dealer had done all that was reasonably to be expected in determining if it was selling to an ultimate consumer; in four cases, arbitrators simply found no evidence of bad faith on the part of the protesting dealers. Arbitrators found that the requesting dealers had either acted in good faith, or had not been proven to have acted in bad faith, in each of the 107 cases.



stressed the inadequate investigation by the protesting dealer of its purchaser, apparently inferring bad faith from that dealer's unreasonable behavior.<sup>28</sup>

Thus, in the majority of cases reviewed (148/271), arbitrators granted reversal and denied the protesting dealer (Dealer 1) sales credit. In the great bulk of these cases (134/148), and of cases denying sales credit (8/10), the protesting dealer (Dealer 1) lost its credit because it had failed to conduct a thorough investigation of its purchaser.

## 2. Findings of Good or Bad Faith

Arbitrators' decisions concerning the grant or denial of reversal requests, or the splitting or denial of sales credit, depended chiefly on findings of the good or bad faith of each disputant. Our review of thirty randomly selected cases,<sup>29</sup> decided by different arbitrators, reveals the fact patterns that gave rise to findings of bad faith, imprudence, or unreasonable investigation of protesting dealers.<sup>30</sup> Although the review discloses some minor inconsistencies in the level of investigation of buyers required by protesting dealers, on the balance these were only insignificant differences distinguishing the decisions of the arbitrators.

Prior to the implementation of the RAB program, Toyota identified certain factors and circumstances relevant to the finding of good or bad faith of protesting dealers; this information was conveyed to all arbitrators. Those factors included the following: (1) out of state location of the buyer; (2) number of vehicles sold; and (3) use of written assurances that vehicles would not be resold by the buyer to another Toyota dealer. Toyota suggested to the arbitrators that the first two factors would alert a selling dealer to the possibility of a broker-purchaser and that a higher level of inquiry into the buyer's identity and business should be required in such cases. Toyota also explained that the third circumstance, the existence of written assurances, could cut both ways in the arbitrators' decisions. On the one hand, Dealer 1 had made some effort to thwart a broker resale, but on the other hand, Dealer 1 had revealed its suspicions of a broker transaction.

In the thirty cases we reviewed in detail, arbitrators frequently cited the factors suggested by Toyota. In approximately one-third of the cases reviewed,

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28. In three of the ten cases in which neither dealer received sales credit due to the bad faith of both disputants, the arbitrator granted the reversal request. In the remaining seven cases, reversal was denied.

29. Decisions from all nine arbitrators were represented.

30. As exemplified in scenario #2, *see supra* RAB Guidelines Section, Section III. B., findings of bad faith on the part of requesting dealers normally depended on evidence of collusion between the purchasing broker and the requesting dealer, or on intentionally misleading statements made to the protesting dealer by the requesting dealer who purchased without use of a broker. Facts which supported collusion were not discussed at length in any of the opinions reviewed. Arbitrators also failed to discuss at length facts amounting to intentionally misleading conduct. For these reasons, the review of 30 selected cases focuses on the good or bad faith of protesting dealers and omits analysis of the good or bad faith of requesting dealers.

arbitrators considered evidence on the issue of written assurances, and in some of these decisions, the existence of assurances was discounted by the arbitrators as self-serving. In all cases reviewed, the arbitrators considered the buyer's location and the number of vehicles purchased.

Other factors weighed by arbitrators included: whether the buyer paid in cash; whether the buyer requested the manufacturer's statement of origin for the vehicles; whether Dealer 1 had prior dealings with the buyer; whether the purchase was consummated by telephone or in person; whether Dealer 1 had sales credit reversed in prior transactions; and whether Dealer 1 made a profit on the sale. Some of these factors were handled uniformly by the arbitrators, such as the treatment of requests for the manufacturer's statement of origin (MSO). A buyer's request for MSO's indicated a sophisticated buyer, and might alert Dealer 1 to a suspect transaction. Other factors such as "prior dealings" and "prior reversals" were handled differently by arbitrators. One arbitrator held that uncontested prior transactions with a leasing company indicated that the buyer was a legitimate ultimate consumer, while another arbitrator required an investigation by Dealer 1 into the existence of lessees before the current sale could be held reasonable and prudent even though the transaction involved the same customer. Arbitrators viewed the existence of "prior reversals" against a particular dealer in varying ways. One arbitrator, in denying a protesting dealer credit, did not let the absence of prior reversals compensate for a wholly inadequate investigation of the buyer by the protesting dealer. Another arbitrator, in granting half credit to the protesting dealer in another case characterized by an inadequate investigation of the buyer, mentioned the absence of prior reversals, although the arbitrator did not indicate that this was the basis for the decision.<sup>31</sup>

All arbitrators weighed heavily the circumstance of "buyer status" in their decisions. Sales to leasing or rental companies, or to dealerships, required some substantial investigation<sup>32</sup> by the selling dealer in order to prove its good faith and reasonability. Given no other unusually suspect circumstances, a lesser investigation<sup>33</sup> was required for the sale of a single car to an individual if Dealer 1 knew the individual to be in the business of leasing or selling cars. In the cases reviewed, all arbitrators agreed that the sale of one car to a person in her status

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31. The existence of "prior reversals" is a less significant factor in the reasoning of the arbitrators. The apparent inconsistency noted in the text may be explained by differences in "buyer status" and "number of vehicles sold." In the first case, the buyer was a leasing company negotiating for the purchase of eighteen vehicles, while in the second case, the buyer was an individual buying a single automobile.

32. One arbitrator found that the following steps taken by a protesting dealer that had been approached by a leasing company constituted a good faith effort: (1) inquiries submitted to its regional office or private distributorship about the alleged leasing company; (2) contacting other regions to check for any record of reversals involving the leasing company; (3) calling dealers from which the leasing company had previously purchased vehicles; and (4) contacting the bank of the leasing company to determine the legitimacy of the prospective buyer.

33. Under these facts, an arbitrator found that merely checking the list of "suspect" leasing companies maintained by the regions and private distributorships, and verifying the business address of the buyer, met the good faith requirement for the protesting dealer.

as an individual<sup>34</sup> was reasonable without investigation, even if the individual lived out of state and purchased the vehicle by telephone. Apparently, arbitrators felt that such sales were in the normal course of business and that the Toyota sales credit policy required no special efforts under such circumstances.

This review of thirty selected cases suggests that, on the whole, differences among arbitrators' opinions are insignificant regarding the good faith of protesting dealers and that an intelligible body of private common law has arisen from the decisions. Dealers and regional managers may read the decisions of the RAB and quickly isolate the factors in a transaction that arbitrators have considered relevant to the good or bad faith of the protesting dealers, such as buyer status and number of vehicles sold.

### *3. Comparison of Arbitrator Decisions to Prior Decision Making*

This development of a private "common law"<sup>35</sup> of sales credit disputes through the decisions of the RAB appears to illustrate the significant advantages of the Toyota program over both the prior in-house decisions of Toyota and the past court opinions in dealer/Toyota lawsuits. The decisions of the RAB have resulted in a consistent interpretation of the good faith exceptions to Toyota's sales credit policy, providing dealers with guidance on how to conduct themselves in suspect transactions. By way of contrast, prior decisions by the courts, often arising under RICO or antitrust issues, had focused more on the duties of Toyota to its dealers than on the relative rights of dealers to disputed sales credit. Beyond the marginal relevance of these court decisions to dealers disputing sales credit, the decisions were surely more difficult and expensive to access than the decisions of the RAB. Dealers might need to hire attorneys, for example, to locate and explain the impact of the most recent Toyota/dealer dispute. In any event, dealers apparently did not view Toyota as a neutral party that issued fair and comprehensive rulings that provided precedential value.<sup>36</sup>

The accessible, evenly reasoned opinions of the RAB have proven more helpful to dealers than the prior in-house decisions by Toyota. As mentioned before, the decisions of the arbitrators may have been more consistent and well reasoned due to the specialized training they received. Before the implementation of the RAB, Toyota published neither the reasoning, nor the outcome, of its

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34. In one case, the protesting dealer testified that he had sold one car to an individual and had performed his "customary inquiry" to confirm that the buyer was not a broker. Nonetheless, the arbitrator denied credit to the protesting dealer upon evidence that title had passed from the dealer to the company, rather than to the individual.

35. Although no decision of one arbitrator is binding on another, the availability of decisions among arbitrators, the great similarity of fact patterns, and the repeated experiences of the arbitrators has led to the development of a body of organizational law that communicates to the participants appropriate guidelines for compliance with the sales credit policy.

36. Unpublished Reversal Arbitration Board Survey of Dealers (1985), conducted by the Private Adjudication Center, Inc.

decisions in dealer disputes. Dealers had no way of knowing what factors Toyota might consider in implementing its strict ultimate consumer test, whether Toyota would equally weigh the same factors in all dealer disputes, or whether Toyota, which had no financial interest in the outcome of any of the dealer disputes it decided, would thoroughly and vigorously investigate all cases. The RAB program addressed all of these shortcomings and provided an inexpensive means by which dealers could acquire the information needed to conform to Toyota's sales credit policy.

## *B. Issues of Procedural Fairness*

### *1. Survey of Participants*

An early survey of sixty-one dealers who participated in the RAB confirmed general satisfaction with the program.<sup>37</sup> Sixty-six percent of the dealers had a favorable reaction to the creation of the RAB. Ninety-five percent felt that the "Guidelines and Procedures" were understandable. Eighty percent of the dealers felt that the procedure was fair, while ninety-eight percent perceived the arbitrator as impartial. Seventy-one percent of the dealers said they were satisfied with the RAB procedure. To date, all RAB decisions have been accepted by dealers and none have sought recourse in the traditional court system.

### *2. Procedural Justice Issues*

A growing body of research literature has focused on what has been labeled "procedural justice."<sup>38</sup> This literature shows that the perceived fairness of a procedural process has important implications not only for whether disputing parties feel they have obtained justice, but also for their subsequent behaviors and their willingness to use the procedures again. The research further indicates that in some instances, procedural fairness appears to be more important than the outcome itself: *e.g.*, clear losers in a dispute may still feel that justice was done. While our study of the RAB procedure was not intended to be a test of the aspects of procedural justice theory, two components of the program deserve comment because they help explain dealer satisfaction with the RAB.

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37. *Id.*

38. See, *e.g.*, E. ALLAN LIND ET AL., THE PERCEPTION OF JUSTICE: TORT LITIGANTS' VIEWS OF TRIAL, COURT-ANNEXED ARBITRATION, AND JUDICIAL SETTLEMENT CONFERENCES (1989); E. ALLAN LIND & TOM R. TYLER, THE SOCIAL PSYCHOLOGY OF PROCEDURAL JUSTICE (1988); JOHN THIBAUT & LAURENS WALKER, PROCEDURAL JUSTICE: A PSYCHOLOGICAL ANALYSIS (1975); S. Alexander & M. Ruderman, *The Role of Procedural and Distributive Justice in Organizational Behavior*, 1 SOC. JUST. RES. 117 (1987); Ronald L. Cohen, *Procedural Justice and Participation*, 38 HUM. REL. 643 (1985); E. Allan Lind et al., *In the Eye of the Beholder: Tort Litigants' Evaluations of Their Experiences in the Civil Justice System*, 24 LAW & SOC'Y REV. 953 (1990); Neil Vidmar, *Procedural Justice and Alternative Dispute Resolution*, 3 PSYCHOL. SCI. 224 (1992); Neil Vidmar, *The Origins and Consequences of Procedural Fairness*, 15 LAW & SOC. INQUIRY 877 (1990).

*a. Independent Neutrals*

An important component of the program is the replacement of Toyota regional offices and the sales department with independent neutrals. Although Toyota perceived itself to be neutral and fair toward individual dealers on the matter of which one obtained the sales credit in disputed cases, it may not have been viewed as an independent and neutral party. It held great power not only with respect to the sales credit policy, but also with respect to a host of other issues bearing on its dealers. Prior to the RAB, Toyota provided the sales credit and adjudicated disputes arising out of its own sales credit policy. The problem with dealers' perceptions may have been further exacerbated by Toyota's failure to provide written explanations for its decisions in individual cases. The RAB is probably perceived as inherently more fair because the arbitrators are not Toyota officials. The imprimatur of neutral decision makers may alleviate concerns of unfairness.<sup>39</sup>

Even the impartiality of the judges may not be as crucial to an impression of fairness of the process as the parties' perception of fairness which is affected by: (1) the opportunity to express oneself, and (2) the opportunity to have views considered by someone in power.<sup>40</sup> The in-house mechanism of dispute resolution initiated by Toyota managers may have impaired the dealers' ability to fully and openly present information and make arguments.<sup>41</sup> Some studies conducted of managers acting as dispute resolvers indicate that "[m]anagers . . . may not provide any structured procedure for the presentation of evidence and arguments,"<sup>42</sup> and "often censor individual disputants . . . ."<sup>43</sup>

Toyota arbitrators are knowledgeable about Toyota policy and the factual circumstances that give rise to disputes. Indeed, through experience and training, they are far more knowledgeable about the situation and the rules than a judge in a court of general jurisdiction. Moreover, their decisions are limited to the sales dispute itself, without other issues that complicated the sales credit disputes in the pre-RAB lawsuits.

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39. James F. Henry, *Alternative Dispute Resolution: Meeting the Legal Needs of the 1980s*, 1 OHIO ST. J. ON DISP. RESOL. 113, 116 (1985).

40. See LIND & TYLER, *supra* note 38. An early survey of Toyota dealers indicated that out of fifty-eight dealers, only one felt that they did not have sufficient time to present their case. Forty-four dealers indicated that the arbitrator understood their position, six felt that the arbitrator did not understand, and eight were uncertain.

41. See Lon L. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 355 (1978).

42. Deborah M. Kolb, *Who are Organizational Third Parties and What Do They Do?* in RESEARCH ON NEGOTIATIONS IN ORGANIZATIONS 207 (Roy J. Lewicki, Blair H. Sheppard, and Max H. Bazerman eds., 1986).

43. Blair H. Sheppard, *Managers as Inquisitors: Some Lessons From the Law*, in 1 MAX H. BAZERMAN & ROY J. LEWICKI, NEGOTIATING IN ORGANIZATIONS 193, 203 (1983) (for example, little investigation into circumstances of dispute by managers; snap decisions by managers; and inadequate consideration of circumstances by managers).

There is also some literature that indicates that important organizational attitudes are affected by procedural justice judgments. The literature argues that these judgments are a strong determinant of participants' reactions to decision making and may have strong effects on attitudes about organizations and authorities versus attitudes about specific outcomes. The RAB effectively dealt with the complaints of the dealers without the perception that Toyota management influenced the outcome. The literature suggests that employees will investigate internal procedures carefully if they do not perceive them as fair and this perception may impact negatively on job performance and compliance with organizational rules.<sup>44</sup>

The procedural justice literature indicates that disputants are often willing to place their dispute in the hands of a third party and even accept the validity of decisions that are unfavorable to them as long as the third party is perceived as neutral and they have an opportunity to fully present the facts and arguments for their case.<sup>45</sup> The RAB hearing provides this opportunity.

### *b. The Asymmetric Binding Character of the RAB*

We are accustomed to thinking of alternative dispute resolution procedures as either binding or nonbinding. In contrast, the Toyota RAB procedure is asymmetrically binding: only Toyota is bound by the arbitrator's decision; a dealer who is dissatisfied with the arbitrator's decision may pursue the case in court. This asymmetric binding is a further feature of the RAB that helps to reduce actual and perceived imbalances of power between Toyota and its dealers. Through the act of agreeing to be bound by the decisions of its arbitrators, Toyota has expressed its faith in the fairness of the RAB, and at the same time, provided dealers with an option, namely, to seek legal recourse, that it does not have.

The survey does not provide actual data bearing on the degree to which asymmetric binding influences perceptions of procedural justice. We present it as a hypothesis that has inherent plausibility and is conceptually interesting, but needs further research attention.

## *C. Evaluating Corporate Goals for the Program*

### *1. Goals for the Program*

The RAB was created to avoid unnecessary confrontation with dealers, reduce escalating litigation costs, improve relations between dealers and Toyota management, and reduce the number of dealer disputes. Interviews with Toyota executives indicate a belief that all of these goals have been accomplished.<sup>46</sup>

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44. See LIND & TYLER, *supra* note 38.

45. See LIND & TYLER, *supra* note 38; Lind et al., *supra* note 38; Vidmar, *Procedural Justice*, *supra* note 38; Fuller, *supra* note 41.

46. Telephone interview with David Laufer, Toyota's Managing Counsel (June 4, 1991).

Since the creation of the RAB, disputes between Toyota and its dealers over the sales reporting policy have virtually disappeared and dealer/management relations have improved. Furthermore, the approximate annual cost of the RAB to Toyota is \$30,000.00<sup>47</sup> — far less than the cost of defending some individual lawsuits.<sup>48</sup>

## 2. Decline in Dealer Disputes

As noted, the number of dealer disputes has substantially declined since the implementation of the RAB. After handling 178 cases in the final eight months of 1985, the program processed 44 hearings in 1986, 79 hearings in 1987, 40 hearings in 1988, 23 hearings in 1989, 11 hearings in 1990, 3 hearings in 1991, and 27 hearings in 1992.

The RAB program created a mechanism for the development of a national list of brokers. Anytime a broker is identified through the RAB, its name is added to the list available to all dealers through the regional offices and Toyota's head office. A dealer may check the list for the broker's name before entering into a suspicious transaction. This broker list has provided many protesting dealers with a clear warning that they will not receive sales credit for sales to suspect brokers and may have some impact on the reduction in disputes. No such information on brokers was available prior to the RAB.

We explored some of the possible explanations for the dramatic decline in the number of dealer/dealer disputes since the implementation of the program. We considered whether dealers who had participated in a hearing before the RAB, or who had learned about hearings involving other dealers, might have come to understand the Toyota policies better, appreciate their responsibilities, and abide more closely by the policies clarified through the process of private judging. We also considered the impact of the neutral forum and emerging private common law.

In order to test these hypotheses, relevant information was gathered from the following sources: (1) interviews with Toyota regional and private distributorship managers;<sup>49</sup> (2) a review of opinions where at least one disputant had participated in the RAB more than once;<sup>50</sup> and (3) interviews with Toyota arbitrators.

Most regional managers thought that dealers had learned more about the sales credit policy since the advent of the RAB. Three of the eleven managers interviewed felt that education about the policy occurred more through district meetings and general mailings than firsthand knowledge of RAB decisions. In short, they felt that the "common law" arising out of the RAB was conveyed to

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47. In 1985, the RAB cost \$6,500.00 a month. Ctr. for Pub. Resources, *supra* note 9, at 15. Toyota budgeted \$80,000.00 for the RAB in fiscal year 1986, \$30,000 in 1991, and \$25,000 in 1992. Telephone interview with David Laufer, Toyota's Managing Counsel (Dec. 23, 1992).

48. David Laufer, Toyota's Managing Counsel, estimated the cost of one lawsuit to be \$200,000.00.

49. One manager who had been hired only recently did not participate in the interviews.

50. The first and last hearings of 83 repeat disputants were reviewed.

dealers indirectly. One manager said that dealers understood that they could get a consistent interpretation of the policy through the RAB.

Five of the nine arbitrators that were interviewed agreed with the majority of managers. When asked whether dealers learned more about the sales credit policy as a result of participating in the RAB, all five arbitrators answered affirmatively.

The most striking evidence regarding the dealers' learning experience surfaced in a selective review of RAB opinions. One would expect some improvement in outcome, or at least a heightened awareness of the Toyota policy, from those dealers who had participated in more than one hearing. Few dealers, however, improved their position in subsequent disputes. Most dealers receiving half credit in their first dispute received half credit in their final dispute; dealers denied credit in their first hearing were usually denied sales credit in a subsequent hearing.<sup>51</sup>

Given the varied responses as to whether the RAB educated dealers and thereby contributed to the decline in sales credit disputes, the interviewees were asked what they believed had caused the decline in the number of sales credit disputes.

Managing Counsel David Laufer attributed the decline in disputes to the implementation of the RAB, noting the concurrence of the decline and the creation of the RAB. The arbitrators' opinions regarding the decline varied. One said that dealers find the results in the RAB more predictable, another that dealers are now more cautious, and another that product availability explains the decline in disputes. Two arbitrators concluded that the decline related to improved understanding of the sales credit policy by dealers.

The majority of Toyota regional/private distributorship managers (9/11) attributed the decline in disputes chiefly to product availability. One attributed the decline to a better understanding of both the sales credit policy and the operation of the RAB, while another thought it was due to both product availability and incentive programs. Seven managers said that the RAB did not affect the number of disputes, three said that it had some impact, and one manager was unsure of the program's effect.

An increase in the supply of vehicles relative to consumer demand is an explanation for the decline in disputes which is supported by the facts. Apparently, a great demand for Toyota vehicles arose several years preceding the creation of the RAB. Due to inadequate supply, dealers hired brokers to buy vehicles from other dealers and then used the RAB proceeding to obtain reversals of sales credit upon the subsequent sale to ultimate consumers. Although demand

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51. In one hearing, the arbitrator accepted a low level of investigation of the buyer, but informed the protesting dealer that in future cases more extensive investigation would be required to earn sales credit.



for Toyotas remains strong today, there is currently a sufficient supply of vehicles.<sup>52</sup> Dealers no longer rely on brokers, and thus, fewer disputes over sales credit arise. Most managers predict that if the demand again begins to exceed the supply of vehicles, dealers will buy vehicles through brokers and sales credit disputes will increase.

Given this evidence, one may reasonably hypothesize that product availability has reduced the number of sales credit disputes since the creation of the RAB. This fact raises a caution against ascribing total credit for the decline in dealer disputes to the RAB. However, even if the product availability hypothesis is valid, the other evidence described above indicates that the RAB did play some role in reducing disputes.

## V. CONCLUSION

The implementation of the RAB appears to have substantially improved relations between Toyota and its dealers by providing an appropriate forum for the enforcement of corporate policy. A small panel of experienced, neutral adjudicators, rather than the managers or other employees of Toyota, decide the sales credit disputes. Participants perceive both the decision makers and the forum to be more fair than the in-house procedures it replaced. This confidence in the neutrality of the forum, the expertise of the decision makers, and the overall fairness of the process may lead to a higher level of satisfaction over the resolution of sales credit disputes.

A consistent body of private "common law" has emerged with the adoption of good/bad faith exceptions to the sales credit policy, the training and experience of a small panel of adjudicators, and the distribution of RAB decisions among arbitrators and dealers. The RAB "common law" appears to have significantly aided the corporation in its effort to convey and communicate organizational rights and responsibilities. The RAB also substantially reduces both the cost to dealers of airing their complaints and to Toyota in defending potential lawsuits arising therefrom.

Features of the Toyota RAB program can serve as a model for other ADR programs. The most obvious and direct application may be in the development of programs in other contexts when disputes arise between corporations and their franchisees.

Another possible application may be in the design of "in-house" programs for resolving complaints about race, gender, or disability discrimination.<sup>53</sup> Many

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52. Toyota built an assembly plant in the United States which increased vehicle supply. Market fluctuations might be thought to explain the decline in disputes, but Toyota sales have increased during the course of the program.

53. See, e.g., Lauren B. Edelman, *Legal Ambiguity and Symbolic Structures: Organizational Mediation of Civil Rights Law*, 97 AM. J. OF SOC. 1531 (1992) (discussion of organizational structures developed to deal with discrimination); Lauren B. Edelman, *Legal Environments and Organizational Governance: The Expansion of Due Process in the American Workplace*, 95 AM. J. OF SOC. 1401

organizations that have developed in-house procedures to deal with employee complaints utilize other members of the organization, *e.g.*, a supervisor or member of another department, as a third party, "neutral" arbitrator. In-house personnel may have the advantage of knowing organizational rules and procedures, but in other respects, they are not neutral parties, and may not be perceived as such. Their role is inherently divided between deciding what is fair in a dispute and protecting the overriding goals of the organization. Sometimes fairness and organizational goals are the same; sometimes they are not. The Toyota RAB concept of neutral parties, who are independent of the organization, but easily educated about its culture and rules, eliminates the role conflict. Similarly, the notions of asymmetric binding may help to demonstrate the organization's belief in the fairness of the procedure and promote its legitimacy and acceptance by complainants.

We offer these observations with limited empirical evidence bearing on their validity, but with the belief that they have *prima facie* plausibility. At the very least, they provide some ways of thinking about the design of ADR programs and invite questions for more research.

To summarize, our investigation of the Toyota RAB program has described several novel ideas that might be used in the design of other ADR programs. These are: (1) the use of a procedure to communicate and enforce formal rules and obligations; (2) the use of neutral arbitrators who are specialists in the sense that they have been trained about the organizational rules and about the cultural and organizational context out of which disputes arise; and (3) the use of asymmetric binding whereby the organization that sets up and promotes the procedure reduces an actual or perceived power imbalance by providing a right of appeal to complainants but surrenders its own right to do so. Adopted in appropriate contexts, these features may promote procedural justice and discourage litigation that is costly to both parties.

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(1990). *See also* Americans with Disabilities Act, 42 U.S.C. §§ 12101-12213 (Supp. 1991), which states that "the use of alternative means of dispute resolution, including settlement negotiations, conciliation, facilitation, mediation, factfinding, minitrials, and arbitration, is encouraged to resolve disputes arising under this chapter." 42 U.S.C. § 12212 (Supp. 1991). The broad scope of the Act will likely cause organizations to incorporate complaints based on disabilities into existing complaint structures or to develop new procedures.



