



**THE REGULATION OF VEHICLE, IMPLEMENT, AND EQUIPMENT  
DEALER FRANCHISES AND DEALER AGREEMENTS**

South Dakota has had a law to govern the relationships between the manufacturers of motor vehicles, farm tractors, and farm implements and their franchised dealers for over fifty years. This law was enacted to prevent arbitrary, unfair terminations of franchised dealers and to promote fair dealing between these manufacturers and their dealers. Similar laws were enacted in surrounding states. The law, which is found in SDCL Chapter 37-5, has been largely successful in protecting South Dakota dealerships. Consequently, the law has been added to several times over the last fifty years to now cover the relationships between the manufacturers and dealers of several other products.

This past legislative session House Bill 1123 was introduced to propose a change to Chapter 37-5 that had been supposedly worked out in negotiations between farm implement manufacturers and farm implement dealers. Unfortunately, the manufacturers and dealers of the other products covered by the law were not involved in the negotiations and some of them objected to the proposed change. The bill was eventually referred to the 41<sup>st</sup> day and a request was made to the Executive Board of the Legislative Research

Council to take a look at these statutes and to take a look at the contractual obligations between manufacturers and dealers and the government's role in those contracts. The request also asked to look at whether there is sufficient nexus among the products covered by this law to continue the law as presently constructed or whether separate statutes or chapters of law would be more appropriate. This issue memorandum will try to address those requests.

**Background Information**

South Dakota law has governed the relationships between manufacturers and dealers of motor vehicles, farm tractors, and farm implements since 1951. Since then, it has been unlawful for such a manufacturer to try to coerce a dealer to purchase or accept delivery of vehicles, parts, or other commodities that the dealer has not ordered. It has also been unlawful for a manufacturer to try to coerce a dealer to enter into any agreement, to assign or sell any contract or property, to expend any money, or to do any other act unfair to the dealer. The law also forbids manufacturers from accomplishing the same results by threatening to terminate the dealer's franchise or dealer

agreement. In addition, a manufacturer is prohibited from canceling the franchise of a dealer without due regard for the equities of the dealer and without good cause. Moreover, the law provides that anyone violating these laws would be liable to any dealer damaged thereby for all damages caused to such dealer by a violation. These laws are now found in SDCL 37-5-1, 37-5-2, 37-5-3, and 37-5-4.

In 1969 legislation was passed to give these dealers additional protection in the case of a franchise termination. The legislation provided that if a franchise contract was terminated the dealer was entitled to the recovery of certain costs and charges for inventory the dealer had on hand. The law change also provided for the repurchase of inventory by the manufacturer upon the death of the dealer. This legislation is now found in SDCL 37-5-6, 37-5-7, 37-5-8, and 37-5-9.

In 1970, the expansion of the law to protect other types of dealers began. That year the provisions of Chapter 37-5 were extended by the Legislature to dealers of industrial and construction equipment. In 1973, legislation was passed to apply Chapter 37-5 to retail motorcycle dealers. The chapter was further amended in 1995 to regulate the agreements between the manufacturer or distributor and the dealer of office furniture, equipment, and supplies. Protections were extended to include boats, personal watercraft, all-terrain vehicles, and snowmobiles in 2000. And finally, in 2001, the law was expanded to include the relationship between the manufacturers or distributors and the retail dealers of outdoor power equipment and repair parts for outdoor power equipment.

Other amendments to the chapter worth mentioning were enacted in 1975 and in 1999. In 1975 the law was expanded to apply not just to franchise agreements but also to sales agreements, security agreements, or other like agreements between manufacturers and dealers. In 1999 legislation was passed to limit the ability of manufacturers of farm machinery to terminate or discontinue their contractual relationships with dealers and to prohibit dealer contracts from including binding arbitration provisions to resolve disputes between the manufacturer and the dealer. This legislation is found in SDCL 37-5-13 to 37-5-15, inclusive.

Another important fact to note is that the 1999 legislation was the subject of a lawsuit brought by some equipment manufacturers who claimed the legislation was unconstitutional (*Equipment Manufacturers Institute v. Janklow*, 300 F3d 842). A federal district court agreed in part in 2001. The court found that the legislation did impair several contractual terms within preexisting dealership agreements and was in violation of the Contracts Clause of the U.S. Constitution. The court also found that the legislation's binding arbitration provisions violated the Supremacy Clause of the U.S. Constitution because it conflicted with the Federal Arbitration Act. After this decision some of the affected dealers and manufacturers attempted to work out a compromise. That effort led to the introduction of House Bill 1123 in the 2003 Legislature.

### **Manufacturer and Dealer Contracts and the Government's Role**

Franchising has been a proven method of conducting business in this country throughout the twentieth century. This

method of doing business by the means of a contractual agreement is generally beneficial to both the manufacturer and the dealer. However, there have been abuses in the past. The greatest area of abuse was from manufacturers who arbitrarily terminated franchise agreements or exercised overwhelming bargaining power over dealers under franchise or dealer agreements. Consequently, a number of federal and state laws have been enacted to prevent such abuse. Two areas where the federal government has enacted such laws are the Petroleum Marketing Practices Act, which is directed toward gasoline retailing, and the Automobile Dealer's Franchise Act, which is directed at automobile franchises. Where the federal government has not been involved, states have determined it is in the state's interest to provide protection to certain dealers. Each of our surrounding states has passed legislation covering some of the manufacturer and dealer agreements that South Dakota has addressed in Chapter 37-5. Dealers of motor vehicles, farm implements and equipment, and heavy construction equipment are protected in each of the surrounding states. Dealers of recreational vehicles, outdoor power equipment, and lawn and garden equipment are specifically protected in one or more of the surrounding states. In each case, the Legislature of that state had determined that it was in the public interest to regulate the relationship between manufacturers and dealers.

Proponents of House Bill 1123 from this last legislative session suggested that South Dakota's law is now too protective of dealerships. They indicated that manufacturers regulated by Chapter 37-5 are reluctant to enter into any new

dealership agreements in South Dakota because it is very difficult for a manufacturer to get out of a dealership agreement, if needed. For instance, if a manufacturer has a dealer in a community and that dealer is not doing a good job of selling the manufacturer's product, the manufacturer cannot terminate the dealer and find another dealer in the community to better serve the community. The proponents suggested the current law may no longer be serving the best interests of the public.

Is it still in the public interest for the state to regulate these agreements between manufacturers and dealers? The federal district court in *Equipment Manufacturers Institute v. Janklow* stated that the closure of a farm equipment dealership increases the number of miles that farmers have to travel for equipment and repairs and that this additional distance is a hardship, not a mere inconvenience for farmers. The court recognized that South Dakota has a significant and legitimate public interest in protecting farm machinery dealers. Past legislatures have determined that the state also has a significant and legitimate public interest in protecting the dealers of outdoor power equipment, office furniture, boats, personal watercraft, all-terrain vehicles, and snowmobiles. Whether or not the public interest has changed and the law needs to be changed is a determination that really only the Legislature can make after hearing from manufacturers, dealers, and the public.

### **Statutory Construction**

As mentioned earlier, House Bill 1123 was a compromise that was negotiated between the manufacturers and dealers

of farm implements. Some of the proposed amendments to Chapter 37-5 would have also affected manufacturers and dealers of the other products covered by the chapter. Dealers of construction equipment testified to the House Commerce Committee that they were not involved in the compromise and did not support the proposed changes to the law. The committee did not know whether the manufacturers and dealers of the other products covered by the chapter were aware of the legislation and, if so, what their positions might be on the proposed changes. Consequently, there was discussion as to whether it might be best to split the current law chapter into separate statutes or even separate chapters to avoid this problem in the future.

Currently, some of the sections of law found in Chapter 37-5 are very difficult to understand. SDCL 37-5-5, 37-5-7, 37-5-8, and 37-5-9 have been added to extensively over the years and these sections now contain some of the longest and most grammatically complicated sentences found in South Dakota law. Attached is a copy of SDCL 37-5-5 as an example of what it meant. It was the determination of previous legislatures that all the products covered by Chapter 37-5 had sufficient nexus to be considered in the same sections of the law. However, the results of all those changes are sections of law that are very difficult to understand. Any attempt to separate or simplify these sections would be a definite improvement.

Chapter 37-5 could be broken up into separate chapters. This would definitely make it much easier if the Legislature wanted to make a change that would only affect the manufacturer and dealer of one of the products. Currently there

are statutes regarding motor vehicle franchises that are found in Chapter 32-6B and regarding snowmobile franchises that are found in Chapter 32-6E. All of the provisions of law regarding agreements between the manufacturers and dealers of motor vehicles and snowmobiles could be consolidated into those chapters. Most of the surrounding states already have the laws regulating motor vehicle dealerships in a separate chapter. Several of our surrounding states also have two separate chapters for their laws regulating dealerships for farm implements and for their laws regarding the dealerships for heavy construction equipment. One disadvantage, however, of doing this would be the potential loss of the uniform treatment of these agreements by the law as changes are made over the years.

Another option would be to come up with definitions for Chapter 37-5 that would simplify the sentence structure used in that chapter. For instance, Montana uses the word "inventory" to define what products are covered by its franchise law. Montana's definition of inventory is a laundry list of products including farm implements and machinery, industrial and construction equipment, automobiles, trucks, motorcycles, snowmobiles, off-highway vehicles, and boats. By then using the word "inventory" in a definition for a dealer, Montana avoided the situation we have in Chapter 37-5 where the list of products is repeated several times in a section, thus making the section very hard to understand. This option could keep everything in one chapter and make it easier to understand.

## **Conclusion**

The Legislature has found it in the public interest for the state to regulate the contractual relationships between the manufacturers and dealers of certain vehicles, implements, and equipment. Only the Legislature can decide if that public interest still exists or if there should be a change in the law. The current law is difficult to understand and

is difficult to amend without affecting each of the products and thus creating the potential for unintended consequences. The laws could be separated into separate chapters as other states have done. Anything that could be done to simplify the sentence structure of the sections found in Chapter 37-5 would make the law much easier to understand.

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**This issue memorandum was written by David L. Ortbahn, Principal Research Analyst for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.**

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**37-5-5. Cancellation of contract -- Recovery of costs and charges by dealer -- Transfer of title and possession.** If any person, firm, or corporation, or their successors, engaged in the business of selling and retailing farm implements or machinery and repair parts for farm implements or machinery, or in the business of selling and retailing industrial and construction equipment and repair parts for industrial and construction equipment, or in the business of selling and retailing outdoor power equipment and repair parts for outdoor power equipment, or in the business of selling and retailing office furniture, equipment, and supplies and repair parts for office furniture, equipment, and supplies, or in the business of selling and retailing automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, or snowmobiles or repair parts for automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, or snowmobiles enters into a written contract evidenced by franchised agreement, sales agreement, dealer agreement, or security agreement, or other form of agreement or arrangement of like effect, the term, contract, as used in § 37-5-5 to 37-5-9, inclusive, means any of the foregoing and their successors. If such person, firm, or corporation, or their successors maintains a stock of parts or complete or whole machines, or attachments with any wholesaler, manufacturer, or distributor of farm implements or machinery or repair parts therefor, or industrial and construction equipment or repair parts therefor, or outdoor power equipment or repair parts therefor, or office furniture, equipment, and supplies or repair parts therefor, or automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, or snowmobiles, or repair parts therefor, and either the wholesaler, manufacturer, or distributor, or their successors, or the retailer, or successor, desires to cancel or discontinue the contract, such wholesaler, manufacturer, or distributor, or successor, shall pay to the retailer, or successor, unless the retailer, or successor, should desire to keep the merchandise, a sum equal to one hundred percent of the net cost of all current unused complete farm implements, machinery and attachments, industrial and construction equipment and attachments, outdoor power equipment and attachments, office furniture, equipment, and supplies, and attachments, and automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, and snowmobiles, including transportation and reasonable assembly charges which have been paid by the retailer and ninety-five percent of the current net prices on repair parts, including superseded parts, listed in a current price list or catalog which parts had previously been purchased from the wholesaler, manufacturer, or distributor, or predecessor, and held by the retailer on the date of the cancellation or discontinuance of the contract. The wholesaler, manufacturer, or distributor, or successor, shall also pay the retailer a sum equal to five percent of the current net price of all parts returned for the handling, packing, and loading of the parts back to the wholesaler, manufacturer, or distributor. Upon the payment of the sum equal to one hundred percent of the net cost of the farm implements, machinery and attachments, industrial and construction equipment and attachments, outdoor power equipment and attachments, office furniture, equipment, and supplies, and attachments, and automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, and snowmobiles, plus transportation and reasonable assembly charges and ninety-five percent of the current net prices on repair parts, plus five percent handling and loading costs on repair parts only, plus freight charges which have been paid by the retailer, or automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, or snowmobiles, plus freight charges, or repair parts therefor, plus five percent handling and loading costs on repair parts only, the title to the

farm implements, farm machinery, industrial and construction equipment, outdoor power equipment, office furniture, equipment, and supplies, and repair parts, or automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, or snowmobiles, or parts therefor, shall pass to the manufacturer, wholesaler, or distributor making the payment, and the manufacturer, wholesaler, or distributor, is entitled to the possession of the farm implements, industrial and construction equipment, outdoor power equipment, office furniture, equipment, and supplies, or automobiles, trucks, motorcycles, boats, personal watercraft, all-terrain vehicles, or snowmobiles, or repair parts therefor.