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The Toyota Class Action Settlement and Economic Justice in America's "Mixed" Economy

By: Stephen Harner – January 2nd, 2012

In his superb new book *The Financial Crisis and the Free Market Cure,* John A. Allison, former longtime chairman and CEO of BB&T Bank and current president and CEO of the Cato Institute, marshals exceptionally broad and long experience and sharp analytical focus to prove the case that the free market produces not only economic efficiency, but also justice.

Unfortunately, Allison also shows that the "free market" has long ceased to exist almost anywhere in the U.S., least of all, perhaps, in banking and financial services. And so, therefore, has economic justice.

Ours is a "mixed economy," Allison shows, where companies trying to compete according to market rules are impeded or sabotaged by unions, government functionaries, victims lobbies, politically connected crony capitalists, and the tort bar. Especially the class action bar.

I doubt that any company's management would endorse Allison's analysis more completely than that of Toyota Motor Corporation (NYSE: TM), or that there is a company that in recent years has provided a better case study of the injustices meted out under our "mixed," politicized, and dysfunctionally litigious economic system.

Last week Toyota announced on December 26 that it had reached a $1.1 billion settlement with plaintiffs in various lawsuits related to accusations of "sudden acceleration" defects in and subsequent massive recalls of Toyota vehicles in 2009-2010. Toyota will take a $1.1 billion charge against this year's earnings to cover the settlement costs. This will be the largest settlement amount by any auto company anywhere in history. It will also be the most unjustified.

In most settlements, the defendants will claim innocence, or at least refuse to admit culpability. In Toyota's case the exculpatory evidence comes from repeated government (including NASA and the National Highway Safety Administration) and private technical tests conducted on Toyota's electronic throttle control systems (ETCS). None of the tests showed any defects.

The settlement does not cover lawsuits seeking compensation for injury and death, which are being taken to trial beginning next month in the court of James V. Selna, Judge of the U.S. District Court for the Central District of California

There is ample evidence to support Toyota's defense that driver error and misplaced floor mats are responsible most, if not all, the cases of alleged sudden, uncontrolled acceleration. Nonetheless, as in virtually every aspect of this media-hyped travesty, Toyota has and will continue to overcompensate wrongly perceived negligence or lack of empathy. The company is offering to install, at no cost to owners, brake override systems on a dozen hybrid and non-hybrid models of cars with ETCS.

But for Toyota, for common sense, and for simple justice, the most egregious and outrageous lawsuits must be those solicited by class action lawyers to make Toyota compensate owners of Toyota vehicles who claim to have suffered losses on the trade-in or resale value of their cars due to the alleged quality issues and recalls in 2009-2010. That the market value of Toyota vehicles declined during the period is arguable (though it was a period of market and price weakness for automakers worldwide). What makes the claim so outrageous and unjust is that damage, if any, would not have been caused by real defects in Toyota cars, but by the politicized, likely government and competitor-stoked, anti-Toyota media feeding frenzy that sensationalized, exaggerated, and distorted (or concocted) stories of "sudden acceleration."

Notwithstanding the above, and to show that in today's America, victimization pays, as part of the settlement Toyota has agreed to fund a $250 million pool from which class action claimants of "economic loss" (and, of course, their lawyers) will be able to draw compensation.

Keeping a stiff upper lip, Toyota management have justified the settlement as necessary to putting the 2009-2010 debacle behind it, so that they can focus on the future. In doing so, they are greatly benefiting the U.S. car market and U.S. consumers. Toyota has continued to redesign and upgrade a majority of the cars they sell, adding value to an already highly competitive product.

In 2012, Toyota's new Camry model sold some 200,000 units in the U.S., up 20 percent over the previous year. In 2013 the new Lexus LS and RAV4 SUV are expected to break sales records. The total U.S. car market is forecast to recover this year to 15 million vehicles. Toyota hopes to keep over 10% market share.

To serve U.S. buyers, Toyota will be investing over $340 million in new capacity in its Indiana plant, raising production from 280,000 to 330,000 units, with major increases in Highlander SUVs and hybrid models.

Again, notwithstanding the injustice, swallowing hard on the settlement seems to have been the right decision for Toyota's owners and investors. On December 27 Toyota's stock jumped 2.6% to 3930 yen on the Tokyo Stock Exchange. But we may question whether it was the settlement, or the continued depreciation of the Japanese yen that caused the stock's rise. The yen has continued to depreciate, and is now at a multi-month low of some JPY87/USD1.00.

The Toyota ADR is now about $95.52 almost a 52 week high (52 week hi/lo $67.27-95.64). In Tokyo the stock price closed the year at 4005 yen, with a price-to-book ratio of 1.31x and forward PER of 17.70x. Toyota stock dropped to a 10 year low of 2330 yen on November 24, 2011, in the wake of the massive recalls and start of U.S. litigation. It had fallen from a high of 8350 yen on February 2, 2007.

So far, Toyota's stock has double from its low, but is only 50% to its previous high. Toyota is Japan's most valuable company with JPY 13.8 trillion (USD 158.7 billion) market value. If there is any company that can lead Japan back to competitiveness and profitability, even in a world where "mixed economies" dispense injustice, it is Toyota.