DEFENDER
THE NADC NEWSLETTER

Preliminary Injunctions in Dealership Termination Proceedings

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When the business relationship between a franchised auto dealer and the factory deteriorates to the point that involuntary termination will be attempted, one of the first priorities for the dealer and its counsel is determining whether there are grounds for getting a preliminary injunction to preserve the status quo until the issues can be resolved, either by settlement or litigation. Conversely, an aggressive strategy by the factory and its counsel might also include seeking a preliminary injunction to force an early resolution of the dispute

Termination of dealer agreements frequently lands the factory and the dealer in litigation, or in some instances, arbitration. Under the federal Automobile Dealers' Day in Court Act and related laws such as the New York State Franchised Motor Vehicle Dealer Law, a factory may be required to receive approval from a court before termination is effective. The grounds asserted by a factory for termination may or may not stand up in court or in arbitration. Litigation is frequently expensive and time-consuming, and months may pass before a judge is able to decide the question of whether to uphold a termination. Arbitration may be less expensive and less time-consuming, but an arbitrator may not be able to fairly decide the termination

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Sidebar

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Servicemembers' Civil Relief Act and Vehicle Transactions

Rob Cohen, Esq

In December of 2003, President Bush signed into law the Servicemembers' Civil Relief Act (hereinafter SCRA) which updates and amends the Soldiers' and Sailors' Civil Relief Act of 1940 (50 U.S.C. § 500, et seq.). So why should dealers care about this? Historically, the Act has placed limitations on such things as civil judgments and interest rates charged to military personnel. The new Act maintains these restrictions and adds a few more. This article will explain some of the rights of military personnel who enter into contracts for the purchase or lease of motor vehicles.

Note: Much of the discussion below, with the exception of the passage on repossessions, has been taken verbatim from the Judge Advocate General's Corps' website (www.jagcnet.army.mil). Various edits have been made for clarification and to make it most applicable to vehicle dealers. (Author makes no claim to original government works.)

The Six Percent Rule

One of the most widely known benefits under the SCRA is the ability to reduce pre-service consumer debt and mortgage interest rates to 6% under certain circumstances.

Consider this example: Three months ago Mr. Smith and his wife bought a car

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President's Letter

Jonathan P. Harvey

A friend once told me that if you have a problem, solve it. A simple suggestion, a short sentence, a tough job. We have a problem to solve.

The December 27th issue of *Automotive News* contained an article entitled "Whistleblower Starts Referral Service" with the subtitle "Overholt will examine dealers' commissions and F&I practices." For those who missed it, the nub of the article was that Mr. Overholt had created a nationwide referral service to "funnel complaints of dealership fraud from consumers and employees to trial lawyers." One of the plans is to launch this service just before the NADA convention in order to embarrass major dealers and public dealership groups. So this compels the question of whether there is something about which the dealerships should be embarrassed? The answer is, "I don't know." The question, of course, must be addressed. If your client has exposure, you should know about it, and if the client doesn't know about it, you should be telling him or her. It is our duty to understand the law, explain the law and see to it that our clients do not run afoul of the law. In my first letter to this Association I wrote that "our clients' problems are best solved by exposure to sunlight and preemptive action." Mr. Overholt apparently understood that. The question now is, do we? There can only be one answer, and there can only be one solution. We must explore this issue with our clients and if a problem arises, work with them to solve it.

So, how can NADC help? There are a number of first-class lawyers with national reputations who are expert in representing dealers and trade associations in the fields of F&I and consumer fraud. Most of them are members of this Association, and every one of them is willing to help and share ideas. All you have to do is ask, and the easiest way to do that is through our on-line forum and our list serve. Self interest motivates us to use those sources to help our clients. Do it today.

On a more pleasant note, by the time you receive the Defender, The NADC Newsletter, six members of our board of directors will have met at the NADA convention in New Orleans. We will be well into the planning stages of our April conference, and our membership will have grown to over 183. Those who are going to New Orleans will make a special effort to visit with possible associate members in the fields of accounting and expert testimony in order to expand our horizons and to help you serve your clients. I encourage you to become active in the NADC and to call me with suggestions. Remember President Kennedy's inaugural speech? Ask not!

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for $13,000, paying $1,000 down and financing $12,000 at 9% interest. Last week, Mr. Smith (a reservist) was called to active duty as a staff sergeant (SSG). Before entering active duty, Mr. Smith earned $42,000 per year. As a staff sergeant he now earns almost $27,000. Because of the SCRA, SSG Smith may ask the car financing company to lower the interest rate to 6% while he is on active duty.

It is important to note that SCRA protection under these circumstances is not automatic. In order to benefit from the SCRA two things must occur: 1) Military service must materially affect SSG Smith's ability to pay the debt; and 2) SSG Smith must inform the finance company (or the dealership if the dealer is holding the contract) of his situation in writing with a copy of the orders to active duty attached, and request immediate confirmation that they have lowered his interest rate to 6% under the SCRA.

In the example above, it is pretty clear that SSG Smith's ability to pay the debt is materially affected by his active status given the significant reduction in income. However, in the event a finance company or dealer would like to challenge that, they can go to court and seek relief. In court, the finance company or dealer has the burden to prove that SSG Smith's ability to pay the loan has not been materially affected by his military service.

Assuming no challenge is made, the finance company or dealer must reduce the interest rate and forgive all interest charges over 6%.

Note: In some situations civilian employers have agreed to pay the military member the difference between the military pay and the civilian pay earned before the call to active duty. In most such situations, military service has not materially affected the member's ability to pay so it is unlikely that the SCRA 6% interest limitation applies. Of course, if the military member's expenses increased (for example, the member must pay for a second apartment at the duty station, or the member's spouse gave up her job to move with him) military service might have materially affected the member and the SCRA 6% interest limit could apply.

What if instead of buying the car before he came on active duty, SSG Smith purchased a used car at his duty station? To do so, he borrowed $4,000 at 9% interest. Since SSG Smith took this debt after entering active duty, the SCRA 6% interest limit does not apply.

Delay of Court and Administrative Proceedings

A major change provided by the SCRA is that it permits active duty service members, who are unable to appear in a court or administrative proceeding, due to their military duties, to postpone the proceeding for a mandatory minimum of 90 days upon the service member's request. The request must be in writing and 1) explain why the current military duty materially affects the service members ability to appear; 2) provide a date when the service member can appear; and 3) include a letter from the commander stating that the service

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issues in a time frame adequate to protect the business interests. Therefore, for either the factory or the dealer, preliminary injunctive relief may appear necessary to protect their business interests during the pendency of termination proceedings.

The request of a factory for a preliminary injunction is typically based on its desire to protect its brand name and reputation from harm caused by an allegedly under-performing or uncooperative dealer. If the factory can establish cause for termination, the factory will seek to enforce its right to prevent continued use of its trademarks and intellectual property by a dealer no longer authorized to use them. The request of a dealer for a preliminary injunction is typically based on its belief that not only is the attempted termination unjustified, but that the goodwill and investment value of a franchised automobile dealership will be totally destroyed by termination. While experienced litigation counsel advise clients that more cases are ultimately resolved by settlement than by judges and juries, a dealer often needs the breathing space afforded by a preliminary injunction to continue operating its business while it has the time available to structure a satisfactory settlement. In the dealership termination context, the satisfactory settlement is not infrequently the sale of the dealership to a new owner approved by the factory.

While courts have varying formulations of the showing needed to justify issuance of a preliminary injunction, a common articulation of the requirements are: (1) irreparable harm, and (2) either (a) a likelihood of success on the merits, or (b) sufficiently serious questions on the merits to make them a fair ground for litigation, and a balance of the hardships tipping decidedly toward the party requesting preliminary relief. While it is not possible to anticipate the numerous fact patterns that can surface in dealership termination disputes, the factory and the dealer will invariably have different viewpoints on the validity of grounds asserted for termination, whether proper notices were given, and fair opportunities extended to cure alleged deficiencies.

Dealership termination litigation, if not resolved after a decision on a motion for a preliminary injunction and an opportunity to settle the dispute on a business basis, can be very lengthy, complex and expensive. Different legal theories may be developed in the effort to prove the termination is justified or unjustified. Legal theories vary and can include antitrust, tax reporting fraud and breach of contract, to name just a few. The evidence needed to determine the outcome on each legal theory may be extensive. Surveys and inspections can be carried out, and their validity questioned. Testimony of key management personnel can be developed, and extensive documentary and/or statistical evidence gathered. Expert witnesses may be necessary on the best management practices and customary methods of doing business, and on the fair market value of the business. Accounting methods and the adequacy of record-keeping may become part of the dispute.

Regulatory requirements, including permits, periodic reports, and government approvals requested or denied, may all become relevant to the issue of whether cause for termination can be established.

In the well-publicized case in Florida in which Anheuser-Busch terminated its exclusive beer distributor in an eight-county area for 29 years, Maris Distributing Company, where preliminary relief was not obtained, after four and one-half years of litigation, a jury found that Anheuser-Busch's termination of Maris for alleged deficiencies was pretextual, and that Maris had not falsified sales reports as Anheuser-Busch alleged. The jury verdict in favor of Maris for $139 million was reduced by the court to $50 million, with cross-appeals still unresolved nearly eight years after the termination. The end is not in sight to one of the most complex and costly distributorship termination litigations in history.

When justified in the particular circumstances, a well-prepared motion for a preliminary injunction, followed by a fair and a timely court decision on the motion, can set the stage for early resolution of the termination dispute through settlement or sale of the dealership, and lift from the parties the burdens and uncertainties of long and costly litigation.

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member's duties preclude his or her appearance, and that he is not authorized to leave at the time of the hearing. This letter or request to the court will not constitute a legal appearance in court. Further delays may be granted at the discretion of the court, and if the court denies additional delays, an attorney must be appointed to represent the service member.

Termination of Leases

Another significant change provided in the SCRA, is found in Section 305. The prior law only allowed the termination of pre-service "dwelling, professional, business, agricultural, or similar" leases. The new provision in the SCRA allows termination of leases by active duty service members who subsequently receive orders for a permanent change of station (PCS) or a deployment for a period of 90 days or more. The SCRA also includes automobiles leased for personal or business use by service members and their dependents. The pre-service automobile lease may be cancelled if the service member receives active duty orders for a period of 180 days or more. The automobile lease entered into while the service member is on active duty may be terminated if the service member receives PCS orders to a 1) location outside the continental United States or 2) deployment orders for a period of 180 days or more.

Default Judgment Protection

If a default judgment is entered against a service member during his or her active duty service, or within 60 days thereafter, the SCRA allows the service member to reopen that default judgment and set it aside. In order to set aside a default judgment, the service member must show that he or she was prejudiced by not being able to appear in person, and that he or she has good and legal defenses to the claims against him/her. The service member must apply to the court for relief within 90 days of the termination or release from military service.

Repossessions/Rescissions

In the event a service member breaches a contract for the sale or lease of a motor vehicle, the dealer cannot repossess the vehicle without a court order. Also, a dealer may not seek to rescind the contract due to any breach by service member. However, these restrictions on repossessions and rescissions only apply when the service member paid any deposit, down payment, or installment prior to entering military service. In other words, if SSG Smith from our example above entered into a conditional sales contract with a dealer after he went on active duty, a breach of that contract could still give rise to repossession without the need of a court order.

But, before you put a service member's car out for repo, there are some other problems which can arise. The National Consumer Law Center has this to say about attempting to repossess vehicles from military bases:

> Even if the Soldiers' and Sailors' Civil Relief Act (now the Servicemembers' Civil Relief Act) does not apply, or when a debt is incurred after the consumer enters service, policy at the military base may require that any repossessor entering the base be accompanied by military police when conducting the repossession. However, the repossession conducted in the presence of the debtor who is aware of a police officer's presence is arguably unlawful, as the official's participation (active or passive) destroys the self-help nature of the remedy, and requires all of the protections of due process. Therefore, unless the repossession occurs without the knowledge of the debtor, any repossession on a military base will necessarily be wrongful, either as a violation of constitutional due process or, if the repossessor fails to seek the assistance of the military police, as a violation of law and regulations applicable to conduct on the base." (*Repossessions and Foreclosures, 5th ed.*), section 6.3.5.1, NATIONAL CONSUMER LAW CENTER

Conclusions

The moral of this story is: tread lightly while attempting to collect a debt from military personnel. Also, dealers that maintain in-house financing or leasing will require assistance from counsel in developing financing guidelines for military personnel.

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Mark Your Calendar!
NADC Conference
April 25-26 in Atlanta

Sessions are being planned for each of the special interest sections: Bankruptcy and Debt Collection, Buy/Sell Agreements, F&I, Federal and State Regulatory Compliance, Labor Law for Dealers, Litigation, Manufacturer Relations and Franchise Issues, Sales and Advertising, Taxation and Warranty, and Fixed Operations. More details in next month's Defender and at www.dealercounsel.com

NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL
Volume I, Number 3
January, 2005
Rob Cohen, Editor
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Defender, The NADC Newsletter is published monthly by the National Association of Dealer Counsel
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