DEFENDER
THE NADC NEWSLETTER

Dealer Loan Documentation:
Like the Old Adage, Everything Is (And Should Be) Negotiable

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Real estate loans, construction loans, refinance loans, working capital loans and other long-term loans are a fixture in the modern dealer's business life. These loans are typically secured by the dealership real estate or the dealership's assets, or both. Regardless of the form of the loan, the dealer will inevitably receive a large stack of loan documents to be reviewed and executed. These loan documents typically include a promissory note, deed of trust (covering the dealership real estate), personal property security agreement (covering the dealership's assets), guaranty, subordination agreement, and other documents, all designed solely for the purpose of protecting the lender's position.

The loan documents are generally prepared by the lender's experienced legal counsel and oftentimes have the appearance of standardized forms with "boilerplate" provisions. This may in turn create the impression that the fine print in the loan documents is not subject to negotiation or change. There are also instances where a dealer is eager to consummate a loan having favorable terms, and therefore decides to forego a careful reading or review of the loan documents.

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Sidebar

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The Class Action Fairness Act of 2005
Legislative Inertia but Little Substantive Change for Dealers

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After much debate and prior failure of an identical bill, the Class Action Fairness Act of 2005 was passed by Congress and signed one day later by President Bush on February 18th. According to the Act's findings, the new law promotes fairness while curbing abuse in the class action process. Class action reform was vigorously opposed by consumer groups and trial lawyers and pursued with equal vigor by pro-business groups, including AIADA. As many readers will recall, AIADA gave its support and enlisted its Board and members to assert the views of dealers and the business community in support of the bill. AIADA's position mirrored the view of the majority of its members, and most likely dealers generally. Surveys reviewed indicate that 70% of AIADA's member dealerships report that frivolous lawsuits are one of the most important issues that dealerships face.

Highlights of the Act

In summary, the Class Action Fairness Act of 2005: 1) Grants the District Courts original jurisdiction of any civil action in which the matter in controversy exceeds $5 million, exclusive of

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Despite the standardized appearance of loan documents, there is frequently room for negotiated revisions – even substantial ones. In light of this, it is especially important to expend the time and money to thoroughly review the loan documents for needed revision. Indeed, it may be dangerous not to do so. By way of example, the following is a list of common loan provisions which are problematic for the dealer but can be revised through careful review and negotiation.

Request Notice and Cure Provision.

Many loan documents state that any failure by the dealer to make a timely payment or to perform any other obligation will be deemed a loan default immediately upon such failure, without any notice or demand. A dealer should always negotiate for a notice and cure provision, which will obligate the lender to give written notice of a default and an opportunity for the dealer to cure it before the loan will be thrown into default. Most lenders will readily agree to notice and cure provisions, although typically limited to 10 days for payment defaults and 30 days for non-payment defaults. Even with such limitations, a notice and cure provision is extremely valuable protection to have.

Seek Exemption from Transfer Restrictions.

Real estate loans almost always bar the owner of the real estate from transferring any interest in the real estate or any interest in itself to any third party. This would effectively bar even transfers to a related LLC for tax purposes or to a family trust for estate planning purposes. The dealer should request exceptions for such transfers, and experience has shown that most lenders will agree to such transfers provided that the transferring entity remains under the control of the dealer principal.

Seek Exemption from Prohibition of Junior Liens.

Real estate loans – and even loans secured by the dealership's personal property assets – typically prohibit the dealer from giving a junior lien to another creditor. The existence of a junior lien on dealership real estate or on dealership assets does not pose a legal threat to the lender's senior lien, and therefore a clause permitting such junior liens is a benefit to the dealer and provides the dealer with some degree of flexibility in securing additional loans.

Subordination of Payments to Dealer Principal Should be Limited.

Lenders often require subordination agreements, which are designed to prevent the dealer corporation from repaying a loan to the dealer principal prior to paying off the existing loan to the lender. The problem is that the language of these subordination agreements is often broad enough to bar not only the repayment of loans by the dealer corporation to the principal, but also bar the payment of *any* sums to the dealer principal – which could conceivably include salary, bonuses, distributions, etc. Dealers should seek a "carve out" which would permit these types of payments to the dealer principal notwithstanding the terms of the subordination.

Avoid Continuing Guaranties.

Careful consideration should be given by the dealer to whether his or her personal guaranty will be comprehensive and unconditional in nature (covering all past and future loans) or confined to the single loan transaction at hand. To the extent the terms of the loan call for a guaranty only as to that loan, or the terms are otherwise silent, the dealer should very carefully scrutinize the terms of the guaranty to ensure that it covers only the loan transaction at hand and does not include any past or future loans.

Avoid Assignment of Dealer Principal's Assets.

In loans where personal property security is required, lenders frequently request not only the dealership corporation, but also the dealer principal, to sign personal property security agreements for the purpose of pledging personal property assets. The problem is that, although the lender may intend to secure only the dealership assets, the agreement signed by the dealer principal may be broad enough to include his or her own personal property, which would necessarily include motor vehicles, bank accounts, and other personal items. Any security or pledge agreement signed individually by the dealer principal should be carefully reviewed to avoid that pitfall. The solution is simple. Any property listed in the security agreement signed by the dealer principal should be limited to property used in the dealership operations or located on the dealership premises.

Force Majeure Clause.

A dealer may be prevented or delayed from timely performing a loan obligation because of events outside of his or her control, such as a riot, flood, or other acts of God. This is especially true in construction loans. A good force majeure (literally "superior force") clause is important as it protects the dealer from a claim of default by providing that problems beyond the reasonable control of the dealer excuses performance.

This list of loan provisions, though representative, is not exhaustive of the types of loan provisions which a dealer would be wise to review for needed revision. A prudent dealer and his or her legal counsel should in all cases review the entirety of all proposed loan documents for that purpose.

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interest and costs, and is between citizens of different states, or citizens of a State and a foreign State or its citizens or subjects; 2) Limits contingent and other attorney's fees in proposed class action settlements that provide for the award of coupons to class members; 3) Prohibits a Federal district court from approving: a) a proposed coupon settlement absent a finding that the settlement is fair, reasonable, and adequate; b) a proposed settlement involving payments to class counsel that would result in a net monetary loss to class members, absent a finding that the loss is substantially outweighed by non-monetary benefits; or c) a proposed settlement that provides greater sums to some class members solely because they are closer geographically to the court; 4) Directs the Judicial Conference of the United States to report on class action settlements, incorporating recommendations for best court practices to ensure fairness for class members and appropriate fees for counsel.

The Debate Over Reform

Supporters of the Act cited historic abuses and unjust enrichment of trial lawyers as the basis for reform. That tact proved a good catalyst for a successful change. As reported by USNews.com, the online service for US News and World Report, "Over the years, class action lawsuits have netted consumers $13 rebates on computer monitors, coupons for free movie rentals, $30 discounts on cruise vacations, and free boxes of cereal. But the lawyers who spearheaded those cases were the real winners, typically walking away with millions of dollars in fees." It may be the windfall to our friends in the plaintiffs' bar that raised the ire of enough of the public that democrats in Congress were finally willing to support President Bush in passing this reform. Apparently, the bill was able to advance because key democrats like Senator Dianne Feinstein of California joined forces with the GOP over these concerns.

Even prominent consumer groups, which certainly opposed the legislation, acknowledged the public's concern over huge legal fees in class actions. In a letter to senators dated February 5, 2005, the Consumers Union, the Consumer Federation of America and the U.S. Public Interest Research Group stated their concerns. The letter sounds the alarm that the Class Action Fairness Act "will virtually wipe out state class actions and thus remove an important venue for redress of injury or fraud for consumers." However, even these prominent consumer advocates voiced concern over the "unjust" enrichment by lawyers at the expense of consumers in class action settlements.

Of course, the White House capitalized politically from the beginning on the issue of unjust enrichment of trial lawyers. In its press release dated October 23, 2003, the President stated, "Yesterday, 39 members of the U.S. Senate blocked an up or down vote on a bill that would reduce frivolous lawsuits and the burden they place on our economy. The Class Action Fairness Act would protect the legal rights of all citizens while ensuring that court awards and settlements go to those who are wrongfully injured rather than to a few wealthy trial lawyers."

Effect on Dealer Class Action Litigation

Blaming the lawyers (as always) was the popular theme that got the job done for the passage of this legislation. But, what is the effect of the Act on dealers and defense of their class action matters? Most news reports indicated that the new law would shift most class-action lawsuits from state courts to federal courts, which historically have been less friendly to such cases.

That shift from state to federal court will not occur in the class actions faced by most auto dealers. This is because dealer class actions will typically fit into several exceptions to federal jurisdiction established by the Act. First, the District Court cannot maintain jurisdiction, or accept removal jurisdiction, if two-thirds of all class members are citizens of the forum state and if the relief sought from at least one forum state defendant is based upon conduct occurring in the forum state (28 U.S.C. §1332(d)(4)). Second, the District Court may decline jurisdiction permissively where the primary defendant and between one-third and two-thirds of the class members are citizens of the forum state (28 U.S.C. §1332(d)(3)). Finally, a non-federal question class action will not be subject to federal jurisdiction if the total number of class members is less than 100 (28 U.S.C. §1332(d)(5)(B)).

While the Act is, hopefully, a catalyst for further change and perhaps a barometer of the public mood, its passage will not substantively change our defense of dealer unfair competition and class action litigation. For most of us, that means that we will continue to defend these matters in state court. In California, where I practice, that means more of the same for dealers facing unfair competition (California's infamous Business and Professions Code section 17200) and other consumer class actions. However, the passage of the Class Action Reform Act, and other successful political action by dealers and allies in the business community, for example, Proposition 64 in California which for the first time establishes standing requirements for private attorney general representative actions, may be the first steps in a long march towards real change and a renewed sense of fairness for businesses fighting such actions. At our firm, we view these steps as reflective of the public (and therefore prospective jurors') ire against frivolous lawsuits that are driven by attorneys' fee awards as opposed to material injury to any consumer. This gives us much food for thought when analyzing settlement value versus the defense of a matter through trial.

For a complete copy of the text of the Bill, go to: www.theorator.com/bills109/s5.html.

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President's Letter

Jonathan P. Harvey

As we approach our first National Conference in Atlanta, I take this opportunity to ask for help from each of you. It is clear that the formation of NADC was long overdue. We are adding members on a weekly basis and should be close to our goal of 300 by the time we meet in Atlanta. We already have 93 registrants for the Conference, expect 100, and we have 11 speakers on diverse topics of timely interest to dealer counsel. These things suggest our association has the potential of being the most significant repository of dealer lawyer expertise in the country, but in order to realize that promise, we must continually search for new and innovative ways to deliver the product. About that, we must be vigilant, and for this I seek your help.

We know that we simply cannot sustain our rapid growth without providing meaningful and continual information, assistance and value to our members. We have a list serve that is beginning to see significant action; we have an on-line forum that continues to provide and explore challenging and timely issues; we have *Defender, the NADC Newsletter* that, although in its infancy, is beginning to play a role in getting information to our members; we have an on-line membership directory that helps our members network; and we are having a conference to satisfy the important goal of face-to-face communication.

We don't know if that is enough. I suspect it is not. The help I am asking of you is the gift of criticism. Will each of you take a few minutes to send me an e-mail with your comments, criticisms and suggestions for what we can do better, what we can do that we are not doing, and what we should stop doing? We have a reasonably good recipe for success, but the way in which we follow that recipe and serve the dish is now the primary issue, and it depends on your appetite.

For example, would you like to have a "Letters to the Editor" section in the newsletter? Would you like to see the membership directory changed in any way? Would you like to have more direct contact with other members? Can we improve the forum or the list serve? Are you able to use the website easily? Do you think we have the right sections for our Conference in Atlanta? Would you like to see more information regarding expert testimony and advice? Is there enough emphasis on the important issues? What are the important issues?

The vitality of our group depends on new ideas, and we must be continually thinking outside the box, trying and failing, trying and succeeding. If we do not work hard at coming up with new solutions, and refining the old ones, we will wither. In my 39 years in the practice of law, I have never seen an organization of lawyers take off so quickly or fill such a vacuum. Now we have to deliver, and to do that, we must get comments from all our members. Will each of you join me in this task so we can have something meaningful for the lawyers of today, and so we can pass something of professional value to the next generation? We can do no less.

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FAQ: Frequently Asked Questions

Answer supplied by Michael Charapp. who is a partner with Charapp & Weiss, LLP in McLean, VA. He is Second Vice President of the NADC and serves as Chairman of the Membership and Advancement Committee.

We have received questions concerning the differences between the National Association of Dealer Counsel and AutoESQ. I would like to take the opportunity to explain why you should choose to be an NADC member.

NADC is a true trade association. It was formed to provide open communication and exchange of ideas among those representing motor vehicle dealers in the broad range of issues that dealers face. Membership is open to all attorneys who represent the interests of dealers without representing those opposed to dealers, with additional membership classifications for non-lawyer auto trade association executives and dealers. There are also membership opportunities for affiliated companies who can contribute to and benefit from a relationship with NADC members. NADC, as a trade association, offers and will offer to its members a broad range of benefits such as publications, conventions and educational meetings, information exchange opportunities through its website and a list serve, and regular opportunities to network and communicate with those with similar interests.

AutoESQ is not a trade association. It is simply a formalized affiliation of a number of lawyers who have communicated over the years. The group's present plans are to limit membership to less than 30 lawyers who will be eligible for membership by invitation only (with a regular membership slot for the annual head of the ATAEs). While the group will have meetings and opportunities to exchange information, it will not be a trade association that provides the wide variety of opportunities for education, networking and communication that NADC offers and will offer.

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