DEFENDER
THE NADC NEWSLETTER

Practical Considerations for GLB/Safeguards Compliance

Les Stracher

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We have all looked from the sidelines with fear and trepidation at the increasing responsibilities imposed on our clients as custodians of personal information. Our clients live in a new regulatory age. By my current count, dealers face over eighty areas of individual concern from a regulatory standpoint. These range from title issues, to work safety, to consumer matters, to environmental concerns and of course privacy issues. In all of this, I have chosen to focus on the privacy issues because this is an area which is somewhat new to our clients and seems to generate a disproportionate share of concern among them.

Of course, all of us recognize that the responsibilities of our clients (considered "financial institutions") go far beyond our customer's expectations of privacy and the protection of their personal information.

The Privacy Notice Under Gramm-Leach-Bliley (GLB)

There are three areas of concern which get raised with some degree of regularity. The first is to, as best one can, try to construct a notice and/or modify business practices to avoid opt-out requirements. The second, as it relates to the internet, is

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Preventive Medicine: Early Detection Helps Ensure a Healthy Dealership Purchase Transaction

Richard H. Kotzen, CPA, and Glenn W. Perdue, AVA

As the trend toward consolidation in the auto industry continues, dealerships are being bought and sold at a steady pace.

Both buyers and sellers can benefit by conducting thorough due diligence focused on the seller's financial condition and operations early in the process. This examination allows the parties to diagnose and properly address issues on the front end that could lead to costly disputes and litigation on the back end.

Taking a History: What's Being Bought and Sold?

The focus of the examination described above depends on what the buyer is acquiring: assets or equity. Although consolidators and private equity firms continue to acquire dealership stock in many cases, the majority of deals today are dealer-to-dealer transactions, and most of these are asset purchases.

In an asset deal, the buyer typically acquires the seller's inventory, fixed assets, and goodwill. The buyer may also acquire the real estate, or it may lease the facility from the seller.

Sellers may prefer stock deals for tax purposes or liability protection. But few buyers are willing to take on the risk involved in a stock deal, particularly as it relates to the seller's liabilities.

Many of these liabilities may be contingent or uncertain, such as bad debts, finance and insurance chargebacks, environmental liabilities, employment dis-

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President's Message

Jonathan P.

There was a fascinating article in the September 11, 2006 issue of Automotive News regarding something called a "Third Age Suit," described in the article by Erin Robinson as "a blue jumpsuit designed to simulate for a 20-something what it feels like to be 30 years older than you are." This simulation suit is used by Ford engineers to assist them in understanding certain age limitations so they can better design their cars. The suit limits mobility, vision and sensitivity of touch, sometimes described as the trials and tribulations of advanced age. While I am not sure why such a suit is necessary, given the ready supply of productive octogenarians, I think the idea is useful. This remarkable suit was designed in the 1990s by researchers from England's Loughborough University. Ford also has a suit that somehow mimics weightlessness to "provide a firsthand experience of what it's like to be pregnant." I don't quite understand the correlation between weightlessness and what it feels like to be pregnant, but I will take their word for it, and I certainly understand their goal. Solutions require preparation and innovation.

You may wonder why I am telling you about this article, and where I am going with this. Here it is: the point being made by Ford engineers, and the whole concept of this kind of simulation, is that each of us must figure out a way to know what it is like to be in someone else's shoes. What does that mean for dealer lawyers? It means that in the absence of a client simulation suit, before we give advice, even that which is well researched and thoroughly analyzed, we must take another step. We must put ourselves in the client's position; think carefully about the client, what they will do with the advice, how they will react to it, and whether it is the right thing for them. This is true whether negotiating a deal, trying to settle a lemon law case, figuring out how to comply with Gramm-Leach-Bliley Act, or simply making sure the clients are up to speed on the legal issues affecting their businesses. This is nothing new, it is a basic rule: walk a mile in the other person's shoes, and you will be a long way towards solving their problem.

On to the mundane. We now have 425 members. Lately I have seen requests for referrals to dealer lawyers in other parts of the country and the inquirers express preference for NADC members. This is a benefit of the Association which was not anticipated by the small group of founders, but it is an exciting and well deserved development. We have started to become a household word in the industry, and it is not by accident. We have developed first rate educational programs, and the daily activity on the list serve speaks for itself. We have a valuable and timely conference on F&I Compliance scheduled for November, and plans are underway for the annual convention in 2007. These events are essential for proper representation of our clients, and your continued participation is the key to it all. Regards to all of you.

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when and whether a visit triggers notice requirements. The third relates to a customer who simply will not sign and thereby acknowledge the notice.

Operationally, having to deal with annual privacy notices and track those customers who choose to opt-out, is a daunting task. In most dealership contexts, other than dealerships with in-house lending departments, an annual notice should not be required. Moreover, an opt-out notice is not required when your client shares non-public personal information ("NPI") with non-affiliated third parties under the circumstances contained in 16 CFR 313.13 and 313.15. Those circumstances include where NPI is shared:

- With non-affiliated third parties who perform services for you or functions on your behalf, (so long as you provide an initial privacy notice and require the third party to enter into an agreement not to utilize the information other than to carry out the purposes for which you disclosed the information);
- With the consent and at the direction of the consumer;
- To protect the security of your client's records and to prevent and protect against fraud, identity theft, etc.;
- To resolve and defend consumer disputes;
- With those having a legal interest with the customer and/or fiduciaries and/or beneficiaries of the customer;
- With your client's attorneys, accountants, auditors and/or rate advisory organizations, guaranty funds or other agencies rating your client for industry compliance;
- To the extent provided by law (including response to judicial process) and, specifically, to law enforcement agencies, state insurance authorities, the FTC, self-regulatory agencies and investigations on matters of public safety;
- To or from a consumer reporting agency in accordance with the FCRA;
- In connection with the purchase or sale of the dealership.

Auditing Non-Affiliated Third Parties

As one would readily admit, these "section 13" and "section 15" exceptions cover a wide scope of activities which would tend to mitigate against the requirement of giving the customer an opt-out notice. Of course, the most frequent mistake I have found is simply that your client fails to require non-affiliated third parties to enter into an agreement along the lines contained in the first bullet point above. I have suggested to all of my clients that they perform a contract audit with such non-affiliated parties and require them to execute addenda documenting their agreement to limit the use of such information. I have also suggested they require all such parties to indemnify the dealership to protect them against potential civil liability.

Requests for Production of Documentation

GLB/Privacy issues often arise while ferreting through third party requests for information. It is within this context in particular that your client is likely to ask for guidance.

Normally, the watchword is to get the party requesting the information to do so pursuant to judicial process. However, one needs to take care that, especially in the instance of law enforcement, that the information is not being improperly withheld and, therefore, impeding an active investigation.

Another issue that arises with ever-increasing frequency, is the receipt of notices from counsel representing the consumer seeking records on their own client's behalf. Invariably, these notices come with no verification and/or documentation evidencing the customer has actually authorized counsel to request the NPI. In such instances, I have required counsel to serve a subpoena for those records. Another pattern falling into the gray area are requests from the manufacturer for NPI in defense of lemon law claims. If you insist on the issuance of a subpoena in this context, you will find yourself on the wrong side of a nasty dispute with the factory. While the conservative approach may be safer, I do believe that such production may well fall into one of the "section 15" categories.

Internet Concerns

Although compliance is relatively easy, I often see website privacy overlooked. Of course, everyone understands that an individual who merely visits a website is not subject to the GLB privacy notice requirements in the same fashion as one who merely visits a showroom is not. However, it is quite common that dealer websites solicit customer information in furtherance of obtaining finance pre-approval. I typically see a screen come up giving the customer an opportunity to input information and send it to the dealer. My only admonition in this instance is to advise the client to make sure that the notice appears before the customer can access any web-based application and that there is an "I Accept" icon for the customer to push before proceeding.

FTC Safeguards Rule

Client Matters

One should make no mistake. The FTC Safeguards Rule is the gathering storm in the area of dealer compliance. Representing dealers in the context of the Rule presents a unique opportunity and danger for counsel. Indeed, it is an area where you can be of immense help to your client and, if done properly, requires constant maintenance and direction.

As a practitioner, this is a difficult sell and you will need to be somewhat proactive. After all, customer information is broadly defined as being any information about your client's customers or information which your client may receive about the customer of another financial institution which can be directly or indirectly attributed to the customer.

We have all had the experience of seeing a client confuse an offer of assistance with an effort to up-sell legal services. Clients, being reactive, may be resistant to your efforts to assist them. However, even at the risk of offending clients who may think that I am being overly aggressive in selling my services, I have made it my practice to send each and every one of my clients a letter advising them that my office offers FTC Safeguards compliancy services. Sending such notices is a good service to your client and a good defensive legal practice. If your client decides to go with some other compliancy service, then I advise them to ensure such entities carry an errors and omissions policy of insurance naming my client as an additional insured, workmen's compensation, and whatever other cover-

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putes, or litigation risks. As a result, stock deals can be much more complicated and often require provisions for purchase price adjustments, indemnification, and escrow arrangements to offset risks associated with unknown or underaccrued liabilities assumed by the buyer.

Stock deals are also more susceptible to disputes because the seller's entire balance sheet comes into play, expanding the number of areas exposed to error, misunderstanding, or misrepresentation. In contrast, the typical asset purchase involves only the asset side of the balance sheet thereby reducing the risks associated with unpredictable liabilities (although in some cases selected liabilities may be transferred).

Vital Signs: What's It Worth?

Many disputes over dealership purchase transactions involve valuation issues: The buyer claims that the value of the assets or equity purchased is less than what was paid and what the seller represented. In examining the manner in which deal prices are developed, consider the following basic approaches to valuing a business:

- Asset approaches, which use various methods to determine the value of the individual assets being purchased;
- Income approaches, which consider the present value of the expected future earnings or net cash flows for the business;
- Market approaches, which use various methods and metrics to value a business based on prices paid for comparable businesses;
- Rule-of-thumb approaches, which are often derived from generally accepted industry-based earnings multiples.

In dealer-to-dealer transactions, the most common measurement of value is a multiple of the dealership's historical pre-tax income, an industry-based rule-of-thumb determined substantially on the market approach. Today, these multiples may range from two to seven times historical pre-tax income (adjusted for "normalized" income and expense items), depending on factors such as franchise type, e.g., Ford, GM, Lexus, BMW, location, and perceived growth potential.

Since a dealership's ultimate value to a buyer depends so heavily on income and cash flow, any errors or misrepresentations that distort a dealership's historical earnings can quickly change the value of a transaction in the eyes of a buyer and lead to litigation.

Risk Factors: Common Sources of Deal-Related Disputes

Once a deal is done, the buyer will monitor the value realized in the transaction and may determine that it falls short of the value the parties anticipated and represented in the closing documents. The buyer's determination, and any litigation that results, may be based on one or more of the following:

Purchase Price Disputes. At the most basic level, disputes between buyers and sellers of businesses are often based on the premise that the seller overstated the value of the business through error or intentional misrepresentation of historical financial information.

Assets and liabilities. Disputes may arise if asset values are overstated, assets are not delivered, or assets are not provided in the promised condition. Similarly, in stock transactions — or in asset transactions in which the buyer assumes certain liabilities — disputes may arise over understated or undisclosed liabilities. In addition, the parties may also disagree over working capital, in some cases triggering litigation over the appropriate settlement amount.

Business performance. A dealership's value to a buyer is ultimately based on its ability to generate future income and cash flow. So, any significant gaps between a dealership's actual income and the income stream represented by the seller can cause problems. This can happen if the seller misrepresents its revenues, earnings, or growth, or if the dealership's performance declines before the transaction is closed.

Misrepresentation and fraud. A party may misrepresent assets, liabilities, or business performance. Or it may actively conceal material facts that may impact business value, such as a key employee's terminal illness or a pending condemnation action that affects the dealership's property. Similarly, a buyer might misrepresent its ability to satisfy franchise transfer requirements.

Breach of contract. Breach of a purchase agreement may occur either before or after the closing. A post-closing breach, for example, may involve violation of a noncompete, nonsolicitation, or nondisclosure provision by the seller or failure to deliver promised working capital. Pre-closing breaches typically involve nonperformance. For example, a party might simply change his or her mind and walk away from the deal. Or a buyer might fail to obtain franchise approval or adequate financing to close the deal.

Financial Care:
Spotting Potential Problems Early

By involving financial experts as early as possible in the process, both buyers and sellers can avoid surprises that can lead to

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F&I Compliance Workshop

November 10, 2006, 9:30 AM to 5:00 PM

Four Points by Sheraton BWI Airport, Baltimore

Plan to attend the workshop created in response to feedback from the annual conference. NADC members indicated a strong desire for in-depth information on F&I compliance.

Join other NADC members at the conveniently located Four Points by Sheraton BWI Airport, five minutes from the airport in Baltimore. CLE credit is available for the 6.25 hours of expert presentations.

The workshop is open to NADC members. The registration fee is $375 and includes breaks and lunch. Special hotel room rate is $155 plus tax. For room reservations, call the hotel at 800-368-7764 and reference NADC at the BWI Airport Hotel.

Visit **www.dealercounsel.com** to register and for updates on program and hotel information.

9:30 to 12:30 – Common but Dangerous F&I Practices/TILA

Moderator: **Rob Cohen**, Auto Advisory Services
Presenter: **Emily Beck**, Hudson Cook, LLP

- Negative equity non disclosure/over-allowances
- Negotiating trades with negative equity
- Backdating
- Consummation and substitution
- Hidden finance charges
- Payment packing
- Menus and videotaping – pros and cons
- State disclosure issues

12:30 to 1:30 – Lunch

1:30 to 3:00 – FCRA/FACTA/Privacy

Moderator: **Patty Covington**, Hudson Cook, LLP
Presenters: **Paul Metrey**, National Automobile Dealers Association and **Mike Goodman**, Hudson Cook, LLP

- Prescreening
- Credit alerts
- Address discrepancies
- Red flag rules
- Risk based pricing status

3:00 to 3:15 Break — *Sponsored by CounselorLibrary.com, LLC*

3:15 to 4:30 – Adverse Action Notices under the ECOA and FCRA

Anne Fortney, Hudson Cook, LLP and
Mike Charapp, Charapp & Weiss, LLP

- General requirements – rapidly developing case law
- Law applicable to specific scenarios faced by dealers

4:30 to 5:00 – Recent Developments in F&I and Compliance

Arbitration, contractual clauses, cash reporting update and other timely issues

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ages may be applicable and appropriate.

The Audit

We should all know that one of the first and most critical elements of FTC Safeguards compliance is the risk assessment or audit. The FTC Safeguards Rule requires dealers to identify reasonably foreseeable threats to customer information. What you may well find, as I have, is that the largest area of compliance concerns reside within your IT department. My first and best advice to anyone doing a privacy audit is, therefore, to make sure that a qualified information technician is retained. Similarly, I would advise any attorney involved in such an endeavor to make sure that he or she avails him or herself of such expertise. Similarly, if your client is retaining a third party service to assist with the audit, it would serve them well to inquire of their computer expertise and staffing.

The key here is to just get the audit done or, in the alternative, make sure it was not your fault that it wasn't done. Your client should also be made aware that the audit must be conducted throughout the dealership (in sales, service, finance and insurance, the body shop, the parts department and in accounting). Some examples of reasonably foreseeable threats to the disclosure of customer information include:

- Customer applications and contracts left on desks and in unlocked offices;
- Failure to secure F&I offices;
- Unsecured computer servers;
- Failure to dispose of customer information;
- Failure to password protect all computers;
- Failure to back-up customer information and to maintain firewalls;
- Failure to download security patches from vendors or other reputable sources.

Oversight of Vendors

Another area where clients are more likely to require the assistance of counsel is in the oversight of vendors. Service providers are defined as any person or entity that receives, maintains, processes or otherwise is permitted access to customer information through its providing of services to a financial institution. The FTC has made it clear that dealers are expected to take reasonable steps to assure that service providers maintain sufficient procedures to detect and respond to security breaches. The dealer may opt to require certifications or representations from such service providers. However, notwithstanding such precautions, dealers must, by contract, require their service providers enter into an agreement wherein they warrant that they have taken appropriate steps to protect customer information. A good example of that language may be found in the 2003 NADA Bulletin, entitled "A Dealer Guide to Safeguarding Customer Information." Again, even if your client thinks they are in compliance, an overall review of your client's vendor agreements will probably be in order.

Conclusion

Our clients must face the unpleasant reality that it's not just about selling cars anymore. Our dealership clients are, unfortunately, forced to run a regulatory and legal gauntlet every day. While there is much they can and should do themselves that may never cross your desk, the legal issues related to GLB and the FTC Safeguards Rule are bound to become a part of your everyday practice, if they have not already.

Les Stracher is a Shareholder with the twenty-five member law firm of Rothstein Rosenfeld Adler, PA, in Fort Lauderdale, Florida. He is the Chairman of the firm's Automotive Law Practice Group. In that capacity he advises dealers on mergers and acquisitions for dealers throughout the country, and concentrates on advising dealers on their day-to-day operations. Mr. Stracher has been involved in numerous buy-sells as well as complex corporate structuring and third party negotiations associated with these transactions as well as other legal issues related to the representation of dealers including, franchise disputes, fixed operations, consumer defense, contractual review and compliance issues.

CLE Update

The State Bar of California awarded four CLE credit hours for the Special Workshop: California Car Buyer's Bill of Rights that was held in San Diego in June. A list of those who attended has been submitted.

The NADC website is a source of information for:

- ***Member Directory, searchable by name, firm, state, area of interest and dealership type***
- ***Forum, an online discussion of timely issues***
- ***List Archive, a collection of messages shared by those members who sign up for the List Serve***
- ***Events, conference information and downloadable materials from conferences and workshops***
- ***Banners that link to associate member websites for information on products and services***
- ***Those wishing to apply for membership will find an online application***

www.dealercounsel.com

New Members

NADC welcomes the following new members:

Full Members

Steven T. Aceto
Steven T. Aceto P.A. Law Office
Asheville, NC

Jeffrey R. Atkins
Atkins & Markoff
Oklahoma City, OK

Richard A. Langer
McNamee, Lochner, Titus
& Williams, PC
Albany, NY

Elizabeth Lord
Jackson Kelly PLLC
Charleston, WV

Brent L. Moody
FreedomRoads
Bowling Green, KY

Tanya G. Richmond
Richmond Law Firm PLLC
Bedford, NH

Perry C. Robinson
The Performance Companies
San Antonio, TX

Fellow

Douglas A. Burke
New Jersey Coalition of
Automotive Retailers
Cape May Court House, NJ

Ronald J. Campione
Bressler Amery & Ross, P.C.
Florham Park, NJ

Christine Collins
CarMax
Richmond, VA

Kyle W. Davenport
McGloin, Davenport, Severson
and Snow, P.C.
Denver, CO

Shannon L. Greenan
Wm. David Coffey, III, & Associates
Austin, TX

Sherrie Gudusky
Charapp & Weiss, LLP
McLean, VA

Kimberly S. MacCumbee
Charapp & Weiss, LLP
McLean, VA

Kenneth J. Murphy
Venable, LLP (formerly Whitwell
Jacoby Emhoff)
Los Angeles, CA

Barkha Patel
Charapp & Weiss, LLP
McLean, VA

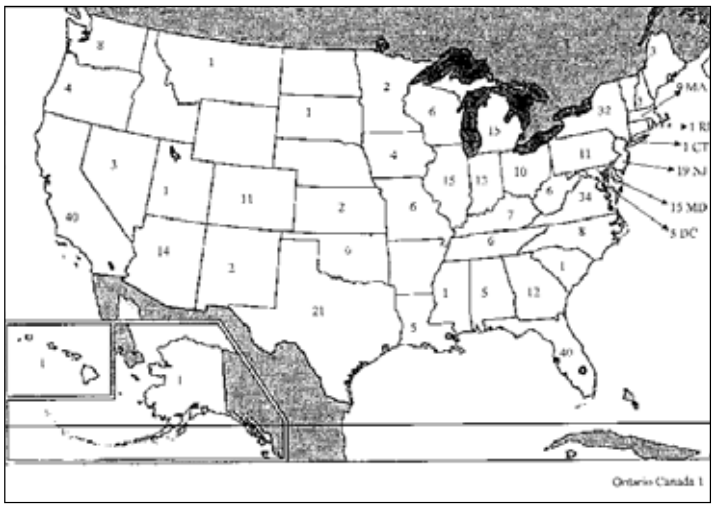
Stephen F. Varholy
Charapp & Weiss, LLP
McLean, VA

Brad D. Weiss
Charapp & Weiss, LLP
McLean, VA

Executive

Steve B. Rankin
Oklahoma Automobile Dealers
Association
Oklahoma City, OK

Where Are NADC Members?



Map shows the geographic distribution of NADC members as of July 31, 2006.

PREVENTIVE MEDICINE ...
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costly, time-consuming disputes and litigation. By conducting a thorough examination up-front, the parties can ensure that the transaction is structured properly, and that the purchase agreement's terms are properly aligned with the relevant financial and accounting representations.

From the buyer's perspective, a financial professional can assist with due diligence and valuation issues, providing assurance that the dealership's financial condition is reasonably represented and that the deal is priced appropriately.

On the seller's side, a financial specialist can help avoid disputes by ensuring that the dealership's assets, liabilities, and income are fairly presented and that the buyer is qualified.

Treatment Options: Repairing the Damage

Even the best-planned deals sometimes go astray. If that happens, the parties may have several remedies at their disposal including specific performance, lost profits, remediation costs, and, in some cases, attorneys' fees, statutory damages, or punitive damages.

The most common claims, however, are for lost profits and business value. One of the most effective ways to secure a full recovery is to engage a damages expert with auto industry experience.

Consider this case example: A dealer with annual earnings of $1.5 million sold its dealership for three times earnings, or $4.5 million. After the transaction closed, the buyer discovered that the manufacturer had underpaid warranty reimbursements during the previous year. A forensic accountant who was familiar with the auto industry and warranty reimbursement arrangements was able to establish a $500,000 shortfall.

The dealer sued the manufacturer for $500,000 in lost profits. It also claimed an additional $1.5 million, representing the lost business value it would have received had those profits been included in the computation of the purchase price. The dealer eventually settled with the manufacturer for $1.2 million.

Prescription for Success

The most effective strategy for a successful dealership transaction is to conduct a thorough examination up front to identify and resolve any deal-threatening issues. But if preventive medicine does not work, a financial expert with auto industry experience can help provide a financial recovery plan.

Richard H. Kotzen, CPA, is an executive with Crowe Chizek and Company, LLC. He specializes in providing assurance, tax, risk management, performance consulting, acquisition due diligence, and litigation support services. Crowe, a top 10 public accounting and consulting firm, provides services to more than 600 dealerships across the United States. Kotzen can be reached at 954.489.7430 or rkotzen@crowechizek.com.

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NADC MEMBER WORKSHOP

F&I COMPLIANCE

NOVEMBER 10, 2006, 9:30 AM TO 5:00 PM
FOUR POINTS SHERATON BWI AIRPORT, BALTIMORE
SEE PAGE 5 AND WEBSITE FOR INFORMATION.

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