DEFENDER
THE NADC NEWSLETTER

Hidden Liability for Customer Attorney's Fees Under Standard Vehicle Sales Contracts

Lane E. Webb and Alan E. Greenberg

Lane E. Webb

The risk of liability for a prevailing customer's attorney's fees under a standard vehicle sales contract was highlighted in a recent arbitration proceeding in San Diego. Despite language in the pre-printed form sales contract that, on its face, appeared to clearly exclude dealer responsibility for the customer's attorney's fees, the arbitrator interpreting California statutory and case authority found that the dealer was responsible for paying the customer's attorney's fees after the sales transaction was rescinded.

The sales contract in the arbitration proceeding did not generally allow for attorney's fees in a dispute between the parties. There was a box, however, just above the arbitration clause in the sales contract entitled in boldface: Rescission Rights. The four subparagraphs of that section stated dealer may rescind the contract if unable to assign it to a financial institution. It explained that dealer may then give buyer notice of rescission within 10 days of signing the contract and buyer must immediately return the vehicle and receive back buyer's consideration. Subparagraph "c" stated:

> If you do not immediately return the vehicle, you shall be liable for all expenses incurred by seller in taking the vehicle from you, *including reasonable attorney's fees* (emphasis added).

The proceeding did not involve an

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Sidebar

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Helping Unhelpful Clients

Jeff Ingram

There are some places I would rather never see again - the inside of a domestic relations or criminal court come to mind immediately. To date, despite the apparent best efforts of some of my clients to ruin those plans, I have generally been able to avoid such places. I cannot say the same for the inside of a bankruptcy court. Unfortunately, my clients keep forcing me back into bankruptcy court. However much I may dislike entering into a bankruptcy court, I bet that my discomfort does not match the discomfort of the lawyer who had the unfortunate responsibility to represent Precision Auto Sales in a recent case.

This case reminds me of many calls that I get in my practice. The phone rings. When I answer, a client or potential client tells me that one of their bogus customers (they always become "bogus" customers after filing bankruptcy) won the race, i.e. the customer filed for bankruptcy before the dealership could repossess the vehicle. However, not knowing about the just filed bankruptcy, the dealership repossessed the vehicle. The question is, "Do I have to give it back?" or some variation thereof like, "Can I make them pay my repo fee before giving it back?" or "Can I make them wait on it?" or "Can I carry it to Alaska and tell the customer to go pick it up there?" After a few minutes of explanation and agreeing to their insistence that the bankruptcy process is not fair, they generally agree to return the vehicle to the customer/debtor.

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President's Message

Michael Charapp

A priest, a rabbi, and a lawyer are traveling in a power boat. The motor dies, and sharks start circling. The priest and rabbi are very nervous sitting in a dead boat while sharks circle, but the lawyer is cool. The priest and rabbi ask about the lawyer's demeanor, and the lawyer has a simple answer – "professional courtesy."

Another lawyer told me this joke. Most of the good lawyer jokes I've heard have been from other lawyers. For years, Jewish comedians have made jokes about Jewish people that aren't funny when Mel Gibson tells them. African American comedians have made jokes about African American people that aren't funny when Michael Richards tells them. Life is like that. We can make jokes or comments about members of a group to which we belong, but we find them offensive if an outsider, especially an outsider who we think doesn't like our group, makes them.

With that background, you'll understand why I found offensive a statement in a recent letter to the editor of *Automotive News*. It seems that *Automotive News* had an article about the latest events in Chrysler's escalating mistreatment of its dealers. Like the other members of the domestic three, Chrysler likes to blame its problems on its dealers. Those of us who represent dealers in franchise matters have become used to Chrysler's heavy handedness. We've suffered with our clients through Chrysler's demands for site control to approve changes that should be perfunctory. We've counseled our clients through Five Star and VPA manipulation and the return of the sales bank.

When Chrysler recently announced it would exclude from its used car auctions dealers who didn't make the sales targets dreamed up by Chrysler, followed by termination threats to approximately 200 dealers because they didn't make the same arbitrary numbers, things boiled over in an *Automotive News* story. I was quoted along with other dealer lawyers who have experience dealing with Chrysler.

Our restrained comments were met with a letter published by *Automotive News* from a Chrysler PR executive explaining how Chrysler just wants to provide helpful advice, and most dealers love Chrysler's programs, so the article must have been stirred by some "lawyers looking to make their next buck." When I'm with lawyers who joke about being driven by the "buck," I can laugh. Here's a story a lawyer recently told me: A lawyer parks his new Mercedes, and as he opens the driver's door another car speeds by and rips off the door. "My new car!" the lawyer yells. A bystander sees this and says, "You lawyers are so materialistic, you didn't even see that the car also ripped off your arm." "Oh no," screams the lawyer, "my Rolex!" Not a bad joke from another lawyer. When I hear such things from a paid publicity hack – er, PR executive – for a manufacturer mistreating its dealers, however, I'm offended.

Practice law long enough, and one gets used to being insulted, maybe even thick skinned. Insults are a regular occurrence. Usually I ignore them. Sometimes, however, I dream of the day I can work over the insulter on the witness stand. Life seldom gives one that chance.

However, I am not so sure that it won't happen with the Chrysler PR type. The way Chrysler is going, there is bound to be litigation brewing. And in the course of that, Chrysler's dealer policy just may come up because, according to the PR type, Chrysler's threats are really meant to be helpful advice. A lawyer whose client is facing termination may find it useful to have the PR type testify to show that the dealer's termination is not only contrary to public policy, it's contrary to friendly Uncle Chrysler's own policy. After all, it was in *Automotive News*.

Like I said, those opportunities really don't present themselves in life. But maybe, just maybe, it will present itself to one of the NADC attorneys. I hope to be around, as I suspect a lot of other NADC members hope, to offer helpful suggestions for that examination.

Michael Charapp, President of the NADC, is a partner with Charapp & Weiss, LLP in McLean, VA.

Upcoming Events

NADC Fall Workshop
October 15 and 16, 2007
The Hermitage Hotel, Nashville
See program information on page 4.

4th Annual Members Conference
April 6 to 8, 2008
Ritz Carlton, St. Louis
Information will be posted as it develops
www.dealercounsel.com

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attempt by dealer to rescind the contract because of an inability to assign the contract to one of its financial institutions. Instead, the proceeding involved an attempt by customer to rescind the sales transaction based upon an alleged breach of contract and negligent misrepresentation by dealer concerning the "towability" of the vehicle.

The matter proceeded to arbitration because of a mandatory arbitration clause in the sales contract. The arbitration clause provided, in part, as follows:

> Each party shall be responsible for its own attorney, expert and other fees, *unless awarded by the arbitrator under applicable law* (emphasis added).

The arbitrator used the last part of this arbitration clause as the foundation to support an award of attorney's fees to the customer.

The arbitrator rejected the argument made by dealer that the phrase "unless awarded by the arbitrator under applicable law" was limited to situations where a statute provided a basis for an award of attorney's fees to the customer. The arbitrator also rejected the argument that the attorney's fees clause in the Rescission Rights section of the contract was narrowly limited by its terms to a specific situation that did not occur, rescission by dealer within 10 days of execution of the contract, and had no application to a rescission action by the buyer.

The arbitrator noted in his arbitration award that dealer's position would be well-taken under the decision in *Sciarotta v. Teaford Construction Co.* (1980) 110 Cal.App.3d 444. There, a standard form building contract provided fees to the builder if forced to sue for the contract price. The case was brought by the owners for breach of the agreement to build a house in "a substantial and workmanlike manner." Prevailing plaintiffs argued that if the builder had sued to enforce the only part of the contract benefiting it and prevailed, it would have been entitled to fees and that to achieve equality, owners who sue to enforce the only part of the contract benefiting them should also be entitled to such fees and argued Civil Code §1717 should be interpreted accordingly to cover any action on the contract. Civil Code §1717 provides that in any action on a contract "where the contract specifically provides that attorney's fees and costs, which are incurred to enforce the contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, *whether or not he or she is the party specified in the contract or not*, shall be entitled to reasonable attorney's fees in addition to other costs" (emphasis added). The court rejected plaintiff's argument, limiting Civil Code §1717's reciprocity provision to the specific provisions of the contract for which attorney's fees were provided. 110 Cal.App.3d at 450-51.

The arbitrator held that the result in *Sciarotta* was essentially what dealer was arguing in this case — a limitation on attorney's fees where a dealer is unable to assign the contract as required to rescind and repossess the vehicle. *Sciarotta*, however, the arbitrator held is no longer the law. The Legislature (apparently agreeing with the dissenting justice who lamented that the majority's ruling permitted the party with superior bargaining strength to thwart the salutary purposes sought to be achieved by Civil Code §1717) amended Civil Code §1717 in 1983 to provide:

> Where a contract provides for attorney's fees, as set forth above, that provision shall be construed as applying to the entire contract, unless each party was represented by counsel in the negotiation and execution of the contract, and the fact of that representation is specified in the contract (emphasis added).

Here, according to the arbitrator, dealer protected itself with the right to attorney's fees in the only circumstance where it was likely to rescind the contract (otherwise, the contract would be assigned to a lender and dealer would have no further occasion for rescission). The buyer, however, was not accorded a parallel right to attorney's fees in circumstances where buyer would likely seek to rescind the contract.

The arbitrator then discussed a number of recent California decisions which he believed supported his position.

In *Kangarlou v. Progressive Title Co.* (2005) 128 Cal.App.4th 1174, escrow instructions provided, [i]n the event of failure to pay fees or expenses due you [escrow company] hereunder, on demand, I agree to pay attorney's fees and costs incurred to collect such fees and expenses. A home buyer sued the escrow company for breach of fiduciary duty a matter unrelated to the payment of escrow fees, and prevailed On appeal, the Appellate Court held that because the fiduciary duty arose from contract, the action was "on the contract." Based on the amendment to Civil Code §1717, meaning that "parties may not limit recovery of attorney's fees to a particular type of claim, such as failure to pay escrow costs," the court found the plaintiff entitled to fees and reversed the trial court. 128 Cal.App.4th at 178-79.

In *Harborview Hills Comm. Ass'n. v. Torley* (1992) 5 Cal.App.4th 343, a homeowner's association's 1971 CC&Rs provided for recovery of attorney's fees by a prevailing party only with respect to non-payment of

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NADC Fall Workshop
October 15 and 16, 2007
The Hermitage Hotel, Nashville

Join your colleagues in Nashville in October for in-depth presentations on critical issues affecting dealerships. The workshop is open to NADC members. The registration fee is $375 and includes the reception, breakfast, breaks and lunch. CLE credit is available for the 5.5 hours of presentations.

Call the Hermitage Hotel at 888-888-9414 by September 12 to reserve a room at the special workshop rate of $209 plus tax.

Register now at **www.dealercounsel.com**, and check the website for complete program information.

Agenda

October 15

3:00 pm — Board Meeting

6:30 to 8:00 pm — Reception, Sponsored by Compli

October 16

7:45 to 8:45 am — Breakfast, Co-sponsored by Cameron Worley Fordham PC & Tennessee Automotive Association

8:45 to 9:00 am – Opening Remarks

9:00 to 11:00 am – F&I Update - Update on F&I Compliance Issues

- Mike Charapp - Charapp & Weiss, LLP, McLean, VA
- Rob Cohen - Auto Advisory Services, Inc. , Tustin, CA
- Anne Fortney - Hudson Cook, LLP, Washington, DC
- Rick Kahdeman - Kahdeman, Nickel & Frost, Westlake Village, CA

11:00 to 11:15 am – Break

11:15 am to 12:15 pm – Privacy - Traversing the Information Security Minefield: Best Practices in Dangerous Territory

- Michael Benoit - Hudson Cook, LLP, Washington, DC
- Mike Shanahan - Stewart & Irwin, P.C., Indianapolis, IN

12:15 to 1:15 pm – Lunch, Sponsored by CNA National Warranty Corp.

1:15 to 2:45 pm – Service & Environmental

- Donn Wray - Stewart & Irwin, P.C., Indianapolis, IN
- Doug Greenhaus - NADA, McLean, VA

2:45 to 3:00 pm – Break

3:00 to 4:00 pm - Telecommunications

- Aaron Jacoby - Venable LLP, Los Angeles, CA

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Occasionally, a person who needs to make that call does not. That is when the fun begins.

When such a client later asks me to defend them in a case alleging a violation of the automatic stay, I generally expect that the client will be cooperative in the defense. I certainly do not expect the client to make its defense even harder than it needs to be. Precision Auto Sales is not one of those clients.

The case of *In re Johnson*, 2007 WL 2274715 (Bankr. N.D. Ala. 2007), started when Harold Johnson bought a 1996 Buick Century from Precision Auto Sales in February 2006. On July 20, 2006, he filed a Chapter 13 bankruptcy proceeding. The debtor listed Precision as a creditor and provided an address for Precision. The address provided was for an unmanned location which happened to be the same address where he made his payments and that was listed on receipts provided by Precision. Precision then repossessed the vehicle, without seeking relief from the automatic stay, on September 9, 2006 the day after Johnson made his first payment to the bankruptcy trustee. Precision refused to return the vehicle even after being notified of the bankruptcy. Instead, it sent a certified letter demanding payment of $2,739.22 before it would release the vehicle.

Five days after the vehicle was repossessed, Johnson filed a Complaint for a violation of the automatic stay. Johnson then filed a motion for a temporary restraining order. Precision was given notice of a hearing on that motion but failed to appear for the hearing. On September 21, the court granted the motion and entered a restraining order. A copy of the order was served on Precision on September 23. It kept the vehicle until October 26, 2006, before it finally let Mr. Johnson have the vehicle back.

The bankruptcy court confirmed Johnson's Chapter 13 plan on October 3. The plan included payments to Precision. Johnson made all required payments both before and after that date.

According to the court, Precision has two locations. One was the business office and one was the unmanned location. The locations are less than 0.5 miles apart or, as the court said, they "were only around the block."

A trial was held on April 26, 2007. The court's opinion sheds light on the difficult position that Precision's attorney found herself in:

> M. Charlie Smith who, was not formally introduced to the Court, is apparently either the principal of the defendant corporation or its owner. Mr. Smith has not attended any of the hearings on this matter and did not attend the trial on April 26, 2007. In regard to the trial, counsel for the defendant explained that "Mr. Smith wasn't able to make it this morning." That explanation did not include that Mr. Smith was ill, had a more pressing appointment, had a serious problem, or had a family matter. It was only that he "wasn't able to make it this morning." (emphasis in original).

Apparently, Precision's unfortunate attorney had to argue, without any proof from Mr. Smith, that the notices were sent to the "wrong" location, that Precision had no knowledge of the bankruptcy when the repossession occurred and that, upon receipt of proper notices, Smith "straightened out the matter." Because Mr. Smith did not bother to appear, the Court inferred from his failure to testify that he would not have been able to support these contentions and would not have been able

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to refute the debtor's testimony.

After hearing the testimony of the witnesses who were present, the trial judge concluded that: 1) Mr. Smith was responsible for having the vehicle repossessed; 2) he learned about the bankruptcy no later than the date that the vehicle was repossessed; 3) he was told again about the bankruptcy two days after the repossession; 4) one of his employees accepted service of an amended complaint; and 5) he kept the vehicle for 45 days after the repossession claiming that he did not know about the bankruptcy.

Mr. Johnson testified that he worked for the U.S. Postal Service. His shift was from 2:15 a.m. to 10:45 a.m. Because of the repossession, his wife had to drive him to work every morning. She then would go home, get her children ready for school and then go to her own job. The debtor would return home by catching a ride on a mail truck that went near his house. He would then walk the rest of the way home. The lack of a car caused him to lose days at work and overtime.

When the vehicle was repossessed it contained a cellular phone, $300 in cash, personal clothes, and personal papers. The day that the vehicle was repossessed, Johnson called Smith and told Smith about the bankruptcy. Smith replied that "he didn't run his cars like that." A few days later, Johnson and his attorney called Smith. Smith told both of them that "he didn't run his cars like that." Once Johnson was finally able to regain possession of the vehicle, the windows had been left down, the inside was wet and all of his personal property was missing. His personal property was never returned to him.

Johnson proved a total of $1,100 in damages: $800 in lost wages and $300 in lost cash. He offered no proof as to his attorney's fees or the value of the other lost personal property. The court granted a judgment of $1,100 in compensatory damages. The court found that Precision had willfully violated the automatic stay and imposed an additional $5,500 in punitive damages.

All in all, Precision is probably lucky. Johnson did not prove all of the damages he claimed. If he had, the compensatory damage and punitive damage amounts almost certainly would have gone up substantially. The Judge, confronted with a creditor who repeatedly ignored the court, the law, good sense and apparently even its own attorney, probably could have imposed a much tougher punitive damage penalty. The next time that Precision has a customer file a bankruptcy case that is assigned to this judge, Precision would be well served to take extra steps to be sure that it complies with all of its obligations. The unfortunate attorney who represented Precision this time may want to think twice about answering the phone next time. I hope that she was at least paid in full for her effort.

Jeff Ingram is a shareholder in the firm of Galese & Ingram, P.C. actively representing dealers in Alabama and Mississippi. He has been involved in the car business for 30 years and representing dealers for 15 years.

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The NADC website www.dealercounsel.com is an importaqnt source of information for members:

- *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*

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assessments. In 1989, the homeowner's association successfully sued a homeowner for unapproved exterior alterations. The court held that the 1983 amendment to Civil Code §1717 was intended to and did overturn *Sciarotta*, and manifested a clear intent "to provide complete mutuality of remedy where a contractual provision makes recovery of attorney's fees available to one party." 5 Cal.App.4th at 348-49. The court further held that the amendment to Civil Code §1717 applied retroactively to the CC&Rs in question.

In *Frank M. Booth, Inc. v. Reynolds Metals Co.* (E.D. Cal 1991) 754 F.Supp. 1441, decided under California law, buyer and seller exchanged forms that did not agree on all terms of the contract. Each party's form permitted it to recover attorney's fees in specified circumstances. The court held that the contract consisted of the terms on which the forms agreed and that the conflicting attorney's fees clauses were converted by Civil Code §1717 "into a clause permitting the prevailing party to recover attorney's fees for any dispute on the contract." 754 F.Supp. at 1448.

Thus, according to the arbitrator, it was clear from these decisions that the courts in California interpret the amendment to Civil Code §1717 as standing for the proposition that if an agreement provides for attorney's fees for any dispute under the contract, then the agreement will be deemed, as a matter of law, to provide for attorney's fees for all disputes under the contract.

The moral of the story is that unilateral contractual attorney's fees provisions are not allowed in California, and the amendment of Civil Code §1717 makes the right to attorney's fees under any part of a contract applicable to all disputes under that contract. The risk of exposure for a customer's attorney's fees in a rescission action far outweighs any benefit a dealer may hope to obtain by including an attorney's fees provision in its Rescission Rights section of its sales contract. The way to avoid the result in the San Diego arbitration (where the customer's attorney's fees were far more substantial than the damages sought or recovered in the lawsuit) is either to eliminate the right to attorney's fees completely in the sales contract or to limit the right to recover attorney's fees to some nominal sum such as $500.

Lane E. Webb is Managing Partner of the San Diego office of Wilson, Elser, Moskowitz, Edelman & Dicker, LLP. Lane is a member of the National Association of Dealer Counsel and devotes a large portion of his practice to the defense of claims against automobile dealerships in California.

Alan E. Greenberg is an Associate in the San Diego office and is a member of Lane Webb's Litigation Practice Group. Alan has over 25 years of litigation experience and also has had extensive experience in the defense of claims against automobile deal-

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