DEFENDER
The NADC Newsletter

The Changing Face of Asset Purchase Agreements

Erin Tenner, Esq.

Erin Tenner

I have been representing automobile dealers for over 20 years. In that time I have handled over 200 buy/sells, the majority of which were asset sale and purchase agreements. I have always focused my practice on trying to keep dealers out of litigation and, at least as far as I know, I have been very successful in that regard. I have only been asked to testify twice in automotive buy/sell litigation, both times in depositions, once on behalf of a client (who sued and won) and once as an expert witness. When I first started doing work for auto dealers in 1985, no one ever asked for a phase I environmental report; due diligence was not much more than a building inspection and a spot check of information on a financial statement; and sexual harassment claims were rarely lodged against auto dealers.

Within my first 10 years of practice, everything changed. Underground storage tanks were leaking across the country and mandatory clean up had begun. Suddenly, everyone was worried about contamination and environmental liability. Next came the Clarence Thomas confirmation hearings in 1991 alleging the then, yet to be confirmed, Supreme Court Justice had made comments about a pubic hair on a soft drink can and soon a flurry of sexual harassment lawsuits against dealers were being filed.

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Sidebar

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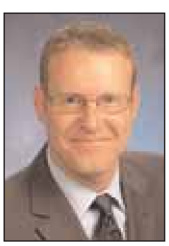
Three Former Car Salesmen Indicted in Alleged Auto Lease Fraud Case

Rob Cohen, Esq.



Rob Cohen

Sometimes it's a good idea to remind our clients that compliance is more than just a formality. Nothing makes this point better than criminal prosecutions against dealership sales personnel.

The Los Angeles County District Attorney's Office issued a press release on April 10, 2008 regarding felony indictments against three former "assistant sales managers" of a large L.A. County dealership.

The press release states that in 2004 and 2005, the indicted individuals were engaged in a practice whereby they "persuaded customers to lease, rather than buy vehicles." The DA's Office further alleges that "Misrepresentations, including the amount of monthly payments in a purchase, were made to consumers who wanted to buy vehicles in order to steer them to the higher-cost lease agreement."

Two of the salesmen were charged with four counts each of grand theft of personal property. The third salesman was charged with one count of grand theft of personal property. Each defendant was taken into custody and released on bail. All pleaded not guilty.

California attorneys may recall a DMV raid that took place in 2005 and was reported by Joel Grover of Channel 4

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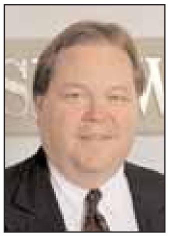

Michael Charapp

The Five Stages of Dealer Litigation Grief

In her 1969 book, *On Death and Dying*, Elisabeth Kübler-Ross explained the Five Stages of Grief. They were so descriptive of the human experience that they are now the standard for discussing the process of grieving.

I was thinking about Ms. Kübler-Ross' model recently when I settled a case for a car dealer. Months earlier I had recommended that he accept a lower demand. At that time I described for the dealer the process he would go through during the case. He argued that he had to litigate the case. After months of attorneys fees, disruption in his dealership, personal anguish and damaging discovery, litigating the case lost its priority.

Car dealers themselves have "stages of grief" when they are sued. Not every car dealer, of course, since some understand that handling legal matters is simply a part of doing business, like earning good CSI, or achieving 100% sales effectiveness or setting sound trade values. When a dealer has the right person handling the matter, the chances of a successful outcome multiply. There are, nevertheless, even in these litigious times, dealers who have not come to accept that reality. Those dealers go through the five stages of car dealer litigation grief when they are sued:

1. Shock. The first time or two that a dealer is sued, the immediate response is shock. The plaintiff's lawyer is a shark, a charlatan, a thief and a liar. I have frequently heard from dealers some variant of the following: "I have been in business ____ years (fill in the blank); this has never happened to me. We are honest and fair. We bend over backwards for our customers. Can't I just call the judge to explain this so that he will drop the lawsuit?" These dealers believed the high school civics lessons that trials are a search for truth and justice. They have not been hardened to the reality that an experienced plaintiffs' lawyer files suits for one primary purpose – not to solve the client's real problem, but to enrich the experienced plaintiffs' lawyer.

2. Denial. After the initial shock, what follows is a series of denials. "There is no way my salesperson failed to disclose the vehicle was damaged;" "the customer knew the condition of the vehicle;" "the customer understood the financing terms;" etc. During stage two, the dealer will not concede any truth to the plaintiff's claims.

3. Anger. When anger sets in, the sky is the limit for what the lawyer should do to vindicate the dealer. I have never had a dealer tell me that he or she will pay me whatever I want to defend a case. Car dealers are too smart for that. But when dealers enter the anger stage, they make very clear they expect no stone left unturned in defending against the unjust legal onslaught.

4. Realization. This is the legal equivalent of the Bataan death march. This is the grueling period between the case going to issue and the trial where many dealers come to regret their earlier stages. This is where a dealer learns that perhaps some of the things plaintiff alleges may have happened. Or that they happened in other transactions. Or that the salesperson involved was terminated because of dishonesty. Or that the F&I person stole money from the dealership. Most often, however, it simply sinks in that the dealership is spending money on its attorneys fees, its employees are busy responding to discovery, productive people have to spend their time in depositions, and its key people have to be available for trial, which is the last place they want to be.

5. Acceptance. After going through the other stages, dealers often come to the point of acceptance. The dealer recognizes the weaknesses in the case that you saw early on. The possibility of further disruption to their employees and to themselves, the possibility of a significant award even after all they have been through, and the specter of paying the plaintiff's attorneys fees lead the dealer to settle the case and to implement changes to maximize the chance that similar future claims will not arise.

The stages of dealer litigation grief are so common that I have come to warn dealers about them. And not just when dealers are defendants in a case. They also go through similar stages when they are plaintiffs in a case. I cannot count the number of times dealers have come to me outraged about some action by a consumer, or by the government, or by a manufacturer, absolutely sure that they are ready for anything that will be thrown at them. The plaintiff dealer, like other plaintiffs, enters a case full of vigor and a desire to fight. After months, that iron resolve often dissipates, and the dealer can come to regret the decision to take on an adversary.

This is not to say that dealers should ignore their rights. When facing professional plaintiff attorneys, dealers are right more often than they are wrong in my experience. Sometimes they need to stand up to prevent future shake downs. Sometimes they need to stand up to establish a point, even though it may be expensive.

What I am saying is that our jobs as lawyers from the early part of a case is to be sure dealers are prepared for the ordeal and understand why they are in litigation. We must be prepared to counsel dealers in the five stages of litigation grief. We must warn them that employees who are key witnesses may leave their jobs, sometimes under difficult circumstances. Dealers must understand that there may be disruption in the dealership, and there may be personal upset for the dealer.

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Avoiding Hidden Finance Charges

Rob Cohen, Esq.

Perhaps the most common Truth in Lending Act (TILA) violation I see (or hear about) is the imposition of a hidden finance charge upon a customer. Finance charges can only be imposed upon customers if properly disclosed pursuant to Regulation Z.

Regulation Z defines a finance charge as "the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a *condition* of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction." (12 CFR § 226.4) (emphasis added)

Certain actions at the dealer level can convert an otherwise legitimate charge into an undisclosed finance charge. For example, comments such as these can conceivably convert the cost of a service contract into an undisclosed finance charge and, therefore, violate TILA:

1. "The bank requires you to buy a service contract."

2. "The bank won't give this rate unless the payment is protected with a GAP contract."

Similarly, raising the selling price of a vehicle to accommodate a bank fee (commonly incurred on sub-prime deals) or to absorb a buy-down charge also violates TILA insofar as the amount by which you raise the selling price may be construed as a hidden finance charge.

Speaking of buy-downs, we often get calls from dealers asking if buy-downs are legal. Rates which are the result of a dealer's buy-down are permissible so long as the fees are absorbed by the dealer as a cost of doing business. Passing the fees along to the customer can be very problematic.

In order to pass the cost along to a customer, the buy-down charge must be separately itemized as either a prepaid or administrative finance charge (assuming state law even allows for that), and must be included in the APR and total finance charge calculations within the TILA disclosures (i.e., the "fed box"). Unfortunately, dealers' DMS systems are not likely programmed to accommodate this type of finance charge (and finance companies probably won't accept the paper even if they did).

If such charges are passed on to the customer (either blatantly on an accessory line or subtly through an increased selling price) without including the proper disclosures, then the amount is a hidden finance charge and, therefore, a TILA violation.

Lesson learned: Interest rates or financing itself cannot be made contingent on the purchase of finance products or accessories. And, bank fees or buy-down charges cannot be passed along directly to customers.

Rob Cohen is President of Auto Advisory Services, Tustin, CA, First Vice President of NADC and Editor of Defender, The NADC Newsletter.

Salesmen Indicted ...
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News (KNBC Los Angeles). This raid marked the beginning of a 2 1/2 year DMV investigation and ultimately culminated in these indictments.

It is important to note that no charges were brought against the dealership itself. The dealership released the following statement that was posted on KNBC's website.

When these allegations surfaced more than two years ago, we pledged full cooperation to the DA's Office and have been working with them.

Our written disclosures to customers comply with the law and are clear. Any customer that reads his or her documents will understand precisely what he or she purchased and the price paid.

We sell well over 8,000 vehicles every year and are extremely proud to have tens of thousands of satisfied customers. The charges filed by the DA pertain to 9 deals.

The three individuals who were charged are each represented by their own individual counsel, and in America they are innocent until proven guilty. The legal process will move forward and it will be up to a jury to determine whether the charges filed against them have any merit.

Rob Cohen is President of Auto Advisory Services, Tustin, CA, First Vice President of NADC and Editor of Defender, The NADC Newsletter.

New Members

NADC welcomes the following new members:

Full Members

Matthew P. Stone
Freeman Mathis & Gary, LLP
Atlanta, GA

Robert D. Tingey
Larry H Miller Group
Sandy, UT

Fellow Members

Mayabanza S. Bangudi
Hudson Cook, LLP
Hanover, MD

Karen E. Leonard
Hudson Cook, LLP
Washington, DC

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I remember John Campbell coming to visit our law office to inquire about taking his dealership public, long before AutoNation or any other publicly traded dealerships existed in the United States. Not long after that, the first publicly traded auto dealership was approved in the U.S. Within a few years, provisions started appearing in contracts that arose out of a completely separate set of standards required by publicly traded companies due to their disclosure and reporting requirements (or so they said). The same provisions, many of which had no relevance at all to an asset purchase, started appearing in contracts drafted for non-publicly traded companies.

Although much has changed over the past 20 years, and contracts can no longer be as simple as they once were, many of the provisions being requested in asset purchase agreements are just not warranted. This article, without being comprehensive, will address some of those provisions that are not necessary to an asset purchase agreement and some of those that are essential. I will also address the benefits of having specific language in certain circumstances.

First and foremost, most attorneys who represent auto dealers understand that a "franchise" cannot be transferred pursuant to the terms of an asset purchase agreement. This is because the dealer sales and service agreement, sometimes referred to as the franchise agreement, prohibits transfer of the "franchise," and it is not a true "franchise," at least under California law. States may differ, but under California law, by definition, to be a franchise a fee must be paid to the franchisor for the franchise. Since auto dealers do not pay a fee, they only pay for product, the franchise laws do not apply.

This distinction is important because manufacturers will not accept an agreement that provides for transfer of the franchise, yet the buyer needs to make sure it gets all rights that the seller had to the dealer sales and service agreement or "franchise" to discourage the seller from withdrawing from the agreement prior to receipt of a decision by the factory. Often an asset purchase agreement will contain only a condition that the buyer must have obtained factory approval. The condition alone is not enough to give a buyer any rights if the seller decides not to go forward. It alone is also not enough to protect the seller so the seller can quickly move to the next deal if approval is not forthcoming. The agreement should provide that it can be terminated by either party if the condition fails. Without that, the parties could be left in limbo.

For instance, what happens if the seller decides he does not want to sell prior to factory approval? If the seller backs out, how does the buyer enforce his right to purchase when no factory approval has been obtained? If the buyer sues the seller, the factory would also have to be named. The agreement would need to provide that buyer had more than just a condition to its obligations in order to enforce the agreement against the seller and the factory. Some helpful provisions would be: 1) That seller has agreed that the buyer is entitled to all franchise rights, if any, that seller has so that buyer can prove to a court that it has the right to the "franchise"; 2) That seller agrees to terminate its franchise; and 3) That seller agrees to use best efforts to assist the buyer in obtaining factory approval. The "if any" language in item one above may be necessary in order for the language to be acceptable to the factory.

Another important provision for the seller is a drop dead date in case factory

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approval has not been obtained. If the provision is left vague with only language to the effect that the closing shall take place on or before a certain date, but without specifying what happens if the deal has not closed by that date, the parties can find themselves in a situation in which the closing date has passed, and neither party has the specified right to terminate the agreement. If the agreement says it automatically terminates, but the parties continue to proceed as though it has not terminated, a later attempt to terminate the agreement may be challenged on the grounds that the agreement does not give either party the unilateral right to terminate. While that issue is being litigated, the seller cannot sell to a third party. If the agreement specifically states that either party shall have the right to terminate the agreement if closing has not occurred by the closing date stated in the contract, the likelihood of a lawsuit over the issue will be significantly reduced.

I was surprised recently to hear an attorney assert that a provision stating that the closing date could only be extended by a writing, did not require that the writing be signed by the parties, even though a standard modification provision in the same contract said all modifications needed to be in writing and signed by the parties. The reasoning was that the standard provision, which provided that all modifications to the contract must be in writing signed by the parties was specific in that regard. Since the paragraph about closing did not specifically say the writing had to be signed by the parties, the argument was that the writing could be an e-mail or other unsigned writing. Frankly, I thought the assertion was absurd, especially in light of California law (Civil Code Section 1641), which provides that the contract should be read as a whole, but it is better to be safe by specifically stating in your contracts, wherever you reference the requirement of a writing, that the writing must be signed by the parties, than to risk litigation over the issue.

Warranties and representations and due diligence provisions always require extra scrutiny. When representing a seller I will always recommend that instead of making lengthy warranties and representations, they only warrant and represent as to their knowledge with respect to certain facts, that "knowledge" be specifically defined so that it does not encompass the knowledge of every employee of the seller, but only two or three who really do have knowledge of what is going on, and that those two or three employees also sign a document confirming to the seller that they have been asked and have no knowledge, or if they do, the extent of their knowledge, with respect to any warranty. This document does not have to include an indemnity provision, because most dealers would not want to impose such a burden on employees, but it will provide some protection to the dealership from claims that it had knowledge if something arises later on.

Giving the buyer the right to perform a thorough due diligence with respect to assets being purchased or leased protects the seller from claims of breach of warranty or misrepresentation. However, a financial disclaimer should also be included to make clear that the seller is not making any warranty or representation as to buyer's ability to attain the same level of financial success as the seller and that the financial statements attached to the agreement fairly represent the financial condition of the seller. To warrant and represent that they are accurate is asking for trouble since people often make mistakes even on financial statements. If the net effect of a mistake does not significantly change the overall financial condition the seller should have no liability.

When representing a buyer it is best to recommend that the buyer conduct a thorough due diligence. With modern technology a buyer can get direct access to a sell-

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er's computers (if the seller is willing to permit this). If a buyer is given such access it would difficult for the buyer to later succeed in a claim that information was withheld. Due diligence should be designed to protect both the buyer and the seller. Due diligence should include all of the following: 1) Environmental due diligence, which needs to go beyond a Phase II and allow for additional testing, sometimes referred to as a "Phase III," if contamination is found to exist; 2) A building inspection, which should only be conducted by a qualified structural engineer who is also able to test the electrical circuitry, plumbing and HVAC; 3) Financial due diligence, the purpose of which should be to verify that asset values are accurately stated on any financial statements on which the buyer has relied for purposes of valuing goodwill and verification that security interests in assets being purchased have been released.

Because of the manner in which environmental due diligence has evolved, more flexibility needs to be built into purchase agreements to ensure the buyer has the rights it will need to make a decision about whether to go forward in the event contamination is discovered. This can include an agreement that the seller will pay for any remediation required up to a maximum dollar amount and that the deal will go forward unless the remediation cost will exceed that amount. Still, ascertaining the cost of remediation can be time consuming and unreliable. There was a time when no one wanted to go near a contaminated piece of real estate. However, with the high price of dealerships these days, small scale contamination that is contained and ascertainable may be worth the cost of assuming to close a deal. There are many ways to frame an environmental remediation provision, but most important is making sure the issue is addressed in the agreement and that the agreement specifies what will happen if contamination is found to exist.

Building inspections are often performed by people wearing the inspector hat, but who have no understanding of structural engineering. Imagine a scenario in which a seller does not realize the extent to which his building has been damaged by earth movement. The seller gives warranties and representations that he is not aware of any structural issues with the building and he truly is not. The buyer has an inspection by an inspector who is not a structural engineer and does not realize that the slight slant in the floor is a big red flag. The building passes inspection and the deal closes. The buyer is now sitting on a land mine. If the building falls down, the injury to people and property could be devastating. If the buyer discovers the problem before the building falls down, he still has to tear down the building and rebuild, causing enormous disruption to the buyer's business and expense. Plumbing, electrical and HVAC inspections are also important, but none of those will be as devastating as an unsound building.

Financial due diligence should not extend beyond the assets being purchased or leased by the buyer. For example, the seller's corporate maintenance is irrelevant to the buyer in an asset purchase. The buyer will want to see a good standing certificate prior to closing, will want a certification as to who the officers are and a certification that a resolution was adopted approving the purchase, but beyond those few items, the corporate documents have no bearing at all on an asset purchase. One large publically traded group throws everything, including the kitchen sink into an asset purchase agreement. I have seen other attorneys pick up those provisions from time to time, but the fact that people ask for them does not make them relevant to the deal. If a seller is giving a warranty and representation that it owns the assets it is selling, the warranty and representation should suffice for purposes of making certain assets are owned by the seller. If there is a legitimate concern that the seller cannot back up its warranties and representations because it will not be financially sound after closing, a personal guaranty of those obligations can be requested.

In addition, confidential employee information should never be disclosed to a buyer without employee consent. I can not tell you how often I see attorneys allowing their clients to disclose confidential employee information. The argument I usually hear when I tell someone my client will not release employee records without consent is that there is an exception to the privacy law for transactions. I have never seen such an exception, nor would that matter to me because it was unlawful to release confidential employee information long before the federal and state privacy laws ever passed. When an employee is interviewing for a job the prior employer can only release information with the employee's consent. The same is true in an asset purchase transaction. A buyer in an asset purchase may or may not hire all the employees of the seller. The buyer can interview employees and ask them for a release of their employment records. If the employee signs a release and waiver, the records can be released. Allowing a seller to release records without the prior written consent of the employee exposes the seller to litigation by any employee whose information was released without their agreement.

There is a lot more to an asset purchase agreement than is discussed here. I could probably fill a book. If you want to keep your clients out of litigation, the best way to do that is to make sure your agreement is clear. Even something as seemingly innocuous as giving "full access to books and records" because the buyer wants to see them can wreak havoc if the seller intended to give full access only to books and record relevant to an asset purchase. If the seller wants to keep corporate records, tax returns and policies and procedures confidential, the provision could be clarified to specify which books and records will be subject to review, e.g., "all books and records reflecting asset values, obligations of seller to be assumed by buyer and such other books and records to which buyer will have access after closing." The section of the agreement dealing with transfer of records should likewise be limited to customer lists, sales and service records and records specifically pertaining to the value of assets purchased by buyer or any maintenance of any such assets.

If all else fails and you end up in litigation, consider mediation. Even the most difficult disputes can be resolved by a good mediator.

Erin Tenner is a partner at Tenner Johnson, LLP and a member of NADC. Erin is available as a private mediator and expert witness. She can be reached at 818-707-8410 or toll-free at 888-501-0040.

CLE Credit

The table shows CLE credit for the annual conference. Not all states accredit programs. We applied only to states requested by registrants, and all those states approved the conference for CLE credit.

State	Credit	State	Credit
Alabama	10.80	Nevada	10.50
Colorado	13.00	New Mexico	10.70
Florida	13.00	North Carolina	10.75
Georgia	10.80	Ohio	10.75
Illinois	10.75	Oklahoma	13.00
Indiana	10.80	Pennsylvania	10.50
Iowa	10.75	Tennessee	10.75
Kansas	11.50	Texas	10.75
Louisiana	10.75	Virginia	11.00
Minnesota	10.75	West Virginia	12.90
Mississippi	10.80	Wisconsin	12.50
Missouri	12.90		

President's Message ... from page 2

The task is to have the dealer pinpoint what he or she is trying to do at the outset – whether it is to establish a precedent, to protect against future shake downs, to stand up for the dealer's rights, or any of a number of other legitimate reasons for being in litigation. But don't kid yourself. Car dealers live in a "today" world. How many ups did we have today? How many deliveries did we have today? How many ROs did we write today? They do not live in a world where matters drag on for months or maybe years. During those months and years, people change, and circumstances change. From the beginning of litigation, dealers need to be prepared for what those changes will mean for them months or years later. That way dealers can either turn their attention to other business matters, or they can choose to litigate with a full understanding of what they are experiencing as they go through the five stages of dealer litigation grief.

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

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Rob Cohen, Editor
rob.cohen@autoadvisory.com
Trudy Boulia, Assistant Editor
tboulia@harveyandmumford.com
Defender, The NADC Newsletter is published by the National Association of Dealer Counsel
7250 Parkway Drive, Suite 510
Hanover, MD 21076
410-712-4037
Fax 410-712-4038
www.dealercounsel.com