NADC
National Association of Dealer Counsel

DEFENDER

The National Association of Dealer Counsel Newsletter DECEMBER 2010

In this Issue:

Save the Date
April 3-5, 2011

7th Annual NADC Member Conference

Trump International Hotel & Tower
Chicago, IL

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Executive Director's Message

Erin K. Hussey
NADC Executive Director

This issue marks the final 2010 publication of The Defender. We have already started to solicit articles for 2011. We encourage all members to share their knowledge and expertise with the NADC community by submitting an article to be published in The Defender. Please contact me at ehussey@dealercounsel.com or Editor Mike Charapp at mike.charapp@cwattorneys.com for more information.

Another way to keep up with the ever changing landscape of the auto industry is to attend the educational sessions at NADC meetings. The elite access to the industry's most knowledgeable and successful attorneys is unparalleled. Plan now to attend the 7th Annual NADC Member Conference, April 3-5, 2011 at the Trump International Hotel & Tower in Chicago, IL.

The planning committee is working hard to put together a program of 14 to 15 hours of relevant topics and speakers. As usual, CLE credit will be available.

Preliminary topics to include:

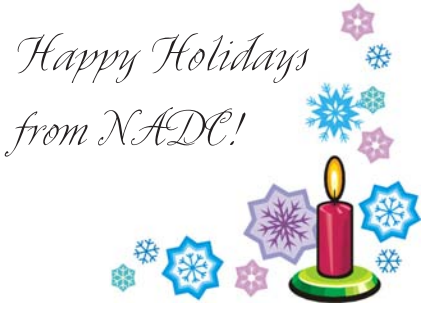
- Class Action Lawsuits (Preventative and Reactive Measures)
- Top 20 Franchise Trends for 2011
- Responding to Pre-Termination Notices and Corrective Measures
- Alternatives in a Post-Arbitration World
- CFPB Update
- NADA Update
- Estate Planning
- Tax Issues Affecting Dealers – UNICAP
- Personnel and Labor Trends
- Social Media

Hotel reservations must be made directly with the Trump International Hotel & Tower by calling 1-877-45-TRUMP. Please reference the NADC Annual Member Conference to receive our discounted rate of $235. A deposit equal to one night's stay is required to hold each individual's reservation.

The room block deadline for hotel reservations is March 11, 2011. Make your reservation today!

Additional program information and registration will be available on our website, www.dealercounsel.com, in early 2011.

I hope everyone has a happy and healthy holiday season! ■



From the Editor: The Compliance Foxtrot

Michael G. Charapp, Editor of the Defender

As I write this, I have just returned from a regional meeting of dealers where I talked about legal issues for 2011. The meeting served as a reminder that in a car dealership, it's never as easy as it looks. Let me explain.

I have been following the regulatory path of the Risk Based Pricing Rule from a safe distance, primarily so that I can advise clients but also because of curiosity to see how the Federal Reserve Board would deal with what is a truly incomprehensible piece of legislation.

Fortunately, as a result of some hard work primarily by the legal staff of NADA representing the interests of car dealers, the Federal Reserve Board agreed on an alternate compliance method. Rather than providing a notice only to those who are granted credit on terms inferior to the terms granted to a substantial proportion of the creditor's other customers, a creditor can simply give a notice of the applicant's credit score with accompanying required disclosures to all who apply for credit. Once this alternative was available, suppliers developed capabilities to simplify a dealer's life by printing the required notice whenever a dealer runs a credit report.

During 2010, dealers received many notices that the Rule is coming. And suppliers have been marketing the availability of their simplified compliance product for months. "Easy", I thought when preparing for the regional meeting. A quick reminder was what I thought I was going to give the group. And then I found something surprising – as I launched into my "reminder" that the Rule is coming, a hefty percentage of the room began writing furiously. It was almost as if I was announcing the rediscovery of the mythical carburetor that allows a car to get 100 miles to a gallon that, it's been rumored, the oil companies paid to keep off the market. I assumed that the dealers in the audience were ready for the Risk Based Pricing Rule. I was wrong.

And so I was reminded that nothing is as easy as it seems when we talk about compliance in car dealerships. Folks in the showroom sell cars. Legal compliance is nice. Moving iron across the sidewalk feeds the family.

Any change to dealership routine must be part of management program that is effectively implemented and enforced. So when I saw the furious writing as I launched into the Risk Based Pricing Rule discussion, I decided I would turn what I intended to be a mere mention into a full description of how the Risk Based Pricing program should be implemented. My two minute mention turned into a twenty minute discussion.

1. Adopt a plan and appoint a coordinator who will be responsible for implementation and continued operation.
2. Make arrangements with a supplier of the notice. Consumer reporting agencies and loan aggregators, among others, have been marketing products that will allow the dealership to print the notice when accessing a consumer's credit report. Using those established suppliers can give a dealer the comfort of knowing that it is using a notice that complies with the Rule.
3. Train staff to deliver the credit score notice to every consumer who applies for credit.
4. Monitor and enforce the program to ensure that employees are delivering the notice. While the Rule does not require that customers sign the notice, have a customer sign a copy, and maintain a copy in the deal or application file. A customer who signs it cannot deny receiving it, and it's evidence that the dealership staff delivered it.
5. Follow up. Spot check deals and application files to be sure that the forms are being delivered. Personnel may have some initial reluctance to comply since they may see this as just another form that must be presented to and possibly explained to a customer, with the possibility of slowing down the process. There may be some resistance, so spot checking to be sure that the notices are being delivered will be important.

In the session, I was once again reminded that in a car dealership, people have established ways of doing things. If management is going to change the way people do things, it must be prepared to take the time to develop a solid program, implement it, train employees to follow it, enforce use of the program, and follow up to ensure that the program is being followed.

Old dance studios used to put on the floor large oil cloths which had arrangements of footprints to demonstrate various dance steps. Follow the steps in time to the music with a little flair and, voilà, you're dancing. I realized that "develop, implement, train, enforce, and follow-up" are very similar. They are the steps for solid legal compliance in a car dealership – the compliance foxtrot. ■

Michael G. Charapp is a lawyer in the Washington, D.C. metro area who represents car dealers and dealer associations. He is editor of the Defender and encourages submissions. Email: mike.charapp@cwattorneys.com.

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Motor Vehicle Issues in Buy-Sell Transactions

Feature Article

By Joseph Aboyoun, Aboyoun & Heller, L.L.C.

I. Introduction

It is often stated that it is the attorney's role in an acquisition to protect his client. It is not his or her role to negotiate the price or to otherwise engage in so-called business issues. The lawyer should ensure the inclusion of the necessary representations, indemnifications and contingencies. He or she should leave the business deal to the client. After all, who understands the business terms (*e.g.,* price) better than the client and his or her financial advisors?

However, the attorney's handling of an automotive buy-sell transaction, as well as the drafting of a buy-sell agreement, is inextricably intertwined with the business terms. As such, the failure on the part of the buy-sell attorney to understand the intricacies of such terms is a significant default in his or her representation of the automotive client (both seller and buyer).

Perhaps the most significant of such business terms are the myriad of motor vehicle issues that arise in a buy-sell transaction. These must be addressed one way or another in a buy-sell agreement. The failure to do so effectively is likely to cost the client significant money and create major discord in the attorney-client relationship. There is no worse experience than the realization at the closing table that one of these terms was not properly addressed in the buy-sell agreement or, worse, totally ignored or forgotten. To do so could cost your client tens of thousands of dollars. Conversely, the proper handling could save your client significant sums and, at the same time, provide further basis for your fees beyond mere billable time. Furthermore, it will strengthen the client relationship and enhance your reputation as an effective buy-sell attorney.

II. Overview

The following is a checklist of motor vehicle issues in a buy-sell transaction:

A. New vehicles:
- (a) Current versus old models
- (b) Mileage limitation
- (c) Dealer swaps
- (d) Inventory mix
- (e) "Punched" vehicles
- (f) Damaged vehicles and missing equipment
- (g) Price adjustments

B. Demonstrators & Loaners
- (a) Limitations
- (b) Pricing

C. Ordered Vehicles
- (a) Adjustments
- (b) Buyer's control over ordering

D. Unfulfilled Customer Orders

It is imperative that each of these issues be considered in the deal and addressed in appropriate fashion in the buy-sell agreement.

It should be noted, however, that it may, in fact, be advisable to omit some of these items in the agreement. In many ways, the key to effective drafting may have more to do with what you do not include in the document than what you do address. From the buyer's side, an example of this principle is the issue of demos or loaners. Should you include these in your first draft or leave it to the seller's attorney to address? Of course, the ultimate decision-maker here is your client. However, it is incumbent upon the attorney to raise these issues with his or her client in preparing the draft.

III. New Vehicles

(a) Includable Items. Simply stated, the selling dealer typically desires that each and every item of new vehicle inventory be included in the deal. The general belief here is that the seller will likely fare better in the price negotiations for these items with the buyer than selling this inventory to third parties prior to, or after closing. These include current model vehicles, older models, demonstrators and loaners. Needless to say, from the buyer's perspective, only current models with minimum mileage and no damage should be included.

The manner in which the buy-sell attorney addresses new vehicle issues will depend in large part on the side of the transaction on which he or she stands. For example, from the seller's perspective, each and every new vehicle in stock or on order, whether current or older models, whether with or without excessive mileage, whether damaged or not, and whether a slow-moving model or hot-seller, should be included in the deal and included at the maximum possible price. From the buyer's perspective, only current model units devoid of all issues (*e.g.,* mileage, damage, etc.) should be included, and included at the lowest

price attainable. Of course, in the end, all of this becomes a function of negotiation and is, to a large part, a function of the price for the deal. For example, if a seller believes he or she has established the optimum blue sky price for the dealership, he or she may be willing to relax the inventory requirements of a deal. Conversely, a buyer who believes he or she has paid "over list" for the franchise in question is likely to be unwilling to absorb even more costs in the form of an excessive inventory burden.

(b) Pricing. The basic price stated in a buy-sell agreement for new vehicles is net factory invoice price which is commonly referred to as the "tissue price". The more difficult question is to what extent this price should be adjusted - generally downward in favor of the buyer. From a buyer's perspective, he or she wants to purchase the vehicle at a price which will allow him or her to be competitive with other dealers of the same line make. As such, he or she wants to be on a par with those dealers. To accomplish this, the buyer will want adjustments to the tissue price for every dollar of cash given or credited to the seller by the manufacturer - either upon stocking the vehicle or thereafter. The most common of such cash payments is known as a holdback.[1] This is typically equal to three percent (3%) of the tissue price which is paid to the stocking dealer in certain intervals (*e.g.,* quarterly). Needless to say, the buyer will typically require an adjustment in his or her favor at closing for all holdbacks on all vehicles purchased at closing. Other typical adjustments in this category are the following:

(1) Advertising payments/allowances;

(2) Floor plan assistance;

(3) Preparation allowances.

It is incumbent upon the buy-sell attorney to understand the details of such adjustments and to draft these in appropriate fashion for his or her client.[2] For example, a floor plan allowance may entitle the stocking dealer to 30-days free floor plan interest on a stocked vehicle. Who should get the benefit of this credit at closing? Does it make a difference as to whether the vehicle is in stock more than 30 days by the date of closing? In the end, it all boils down to negotiation and proper drafting.

Not all adjustments are in favor of the buyer. In this regard, it is common for a seller to expect an adjustment for any special equipment or add-ons installed on a stocked unit. It should also be noted that seller will not give a preparation allowance credit to the buyer if it is the seller that has, in fact, prepped the vehicle.

(c) Demonstrators & Loaners. Typically, a buyer will only agree to purchase units with very low mileage. Of course, there are no vehicles in stock with no mileage. In most cases, the mileage is less than 100 miles. The exception to this are the units purchased from another dealer, known as "swaps". These can typically have mileage of as much as 300 to 500 miles. For the most part, however, these are still considered unused for purposes of drafting, although swaps are typically limited to a small number (*e.g.,* 6 units).

The situation becomes a little more complicated with demonstrator units. By and large, a buyer does not desire to purchase these since these typically entail mileage of several thousand miles. For the most part, these are considered a liability or, at least, a nuisance. Obviously, the seller prefers this inclusion. In the end, the inclusion becomes a function of an adjusted price and other limitations. For example, it is common for the price to be reduced by a mileage factor (*e.g.,* 254 per mile). It is also typical to place an overall limit on the number of includable demos (*e.g.,* 6 units) and a mileage ceiling for each unit (*e.g.,* 6000 miles). The same principles will typically apply to loaner vehicles.

(d) Damaged Vehicles. Damage to new vehicle supply while the units are in transit to the dealership or while in stock is not uncommon. It would be unfair to a seller to exclude a unit from a deal simply because there is a scratch or minor damage. Most buy-sells provide for this and require the buyer to purchase a damaged unit as long as the damage is minor in nature (*e.g.,* less than $500) and does not involve frame damage. There is also an overriding concern as to whether the extent of the damage will require disclosure to the ultimate consumer in the retail transaction. Typically, the buy-sell agreement provides that damage which requires disclosure under applicable state consumer laws disqualifies the vehicle from inclusion. Obviously, a buyer does not want a vehicle which will likely lead to a consumer problem.

(e) Punched Units. Most buy-sell agreements provide that a vehicle is only eligible for inclusion if it has not been reported as sold to the manufacturer. Unfortunately, there are dealerships that have reported units as sold before an actual retail transaction in an effort to reap the benefit of incentive payments or some bonus program. This practice is known as "punching" the vehicle. Sometimes, the manufacturer encourages this dealer policy in order to ensure that a program is reported as successful in order to artificially increase the alleged retail sales for a particular period of time. Of course, manufacturers will deny that there is such a policy. However, it clearly exists in the industry.

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[1]Please keep in mind that not all franchisors provide holdback payments or credits upon stocking. BMW is an example of one who does not. It is also noteworthy that some credits are only provided upon the retail disposition of a unit. As such, no adjustment is required at closing unless the vehicle has been prematurely "punched", as discussed in part (e).

[2]To do this effectively requires an investigation into the franchisor's pricing policies. An automotive accountant can assist in this regard as well.

Needless to say, buyers are normally unwilling to accept any units that have been "punched". The main reason for this is that the punch date starts the warranty period for a vehicle. If there is a 24-month warranty and the unit is actually sold two months after the punch date, the customer only receives a 22-month warranty and that is a difficult dilemma to address by the dealer who ultimately sells the unit. Of course, there is always room for negotiation in such items. If a buyer is to be interested at all in such units, he will likely require a significant price discount. This negotiation will also take into account whether the seller received any incentive monies upon the premature retail reporting of the unit.

IV. Pre-Owned Vehicles

The handling of pre-owned vehicles in a buy-sell can be quite troublesome. There are a myriad of potential problems, including what should be included and, of course, the price formula or, more likely, price index, to be applied (*e.g.,* NADA price lists). It has been my experience that the preferable way to address pre-owned inventory in the agreement is to simply leave what units are included and the price to be paid for each to a mutual agreement to be developed by the parties at or prior to closing. Whatever is not ultimately purchased by the buyer can be disposed of by the seller in the usual ways. Quite frankly, I find it almost nonsensical to burden buy-sell negotiations and the drafting with this aspect when the parties spend their livelihood buying and selling used vehicles. They do not need attorneys to tell them how to buy and sell these items.

Of course, if the parties insist otherwise, then the provision must be tightly drafted to address what items are included and what price index will be employed. It may also be advisable to appoint a mediator or arbitrator (*e.g.,* an automotive accountant common to both sides) to break the deadlock on any disputed items.

V. Unfulfilled Customers Orders

Typically, on the day of closing, there are several customer orders that remain unfulfilled. This is either because the vehicle was on order from the manufacturer and has not yet been received or because the vehicle is still in the process of preparation or because the customer has not yet concluded the financing arrangements to consummate the deal. Since the selling dealer will no longer be authorized to conclude a retail transaction after the closing (unless he holds another dealership in the same geographical area of the same line make (which is unusual), the unfulfilled orders are assigned to the buyer in the buy-sell agreement. This, of course, makes abundant sense and is quite straight forward. However, the question arises as to how the parties split the proceeds from the ultimate retail transaction. The seller typically looks for consideration for these orders since the seller is the party that generated the deal. The buyer wants to be compensated as well since it is the party that will actually consummate the transaction with the customer and deal with any consumer issues arising from that transaction. In the end, the fair approach is an equal split of the net profit from the deal. Separately, the buyer will want a credit for the deposits received by the seller at the time the order was placed.

VI. Conclusion

There are a myriad of issues that arise in buy-sell negotiations. Each aspect of the deal requires careful scrutiny and attention. However, the issues surrounding the motor vehicle inventory of the selling dealership is a very significant area of concern and has the potential of creating hidden costs to the party not properly protected in the buy-sell agreement as it concerns these issues. To be sure, it is unrealistic to believe that every aspect of the motor vehicle component will be resolved in one party's favor. However, it is incumbent on you, as the buy-sell attorney, to assure that each aspect is fully explored with the client so that an optimum position can be achieved. ■

Aboyoun & Heller, L.L.C. has developed a long-standing reputation for the handling of automotive-related transactions. In this regard, Mr. Aboyoun has been involved in the purchase and sale of automobile dealerships and related transactions for over 25 years.

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