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DEFENDER

The National Association of Dealer Counsel Newsletter JULY / AUGUST 2011

In this Issue:

Save the Date
October 9-10, 2011

2011 Fall Conference

Trump International Hotel & Tower
Chicago, IL

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Score Another One for the Federal Arbitration Act

By Oren Tasini, Haile, Shaw & Pfaffenberger, P.A.

The United States Supreme Court continued its love affair with arbitration in its recent decision of AT&T Mobility LLC v. Concepcion, 563 U.S. (2011). The Court decided that an arbitration agreement which precluded participation as a class member in a class action was valid, and reversed both the 9th Circuit and California case law holding such a class action waiver to be unenforceable.

There is really no reason to bother with the facts of the AT&T case given that the Court's far reaching language on the enforceability of arbitration clauses, and the limited basis under which they can be voided following AT&T is what makes the case of interest. In rejecting the decision of the 9th Circuit, which had relied on California state decisional law and a specific California statute, in finding such agreements to be unconscionable, the Court stated '[w]hen state law prohibits outright the arbitration of *a particular type of claim, the analysis is straightforward; the conflicting rule is displaced by the FAA*". The Court went further to hold that, although the FAA allows contracts to be set aside under Section 2 of the FAA on grounds that exist at law and equity for revocation of contracts, where the application of a defense applies only because the agreement in question is an agreement to arbitrate or the defenses derive their meaning from the fact that the agreement to arbitrate is at issue, this fails to put arbitration agreements on equal footing with other contracts and can thus not be a basis for refusal to enforce the terms of the arbitration clause. To hold otherwise, the Court reasoned, would eviscerate the purpose and intent of the FAA to promote arbitration and to honor the parties' agreement to arbitrate. In closing, the Court stated that because the law in California "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" the law in California was preempted by the FAA.

Thus, the holding in AT&T leads to the logical conclusion that any state statute or case law that prohibit a type of claim from being the subject of arbitration, due to the fact of arbitration alone being the cause of the objection (for example, an objection to arbitration being unfair to the consumer due to the high cost) is preempted by the FAA and the state statute or case law cannot now find that such a claim is not subject to arbitration. As in many states, courts have found that a variety of claims cannot be subject to arbitration on grounds of public policy or violation of statutory frameworks that promote a public policy (substantive unconscionability). The AT&T decision puts into doubt the continued viability of this conceptual framework for courts analyzing arbitration agreements. If the court concludes that the unconscionability arises as a result of the requirement that the parties are required to arbitrate, AT&T precludes that

holding. Perhaps a claim that an arbitration clause procedurally is unconscionable, *e.g.* fraud in the inducement remains viable, but taken in the context of the Rent-A-Center, West Inc. v. Jackson, case which held that a party must challenge the arbitration clause as specifically being procedurally unconscionable, as opposed to the entire contract, the procedural unconscionability defense is weak, if not gutted.

Therefore, I encourage you to read the AT&T Mobility case, and I further encourage you to provide for the FAA to govern your arbitration agreements to give as much ammunition as possible to block an argument by a plaintiff that requiring arbitration is unenforceable or "unfair" under some state law grounds. The Supreme Court's decision that any state law that blocks or is an obstacle to implementing the federal policy under the FAA to encourage arbitration is "displaced" by the FAA is a powerful weapon in protecting pre-dispute arbitration agreements with class action waivers. ■

Oren Tasini is an Attorney with the law firm Haile, Shaw & Pffafenberger, P.A. in Palm Beach, Florida. Oren is one of the foremost authorities in Automotive Law in the United States, and assists automotive dealerships with legal compliance, regulatory and franchise matters, and in the purchase and sale of automotive franchises.

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Executive Director's Message

Erin K. Hussey
NADC Executive Director

You may have noticed a name change in the 2011 Fall Conference. This event was previously labeled the "Fall Workshop". Considering the quality content, expert speakers and valuable take home information, we considered this event to be much more than just a workshop. Thus the name change and the introduction of the Fall Conference.

The 2011 Fall Conference will be held October 9-10 at the Trump International Hotel & Tower in Chicago, Illinois. The planning committee has lined up an excellent agenda with timely sessions that can't be missed! To register for the Fall Conference, please visit the Events section in our members only section of the website at www.dealercounsel.com.

2011 Fall Conference Sessions include:

SUNDAY – October 9th
3:00 to 5:00 pm Board Meeting
6:00 to 7:30 pm Reception

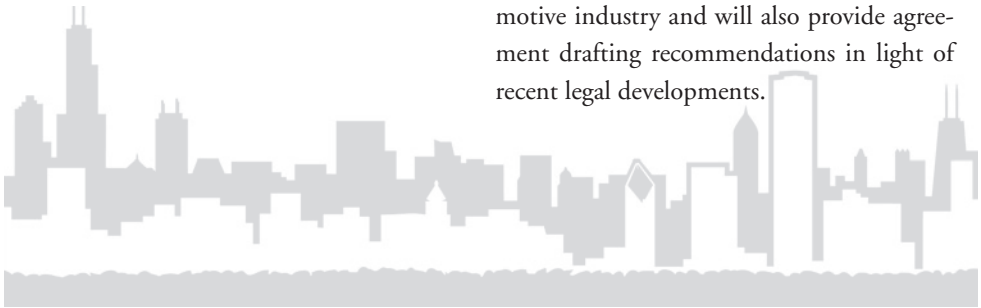
MONDAY – October 10th
7:00 to 8:00 am Breakfast
8:00 to 8:15 am Opening Remarks

8:15 to 9:45 am
Spot Deliveries Under Attack
Rob Cohen, Auto Advisory Services, Inc.
Jeff Ingram, Galese & Ingram, P.C.
Alex Kurkin, Kurkin Forehand Brandes LLP
This session will discuss the legal theories plaintiff attorneys are using to attack spot delivery practices. Plus, panelists will discuss best spot delivery practices and the proper drafting of rescission agreements. Topics will also include: retail installment contract integration clauses, Truth-in-lending Act violations, consummation and contract dating issues, single document rule problems, rescission rights, contractual conditions precedent/subsequent, and improper use of bailment and borrowed car agreements in spot delivery scenarios.

9:45 to 10:00 am Break

10:00 to 11:00 am
Arbitration and Class Action Waivers
Michael Dommermuth, McGloin, Davenport, Severson and Snow, P.C.
Shawn Mercer, Bass Sox Mercer
Christian Scali, Arent Fox, LLP
This panel will focus on the impact of the AT&T Mobility v. Concepcion Supreme Court decision and other case law developments which impact the use of pre-dispute arbitration clauses and class action waivers in agreements between dealers and consumers. Legislative and regulatory attempts to restrict or eliminate the use of such agreements with consumers will also be addressed.

The panel will analyze various pros and cons associated with the use of arbitration clauses and class action waivers in the automotive industry and will also provide agreement drafting recommendations in light of recent legal developments.



11:00 to 11:15 am Break

11:15 am to 12:15 pm

NADA Update

Andrew Koblenz, Vice President, Legal and Regulatory Affairs

Paul Metrey, Chief Regulatory Counsel, Financial Services, Privacy, and Tax

NADA attorneys will provide an update on an array of legislative and regulatory developments affecting car and truck dealers, including the FTC motor vehicle roundtables, other Dodd-Frank Act initiatives, the scope of the Risk-Based Pricing Rule, efforts to eliminate LIFO, estate tax reform, the regulation of greenhouse gases, overtime pay for service advisors, OSHA recordkeeping requirements, and more. Time will be set aside for attendees' questions.

12:15 to 1:15 pm Lunch

1:15 to 2:15 pm

The Closing Process and Pitfalls in a Dealership Acquisition

Erin Tenner, Esq., Tenner Johnson, LLP

Steve La Bonte, Esq., LaBonte Law Group, PLLC

Ted Kobayashi, CPA, Kobayashi and Company

The panelists will walk you through the Closing process for the purchase and sale of an automobile dealership and help you to navigate potential pitfalls. Learn the do's and don'ts and the issues that can make or break your deal, or land you in litigation. This presentation will focus primarily on asset sales but will touch on stock sales transactions. Learn how to plan for a smooth closing without all the typical hiccups and how to prepare your client for the closing process.

2:15 to 2:30 pm Break

2:30 to 3:30 pm

The Government: An Employee's New Best Friend

Christopher Hoffman, Fisher Phillips LLP

In the past year, few changes have occurred in the statutes governing labor and employment law. However, the current Administration is making major changes through the rule making process, interpretations and in the administrative agencies' handling of claims. This session will focus on the new approach and rules promulgated the DOL, NLRB and EEOC.

3:30 to 4:30 pm

Effective Strategies for Countering the New Wave of Manufacturer Oppression

Leonard A. Bellavia, Bellavia Gentile & Associates, LLP

A practical approach on how dealer attorneys should respond to the onslaught of factory demands and practices which have emerged since the 2008-2010 industry meltdown.

4:30 pm Closing Remarks

5:00 to 7:00 pm

NADC 2011 Fall Conference Closing Reception

Sponsored by Anderson Economic Group

A gathering for members and guests to mingle, network, and reflect on the conference.

Location: TBD

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Book Excerpt: Factory Approval

(from Auto Dealer Law)

By Michael Charapp, Esq. & Rob Cohen, Esq.

Feature Article

The following is an excerpt from our recently published reference book titled *Auto Dealer Law, The Definitive Guide to the Purchase, Sale, and Operation of Vehicle Dealerships.* Mike Charapp and I have been working on this publication for over two years. We set out to provide a comprehensive legal reference tool for dealers and their lawyers, addressing everything from buy/sells to anti-trust, emergency preparedness to the Fair Credit Reporting Act, vendor relations to advertising compliance. A weighty tome, to be sure, that contains all the advice, bullet points, and scenarios we could muster based upon decades of experience advising and representing dealerships.

- Rob Cohen

Dealer Summary:

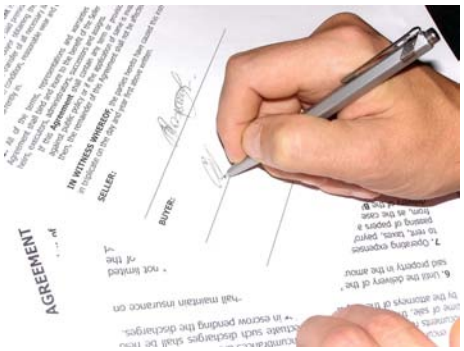
- ✓ All ownership changes must be approved by the franchisor, whether it is a change in a minority interest, a change in controlling interest, or a sale of the dealership. Submit for approval before making the change and know your state law rights.
- ✓ All franchisors require full completion of applications for approval. Fill out the dealer application completely and submit the required materials.
- ✓ Franchisors want a copy of the agreement by which the change will take place. Make sure you submit the entire agreement.

Introduction

Franchisors of auto dealerships are quite demanding when it comes to change of ownership. It is not a game of horseshoes. Close is not good enough. An applicant for a change must comply completely with the requirements of the manufacturer. Request an entire package from the franchisor of what it will want to consider, and complete the package fully.

There may be franchise laws of your state that affect the manufacturer's discretion in whether to approve an applicant or what it can demand from an applicant. Know your state law.

Apply for consent before making changes. Franchise agreements require that a change in ownership is subject to manufacturer approval. A change made without the consent of the manufacturer may be considered a violation of the dealer agreement giving the franchisor leverage to make demands upon you.



Get Approval of All Ownership Changes Before Making Them

No matter what type of ownership change you are making, apply to the manufacturer and get approval before completing it.

• *Minor ownership change.* Franchisors may not be as picky about ownership changes of 10% or less. Some franchisors may be forgiving if a very minor ownership change is made without approval. However, why take the chance? An example of minor ownership change is the replacement of a general manager with a right to purchase equity. Even though the dealer may want the general manager to start quickly, the actual transfer of equity should not take place until the change is approved.

• *Change in control.* Sometimes a change in the controlling interest of a dealership may take place. This is often the result of a child taking over for a parent or a dealer operator acquiring sufficient equity from the dealer owner to take control. Without question, a change in control requires prior consent of the manufacturer. A change in control without prior consent is risky.

• *Sale of the dealership.* In every sale of a dealership, prior manufacturer consent is required. In fact, in most states that license dealers, a letter from a franchisor appointing the new dealer owner or the new dealer sales and service agreement will be required to even license the operation. One who buys and completes the deal on a dealership before manufacturer approval is apt to lose everything.

A Franchise Is Not Transferred in a Buy/Sell

Many buyers and sellers assume that the seller will transfer its franchise in a buy/sell transaction. That is not the case.

The buy/sell agreement simply allows the buyer to apply for and to obtain its own dealer sales and service agreement. The buyer is actually purchasing the business of the seller and the resignation of the seller from its franchise.

At closing, the seller's resignation will become effective (since the resignation docu-

ment will probably have been submitted weeks earlier as part of the application package), and the buyer will sign its new dealer sales and service agreement.

Most franchise agreements and many state laws provide for the right of a dealer in the event of termination to return cars, parts, signs and tools. However, in the event of a termination as part of a transfer of the business, those rights are generally not available. That is why the seller will want the buyer to buy its inventories since it will have no rights to return those under the termination provisions of its sales and service agreement.

The Standard for Approval in the Buy/Sell Agreement

Some parties to a buy/sell agreement assume that a simple provision that the deal is subject to franchisor approval is sufficient. While that is often simply what many contracts state, buyers and sellers really should give greater consideration to the franchisor approval provision in a buy/sell agreement.

• *The buyer and seller should define what is an approval.* Often, a franchisor will approve the applicant for a standard sales and service agreement. However, a franchisor may also provide approval under certain conditions such as the agreement of the buyer to build certain improvements or to take other actions. If those conditions will not be acceptable to a buyer, then the buyer should make sure that the conditional approval is not deemed to be an approval for purposes of the buy/sell contract. Buyer and seller should both understand going into the deal what an acceptable approval will consist of.

• *The parties must understand their state law rights.* State laws often give buyers and sellers rights to have the franchisor adequately consider the application for transfer of a dealership without considerations prohibited by the statute. The parties to a buy/sell agreement should understand what the state law provides so that each can judge whether any issues a buyer may have will present problems in the deal.

• *Understand state law time periods if they exist.* Sometimes the state franchise law will provide the manufacturer a specific period of time to consider the buy/sell agreement. If it does not disapprove within that period of time then the transaction is deemed approved. The parties should include appropriate time periods in the agreement to take advantage of the presumptions of state law.

Application Process

Applying for franchisor approval can be quite time consuming for the buyer.

• Once a buy/sell agreement is signed, it is

the job of the seller to notify the franchisor. The franchisor will issue an application package.

• The application is generally very detailed and very substantial. The application seeks information concerning the applicant's background, character, financial capability, experience, and performance in the car business. It is important to complete the application and provide all of the other information requested. Franchisors are notoriously picky and will demand complete information to even begin to consider the deal.

• With the application, the buyer can expect to have to provide very substantial additional information and materials.

- *A financial statement.* The buyer will have to provide full disclosure of its financial capability.

- *Pro forma operating statements and a pro forma balance sheet.* The franchisor wants to know what the capital structure of the dealer will be and how the applicant views the financial potential for the dealership.

- *Proof of floorplan.* The manufacturer wants to know that the buyer will have a floorplan line to purchase new vehicles. A complete floorplan package generally must be submitted with the application.

- *Proof of right of occupancy.* The franchisor will want to see the lease under which the dealer will occupy the premises to ensure that there will be a place from which business will be done.

- *Information concerning the buyer's other dealerships.* If the buyer has other dealerships, the manufacturer will want complete information concerning sales efficiency and CSI of those dealerships.

- *Resolutions and/or minutes of meetings.* Most franchisors want to see proof that the transaction is appropriately authorized.

- *The agreement.* Franchisors want to see the *entire* buy/sell agreement, including schedules and any ancillary agreements.

- *Other materials.* Depending on the franchisor, there may be other materials that must be submitted.

• Buyers and sellers sometimes think that they can make "side agreements" that the franchisor doesn't necessarily have to know about. That is simply not correct. A franchisor will want to see the entire agreement, including all attachments and any side agreements. Many franchisors require a statement that the submitted agreement is the entire agreement.

- *Full disclosure is in the best interest of the seller.* In the event the franchisor exercises its right of first refusal and assigns the buyer's rights to purchase to another (if permitted by state law) the seller will want to make sure that every aspect of the buy/sell agreement is fully disclosed. If the seller and buyer have side agreements for the selling dealer to be paid for consulting, or to be provided vehicles, or receive any other benefit that is not submitted as part of the application package, the assignee of the contract who steps into the buyer's shoes does not have to perform those side agreements.

- *Full disclosure is a benefit to the buyer.* A franchisor's exercise of the right of first refusal is frustrating for the buyer. A great deal of work goes into negotiating the deal, finalizing the contract, and doing the application. If there are agreements that the buyer makes that are not included in the package sent to the manufacturer, the deal may very well look like a bargain. That could give the franchisor the temptation to exercise the right of first refusal where it might not otherwise do so.

What is a Right of First Refusal?

Just about every dealer sales and service agreement has a right of first refusal for the franchisor. Under this provision of the franchise agreement, the factory may exercise

its right to step into the shoes of the buyer of a dealership. Often, the franchisor will assign its right to another dealer or applicant to perform the contract as the buyer in place of the original buyer. In that case, the original buyer is left out in the cold, and the assignee becomes the new dealer.

• *How does a right of first refusal operate?* Generally, there is a time period in the dealer sales and service agreement by which the right of first refusal may be exercised. That time period may be affected by state law. If the franchisor does not exercise its right within the time period, it loses its right. Some states prohibit the exercise of the right of first refusal.

• *What happens to the seller?* In the event the right of first refusal is exercised, there is no real change for the seller. The new buyer simply steps into the shoes of the original buyer, and it must perform the contract exactly as the original buyer would have been required to do. Of course, under those circumstances, any "handshake" or other unwritten agreements between the seller and original buyer are lost.

• *What happens to the original contract buyer?* If the franchisor exercises its right of first refusal, the original contract buyer no longer has the right to purchase the store. Under the franchise agreement, which may be affected by state law, a dealer does have the right to recover its expenses if demanded within a time specified by the dealer agreement or by law. Generally, however, these expenses may not include the time of the dealer and its personnel spent in investigating the deal and negotiating the buy/sell. ■

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.

Rob Cohen, Esq., President of Auto Advisory Services, Inc., Tustin, CA.

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