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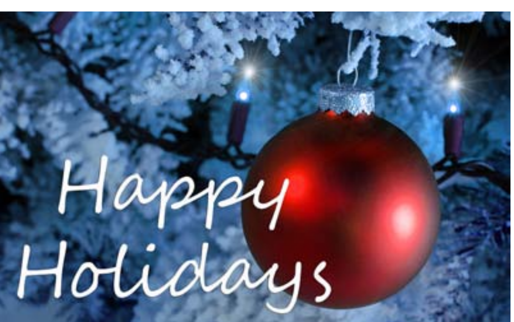

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The Dealer's Holy Grail and Integration Clauses – A Myth and a Reality

By Scott Silverman, Silverman Advisors, PC

Have your clients ever had a CRM or marketing solutions provider under-sell and over-perform? Unlikely. Whether or not there is any holy grail of increasing sales and creating a more efficient process, there isn't a single dealer that has given up on the idea that they will eventually find it. The best sales promotions or gimmicks usually don't perform anywhere near as promised, and those that are true "game changers" predominantly come with a significant down-side because they push the regulatory envelope (unfortunately, misleading and false advertising actually works for the short-term). At the same time, every CRM tool has limitations, and there never has been and never will be, a "turnkey" product that will address every dealer's concerns. One fact seems abundantly clear - every product sold by a car dealership vendor eventually fails to perform some function that was a highlight of the sales pitch. As soon as a dealer gripes about not getting what they paid for, vendors turn to their boilerplate one-sided agreements to "hold them to the contract" and to continue receiving monthly charges over the multi-year remainder of the agreement.

Why would anyone agree to a long-term commitment during times of enormous change? Because they were wooed by the idea that they may have found the Holy Grail. As one dealer recently said, "We can be like fish; you see something shiny and you go after it."

Most dealers and dealer groups, at any given time, are working with several vendors that have sold them on the latest iteration of the "can't miss product" or the most comprehensive CRM system that money can buy. Hits and misses in this area are inevitable. Every dealer must increase the likelihood that their misses are not tied to a long-term commitment.

For each of these vendor contracts dealers and their advisors need to consider the obvious – what is the dealer getting and what is the dealer giving up in return? As counsel we need to proactively warn them that their antennas should go up when they are handed a contract that resembles an unpacked ream of paper. This does not always do the trick as many vendor contracts now have critical addendums and standard terms that are not physically presented – rather the vendor alerts dealers the terms and conditions can be downloaded from their web-site. This means one of three things: (1) you could be looking at two reams of paper to be read and they are trying to avoid incurring the cost of paper, (2) the vendor is trying to bury the abusive and unconscionable terms that you would never endorse if you read them, or (3) a combination of 1 and 2. Getting dealers' attention on these issues is not an easy task as they rarely consult their professionals on the front end before signing – and only seek our guidance when they have signed the agreements stacking the deck against them (and usually with foundational understandings that are contradicted by the terms they never read).

For vendors there is good reason for lengthy contracts. Most vendors have had countless disputes with dealers, and have faced every creative (and factual) argument imaginable that dealers have used to avoid being locked into contracts that no longer serve their original purpose. Accordingly, these contracts are carefully crafted to pre-empt every creative argument that one can imagine.

Whenever a business partner or vendor fails to perform, one of the best (or most common) arguments is always the same "I did not get what was promised." However, there is a big loophole here. Every legitimate contract is drafted to reduce dealer's ability to complain about not getting what was promised – and contains an "integration clause" to accomplish this goal. Everyone has read an integration clause. Typical language will state:

> This Agreement constitutes the entire agreement between the Parties relating to this settlement. This Agreement supersedes any prior written or oral agreements concerning the subject matter. This Agreement may not be amended or modified except by an instrument in writing executed by all Parties or their respective representatives.

Who hasn't used or heard the expression "I remember when a hand-shake deal was stronger than a written contract." Integration clauses have killed this concept. It is not that dealers can't rely on what is orally promised – they just need to make absolutely sure that the keys to what they were promised are transcribed into the written contract.

Some vendors have discovered the stigma that comes with these long terms contracts and have promoted the idea of something closer to pay-as-you-go services. What might be lost with the perceived second-tier vendors offering short term deals is probably offset by the reduced commitment. Don't let your dealers underestimate how much their business will change and the need for flexibility. Don't let them get seduced by the idea of saving short money (or even legitimate dollars) by locking into a long-term deal.

What should your dealers take away from others that have learned the hard-way:

- Thoroughly explore alternatives to any proposal for contracts that extend beyond 1 year (especially for CRM systems); and
- Constantly advise them to read what they sign and ensure it is consistent with what they were sold. ■

Scott Silverman founded Silverman Advisors, PC in 2011. Scott also serves as outside general counsel for the Massachusetts' State Automobile Dealer Association representing dealer interests through-out the Northeast on franchise and regulatory issues and is a member of the NADC Board of Directors.

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President's Message

Patricia E.M. Covington
Hudson Cook, LLP
NADC President

Hot off the Presses! As I write this letter, I sit here at the FTC's *Third Roundtable to Address Consumer Issues in Motor Vehicle Sales, Financing and Leasing*. I thought it appropriate to give you a mini-report on what occurred. This is the last roundtable in the FTC's "listening tour" to gather information on consumers' experiences when buying and leasing motor vehicles.

There were five panels – two on leasing, one on financial education and the final two aimed at "what are the problems we need to be concerned with?" and "what should we do about these problems?". Overall, there was no new alleged bad conduct raised. Rather, we heard the consumer advocates rail on about the same alleged bad acts of dealers they've previously asserted – most, if not all, of which are already illegal. As with the previous two Roundtables, the consumer advocates did not introduce any credible empirical data to support their anecdotal-based claims and stories.

What was very interesting, however, was that there were two topics of particular interest to consumer advocates and the FTC, spot delivery and dealer participation. Most of the discussion centered on these two issues, even when a panel was designed to cover other topics. The panelists somehow always found themselves talking about these issues.

What was said? With respect to spot delivery, the consumer advocates claim that consumers are being tricked, coerced and/or harassed into returning vehicles to the dealership, only to be forced to sign a new contract just so the dealer can "make more money" on the deal. Industry representatives did a good job rebutting that this is rarely the case, and that many times unwinds and rewrites are due to credit issues of the consumer.

Industry representatives were careful to distinguish "spot delivery" (*i.e.,* conditional sales) from abusive "yo-yo" shenanigans, pointing out that not all conditional sales or spot deliveries were bad. Most spot deliveries, by a very large margin, are conducted successfully, without incident or problem, with the consumer very happy to drive out of the dealership with the vehicle. This consumer convenience (to leave with the vehicle) was not lost on the FTC. Practices that consumer advocates hammered on were the following: the dealer selling the trade-in and forcing the consumer to buy a replacement vehicle, the charging of mileage fees for the distance the consumer drives the car before its return, and dealers failing to make clear that the transaction is conditional on the dealer being able to sell the contract.

As for rate participation – it was the same ole' difference of opinion. Tom Hudson described the chasm as consumer advocates and industry being on the separate planets of Venus and Mars. Consumer advocates think that dealers are getting "kick backs" and that the "buy rate" is a rate readily available to the consumer. Industry representatives fought hard to clarify that the "buy rate" is a wholesale rate not available in the marketplace to the consumer.

Industry representatives also argued that a dealership, just like any other seller of goods and services, is entitled to earn a margin on the product or service it is selling – in this case credit. The industry representatives also pointed out that dealer financing spurs rate competition in the marketplace. Consumers frequently come into dealerships with offers from banks and credit unions, that dealers try to beat, sometimes successfully. All of which is good for the consumer.

While much of the discussion centered on spot delivery and participation, there were other interesting and noteworthy discussions. Here are just a couple of snippets:

- The consumer advocates want to ban leasing – they say it is WAY too expensive and that no customer should want this option. Stuart Rosenthal suggested the notion of consumer "choice" be considered, and revealed that some customers ***actually like*** leasing. There are repeat lease customers and even repeat customers who lease from the same dealership. Wow, who knew!
- On the topic of consumer and business education, Andy Koblenz suggested educating consumers through "experiential" learning and finding ways to make education "come alive". He gave the example of his wife teaching her students how to use a checkbook. She gives her students a checkbook ledger and a pretend "job", and then throws them into simulated "real life" situations. During the role play they are confronted with some difficult financial challenges (like a tornado taking the roof off the house) to which they must respond. The FTC moderator and consumer advocates liked Andy's "experiential" learning idea. Wouldn't it be nice if the FTC focused on something that might actually help, like consumer education?! Especially since both consumer advocates and industry representatives agreed that more consumer education is a good thing.
- Another thing everyone agreed on was that current law should be enforced. Consumer advocates conceded that many of the problem practices were already illegal, and one even admitted to the effectiveness of enforcement as being "pie in the sky." Industry representatives asserted that their

clients pay attention to enforcement actions and that these do indeed impact dealers' thinking and behavior. So, maybe some targeted enforcement is the right choice?

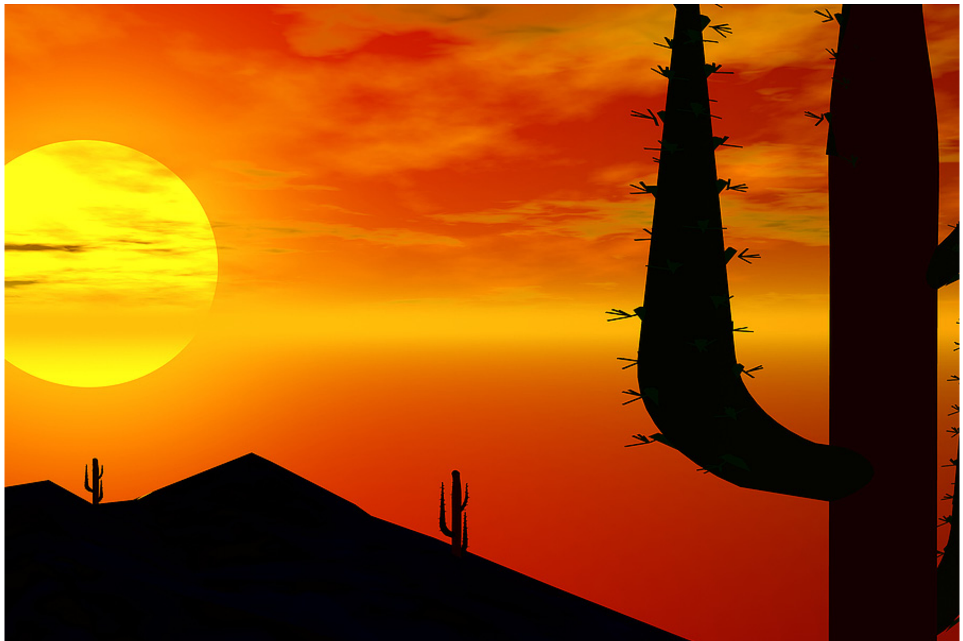
The NADC again was well represented on the Third Roundtable panels. We had the perennial Andy Koblenz of NADA, along with veteran presenters Tom Hudson and Michael Benoit of Hudson Cook, Mike Charapp of Charapp & Weiss, Paul Metrey of NADA and Terry O'Loughlin of Reynolds & Reynolds. New to a panel was Stuart Rosenthal of the Greater New York Automobile Dealers Association. As always, our members did a great job representing our clients and the industry. So, thank you.

Finally, the FTC refuted media reports that they were already rulemaking – they are not. They are still working through and digesting what they've heard. The comment period on the topics discussed at the roundtables remains open until the end of January, 2012.

In his closing remarks, Reilly Dolan, Acting Associate Director of the Division of Financial Practices, stated that the FTC wants "hard facts" and data after which they'll take appropriate action. Hopefully, the FTC will stay true to this promise *(and the prevailing legal standard)* before rulemaking: requiring empirical evidence that the targeted unfair and/or deceptive behavior on the part of dealers is pervasive. Fingers crossed!

Until the next time, we at the NADC wish you and your families a wonderful holiday season! ■

Patty Covington



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Fiduciary Duty in Franchise Cases: Win Some, Lose Some

Feature Article

By Russell P. McRory, Robinson Brog Leinwand Greene Genovese & Gluck P.C.

As state dealer laws have become more comprehensive, common law claims have become less important in automotive manufacturer-dealer litigation. However, three recent decisions out of New York and Ohio reaffirm the continued viability and relevance of common law breach of fiduciary duty claims. The two New York decisions were both from add-point cases commenced before New York's dealer act was amended to add relevant market area protections. The Ohio decision was from a relocation case where the dealer's statutory administrative challenge was dismissed for lack of standing. As a result, in all three cases, by necessity, the dealers relied on common law theories of liability, including breach of fiduciary duty.

In the New York case of *Manhattan Motorcars, Inc. v. Automobili Lamborghini, S.p.A.* [1] and in the Ohio case of *Franklin Park Lincoln-Mercury, Inc. v. Ford Motor Co.* [2], the dealers' breach of fiduciary duty claims survived motions to dismiss. At the summary judgment phase, however, the results are mixed. In a recent New York decision, *Legend Autorama Ltd. v. Audi of America, Inc*[3], the dealers' breach of fiduciary claim survived a motion for summary judgment.[4] However, later in *Franklin Park*, the dealer's fiduciary duty claim did not survive summary judgment. [5]

All four decisions recognized the general rule that franchise relationships, including those in the automotive industry, are not inherently fiduciary in nature. However, each also recognized that under certain circumstances the law will find that an automobile manufacturer owes a fiduciary duty to its dealers.

The New York decisions are ultimately rooted in the New York high court's decision in *A.S. Rampell, Inc. v. Hyster Co.*[6] which found that a heavy truck dealer-distributor had adequately pled a breach of fiduciary duty claim against its manufacturer. In doing so, the *Rampell* court found that the dealer adequately stated the two necessary elements of a fiduciary relationship: (1) dominance by the manufacturer and dependence of the dealer; and (2) a confidential relationship between the manufacturer and dealer.

Despite the fact that breach of fiduciary duty is a common law theory, the *Rampell* court cited and relied upon the legislative history of New York's then-existing dealer termination statute to find that the first element of a fiduciary relationship was well pled. Specifically, the Rampell court cited history describing automobile manufacturers' power of life and death over their dealers, the unfair pressures placed on dealers, and the threats of arbitrary franchise cancellations. As a result, the *Rampell* court held that "[i]n the present case we are not dealing with competition between economic equals, but rather with the destruction of a relationship between the manufacturer and the distributor which is recognized to be that of dependency of the latter upon the former."

Like most state dealer laws, New York's modern dealer act contains express legislative findings stating its purpose, and there is extensive history detailing the legislature's intent to protect dealers against the dominance of manufacturers. The legislative history of New York's modern dealer act speaks of the "disparity in bargaining power" between manufacturers and dealers, dealers having "few if any rights" compared to manufacturers, dealers being able to "do nothing to oppose the will of the manufacturer," and similar pronouncements on the disparity of power. Following *Rampell,* the *Manhattan Motorcars* and *Legend Autorama* courts were able to rely on the New York dealer act's express statement of purpose and its legislative history to find the first element of a fiduciary relationship: dominance by the manufacturer and dependence of the dealer.

However, as the *Rampell* court cautioned, "dominance taken alone may be insufficient to show such a relation of confidence… Absent the relation of confidence between the parties, the complaint would not state facts sufficient to constitute a cause of action." The *Rampell* court found the requisite confidential relationship by looking to the dealer agreement that required the dealer "to make its lists of prospective customers available…; to keep records of [customer solicitation] available…; to give reports on its inventory and its financial condition, or any other information…which may be reasonably required…."

Modern franchise agreements impose the same, if not more, requirements on dealers today that the *Rampell* court found created the dominance and confidentiality necessary to the special bond necessary as an element of a fiduciary relationship. In addition to provisions requiring dealers to provide confidential internal financial, business and customer information, dealer agreements also typically require dealers to maintain certain inventory; maintain a certain sized facility with specific architectural requirements; maintain certain numbers of sales and service staff trained to manufacturer-set standards; give the manufacturer the right to set sales and service performance standards as it sees fit; give the manufacturer the right to approve senior dealership executives; and provide other rights for the manufacturer. Manufacturers also use margin earn-back incentive programs to enforce compliance with their requirements. Since many dealers cannot remain profitable without these earn-backs, they are effectively requirements of the franchise.

When pleading or defending a dispositive motion on a breach of fiduciary duty claim, it is critical to review the dealer agreement and its standard provisions carefully, including any operating, personnel and facility standards incorporated by reference. The *Manhattan Motorcars* decision discussed the terms of the dealer agreement that gave the manufacturer:

> "…near life and death economic power over [Manhattan]…: Of particular significance are those terms 'requiring [Manhattan] to provide reports to [Lamborghini] concerning sales, inventories, customer data, and all information concerning [Manhattan]'s business…'. Manhattan has therefore pled circumstances sufficiently extraordinary to allow its claims for breach of fiduciary duty to proceed."

In short, by pointing to the state's public policy, as manifest in its dealer law's legislative purpose and history, and by pointing to the specific terms of the franchise agreement and the obligations of the franchise, the *Rampell* and *Manhattan Motorcars* decisions provide a template to plead a viable breach of fiduciary claim arising out of the motor vehicle franchise relationship.

Of course, manufacturers will have something to say in the matter. Based on the available briefs in the *Manhattan Motorcars, Franklin Park* and *Legend Autorama* cases, one can discern a pattern to the recent arguments asserted by manufacturers against breach of fiduciary duty claims.

Manufacturers will point to cases involving other sorts of franchises, like gas stations, fast food, soft drinks or fashion. Gas stations, fast food restaurants and other franchise relationships are readily distinguishable in scale and scope from the automobile franchise industry. Moreover, because there is a growing body of fiduciary duty caselaw specific to the automobile franchise relationship, these decisions involving other industries should not be treated as particularly persuasive.

Pro-manufacturer decisions specific to the automobile franchise industry are often readily distinguishable and their persuasiveness can be blunted. Manufacturers will generally point to cases applying Michigan law holding that a fiduciary relationship does not exist between automobile manufacturers and their dealers. Most notable is *Bero Motors Inc. v. General Motors Corp.*[7] Ironically, the *Bero Motors* decision was relied upon in two recent New York federal court decisions also applying Michigan law: *Crest Cadillac Oldsmobile, Inc. v. General Motors Corp.*[8] and *Robert Basil Motors, Inc. v. General Motors Corp.*[9] Ultimately, this line of cases should have limited impact outside of Michigan or cases applying Michigan law. In fact, it is not at all clear why the two New York federal cases were even applying Michigan law in the first instance. As recognized by yet another New York federal court in *C. Basil Ford Inc. v. Ford Motor Co.,*[10] New York's dealer act provides that it is unlawful for a dealer agreement to require that disputes between a manufacturer and a New York dealer be determined through the application of another state's laws.[11]

In addition to *Bero Motors* and its progeny, manufacturers will cite two older federal cases, *Capital Ford Truck Sales Inc. v. Ford Motor Co*[12] decided in the Northern District of Georgia and *Rick Michaels Ford, Inc. v. Ford Motor Co*[13] decided in the Northern District of Illinois. However, the federal district court in Ohio that decided the *Franklin Park* case at the dismissal stage distinguished these cases as simply stating the "general rule." *Franklin Park* went on to conclude that because the dealer's allegations tracked the "exceptional circumstances" alleged in *Manhattan Motorcars,* the fiduciary duty claim would be allowed to proceed.

However, at the summary judgment stage, the *Franklin Park* court cited these same cases when ruling against the dealer. Although the earlier *Franklin Park* decision stated that New York law was "in line with the 'special trust' touchstone under Ohio law," the about-face in *Franklin Park* appears to be based, at least in part, on differences between New York and Ohio law. According to the second *Franklin Park* decision, Ohio's "special trust" analysis requires that there be "an understanding held by both parties to the subject agreement, that a special trust and confidence has been reposed by the franchisee in the franchisor."[14] However, New York law is different. As *Rampell, Manhattan Motorcars* and *Legend Autorama* make clear, in New York, a franchise fiduciary relationship is created where there exists dependency combined with a relation of confidence (which <u>may</u> be found in the contractual agreements). New York law does not impose an additional requirement that there be "an understanding, held by both parties." In short, individual state law may be critical in whether a breach of fiduciary duty claim survives summary judgment.

Although the later *Franklin Park* decision did not allow the determination of the existence of a fiduciary relationship to go to a jury, New York courts routinely leave the that determination for a jury. In *Monahan Ford Corporation of Flushing v. Ford Motor Company*[15], a New York bankruptcy court held that:

> "It is generally held that a franchisor/franchisee relationship does not give rise to a fiduciary relationship. However, a fiduciary relationship may arise in a franchisor/franchisee relationship if a confidential relationship was created or if the franchisee was obligated to accept the requirements allegedly imposed by the franchisor because of the franchisor's position of dominance.…[S]ince fiduciary relationships can arise between a…franchisor and franchisee, Ford and FMCC's motions to dismiss the breach of fiduciary duty claims against them must be denied because whether fiduciary duties actually arise between the parties is a question of fact." (internal citations omitted)

Likewise, at the summary judgment stage, the *Legend Autorama* case held that "[w]hile Audi urges the court to apply the general rule and find that it owes no fiduciary duty to [the dealers], they have raised factual issues concerning the nature and extent of their relationship with Audi, which requires the denial of summary judgment."

Manufacturers have also relied upon cases that do not involve an existing automobile franchise relationship: the decision of the federal court in the Northern District of Ohio in *Pasqualetti v. Kia Motors America, Inc.*[16] and a New York court decision in *Bevilacque v. Ford Motor Co.*[17] In *Pasqualetti*, as recognized in *Franklin Park,* the plaintiff was merely a prospective franchisee, not an existing dealer. Likewise, in *Bevilacque*, the plaintiff was merely the minority owner of the franchised dealer. Such cases should be readily disregarded as inapposite.

Manufacturers will also argue that a breach of fiduciary claim should be dismissed because it is merely duplicative of a breach of contract claim. This precise argument was rejected in *Legend Autorama:*

> "Contrary to Audi's contentions, the breach-of-fiduciary-duty cause of action is not duplicative of the breach-of-contract cause of action. The same conduct that may constitute the breach of a contractual obligation may also constitute the breach of a duty arising out of the relationship created by the contract, but that is independent of the contract. In assessing whether a contractual claim will preclude a claim for breach of fiduciary duty, the question is whether there exists an independent basis for the fiduciary-duty claim apart from the contractual claim, even if both are related to the same or similar conduct…Pleading a breach of fiduciary duty is appropriate when a plaintiff, even if claiming a breach of contract, should have a remedy in tort for betrayal and breach of trust…Here, the fiduciary duty, if any, arises out of Audi's purported position of control and dominance over [the dealers] and their dependency on Audi. Thus, it arises out of the parties' contractual relationship, but is independent of the contract itself." (internal citations omitted)

In fact, even where the dealer agreement at issue expressly disclaims that it creates any fiduciary relationship[18], *Legend Autorama* can be cited in support of the argument that a breach of fiduciary claim should nevertheless proceed because it "is independent of the contract itself." It is even better for the dealer if the applicable state dealer law prohibits provisions in franchise agreements that limit the dealer's ability to assert legal and equitable rights. For example, N.Y. Veh & Tr. L § 466 provides that "[i]t shall be unlawful for a franchisor directly or indirectly to impose unreasonable restrictions on the…dealer relative to…[the] assertion of legal or equitable rights with respect to its franchise or dealership." Thus even an express disclaimer in the dealer agreement may not be an insurmountable obstacle to a well-pled breach of fiduciary claim.

In the end, by bringing *Rampell* into the forefront, *Manhattan Motorcars* and its progeny have revitalized the breach of fiduciary duty theory in automobile franchise litigation. In *Rampell, Manhattan Motorcars,* and *Franklin Park,* the dealers' breach of fiduciary claims all survived motions to dismiss on the pleadings. In *Legend Autorama*, an add point case, the dealer defeated the manufacturer's motion for the summary judgment, even though the franchise agreement provided that it did not grant the dealer an exclusive right to any area or territory. As a result of these decisions, the breach of fiduciary claim remains a vital tool for dealers against manufacturers, particularly when faced with gaps in the state dealer law. ■

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1. *Manhattan Motorcars, Inc. v. Automobili Lamborghini, S.p.A.,* 244 F.R.D. (S.D.N.Y. 2007)
2. F*ranklin Park Lincoln-Mercury, Inc. v. Ford Motor Co.,* 2010 WL 2650041 (N.D. Ohio 2010)
3. *Legend Autorama Ltd. v. Audi of America, Inc.,* 2011 WL 2811461 (Sup. Ct. Suffolk Co. 2011)
4. The Author represents the plaintiff dealers in *Legend Autorama.*
5. *Franklin Park Lincoln-Mercury, Inc. v. Ford Motor Co.,* 2011 WL 5361738 (N.D. Ohio 2011). The plaintiff dealer has filed a FRCP Rule 59(a) motion to alter or amend the judgment, which remains pending.
6. *A.S. Rampell, Inc. v. Hyster Co.,* 3 N.Y.2d 369 (1957)
7. *Bero Motors Inc. v. General Motors Corp.,* 1001 WL 1167533 (Mich.App. 2001)
8. *Crest Cadillac Oldsmobile, Inc. v. General Motors Corp.,* 2005 WL 3591871 (N.D.N.Y. 2005)
9. *Robert Basil Motors, Inc. v. General Motors Corp.,* 2004 WL 1125164 (W.D.N.Y. 2004)
10. *C. Basil Ford Inc. v. Ford Motor Co.,* 2009 WL 909697 (W.D.N.Y. 2009)
11. From the briefs, it appears that the choice-of-law section of New York's dealer act, N.Y. Veh & Tr. L. § 463(2)(t), was not raised in either *Crest Cadillac* or *Robert Basil.* In both cases it was either agreed or undisputed that Michigan law applied to the common law claims. That might be because the version of section 463(2)(t) in force when *Crest Cadillac* and *Robert Basil* were decided contained several exceptions. These exceptions were removed when that section was amended in 2008, which may explain the different result in C. Basil Ford.
12. *Capital Ford Truck Sales Inc. v. Ford Motor Co.,* 819 F.Supp 1555 (N.D.Ga. 1992)
13. *Rick Michaels Ford, Inc. v. Ford Motor Co,* 1982 U.S. Dist. LEXIS 16502 (N.D.Ill. 1982)
14. Citing Saydell c. Gepetto's Pizza, 100 Ohio App.3d 111 (1994)
15. *Monahan Ford Corporation of Flushing v. Ford Motor Company,* 340 B.R. 1 (Bankr.E.D.N.Y. 2006)
16. *Pasqualetti v. Kia Motors America, Inc.,* 663 F.Supp.2d 586 (N.D.Ohio 2009)
17. *Bevilacque v. Ford Motor Co.,* 125 A.D.2d 516 (N.Y. App. Div. 1986)
18. For example, the Standard Provisions of General Motors' Dealer Sales and Service Agreement provides "No fiduciary obligations are created by this Agreement."

Russell P. McRory is a partner at Robinson Brog Leinwand Greene Genovese & Gluck P.C. in New York where he heads the firm's automotive franchise practice group.

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