NADC
National Association of Dealer Counsel

DEFENDER

The National Association of Dealer Counsel Newsletter JULY/AUGUST 2012

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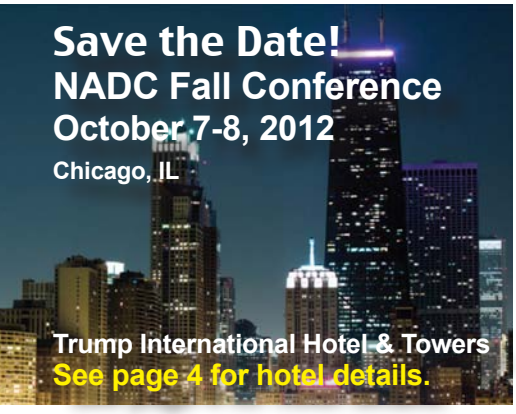

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Drafting or Reviewing Arbitration Agreements

By Tom Hudson, *Hudson Cook, LLP*

Our firm frequently prepares arbitration agreements for dealers to use in connection with the sale, lease and financing of vehicles. We also review (by the dozens) arbitration agreements used by dealers. The ones that we review range all the way from good to "not-too-awfully-bad" to "what were you thinking (or smoking) when you wrote that?"

I'll discuss below some of the shortcomings we often see. If you have an arbitration agreement, or if you're in the process of preparing one, this article might provide a convenient checklist.

In each instance, I'll identify the problem, then I'll discuss why it is a problem. If a fix isn't obvious, I'll recommend one.

1. The arbitration agreement does not prohibit class actions.

One of the main reasons for using an arbitration agreement is to provide an effective initial defense against class action lawsuits. To prevent class actions, an arbitration agreement must expressly state that no class actions will be arbitrated and that no class relief will be granted.

If an arbitration clause lacks such language, it leaves open the possibility that the arbitrator or a court might permit class-wide arbitration. Class arbitration is, from the dealer's point of view, the worst possible outcome, because the dealer will face the potential of class damages without the benefit of the procedural safeguards afforded to class defendants by the courts' procedural rules.

Plaintiffs' lawyers argue that an arbitration agreement that waives class action relief for the consumer is unconscionable under state law and therefore unenforceable. Industry lawyers argue that the Federal Arbitration Act preempts state law, and that the FAA's treatment of arbitration agreements as contracts means that the dealer and the consumer can, if they wish, agree that only their disputes, and not those of a class, will be subject to arbitration. It strengthens the dealer's argument when the arbitration agreement expressly prohibits class actions. Note, though, that these issues are still being litigated, even after recent U.S. Supreme Court opinions seemed to address them.

2. The arbitration agreement is not conspicuous.

An arbitration clause appearing in a buyers' order or retail installment sales contract is often in the same type and font as many other provisions in the document, and sometimes is less conspicuous than some provisions. Plaintiffs will argue that the lack of conspicuousness is an element of procedural unconscionability. To avoid that argument, the arbitration agreement should appear in bold type, in capital letters, preferably surrounded by a bold box, and an acknowledgement that the purchaser has

read the arbitration clause and agrees to it should appear on the front of the document separately signed or initialed or if not separately signed or initialed, as close to the purchaser's signature line for the document as state law will permit. Any other window dressing that can be added to the form, such as including the phrase (WITH ARBITRATION CLAUSE) to the form's title, will help.

3. The arbitration agreement does not state that arbitration is to be conducted under the Federal Arbitration Act.

Most, if not all, states have an arbitration act, but for several reasons, we recommend that the arbitration agreement state that arbitration is to be conducted under and governed by the Federal Arbitration Act. A large body of law has been created by court decisions interpreting the FAA, including many important cases dealing with the pre-emptive effect of the FAA, and most of it is favorable to dealers and creditors. Dealers shouldn't squander that advantage. State arbitration laws can be trumped by other state laws (such as laws prohibiting the waiver of a jury trial); for the most part, the FAA can't be.

4. The arbitration agreement names only one arbitration organization.

Plaintiffs have attacked arbitration agreements that name only one arbitration organization, arguing that the dealer/creditor, by naming the arbitration organization in its form documents, will be sending the arbitration organization a significant amount of business, resulting in bias on the part of the arbitration organization toward the dealer/creditor. This argument is usually groundless, given how few times a dealer is likely to invoke arbitration. Nevertheless, to meet this argument, we recommend using at least two arbitration services and letting the customer select the one to use. Dealers frequently choose the American Arbitration Association, one of the best known organizations offering

arbitration services and one that operates nationally. Some dealers prefer regional or local organizations. It is an even better practice to name at least two arbitration organizations, and also to provide that other arbitration organizations beyond the two that are named will be considered upon the customer's request, provided the dealer agrees.

5. The arbitration agreement provides that ALL disputes subject to it will be arbitrated.

This is a rookie drafting mistake that is easy to make. After all, somebody told the lawyer to draft an arbitration agreement, right, so the lawyer's agreement says all disputes will be arbitrated. The better way to craft an arbitration agreement is to provide that arbitration is required only when the dealer/creditor or the customer requests arbitration. That leaves the parties (and especially the dealer) free to use the court system when that seems more advantageous than arbitration. At least so far, consumers almost never initiate arbitration proceedings, leaving the dealer with the ability to arbitrate or go to court, as it sees fit.

6. The term "dispute or claim" is not defined, or is too narrowly defined.

Many arbitration agreements don't define the term "dispute" (or whatever term is used to describe the issue between the customer and the dealer). The term should be defined as broadly as possible, and should, for example, expressly include disputes dealing with advertising and credit application. Disputes with the dealer's employees, agents and assigns should be included, as well. If they aren't, the dealer might be able to escape litigating a fraud claim in court, but the dealer's agent or assignee, if separately named in the suit, could not escape. Consider adding some language a reviewing court can use to justify giving the term an expansive meaning – something like, "The term "dispute" shall have the broadest possible meaning."

7. The arbitration agreement does not set forth standards for the arbitrators.

There's often no requirement in an arbitration agreement that arbitrators be lawyers or judges, and there often is no requirement that in reaching his/her decision the arbitrator apply substantive law. This leaves open the possibility that a non-lawyer arbitrator deciding the case might be swayed in his/her decision by non-legal factors, and might be more likely to "split the baby" in rendering his/her decision. Think about whether a written decision by the arbitrator would be helpful. If it is, say in your agreement that one is required. Should rules of evidence or statutes of limitation that would apply in a court of law apply in arbitration? If so, say so.

8. The arbitration clause is silent with regard to the place where arbitration will take place.

Stating that arbitration will occur in the county and state of the purchaser's residence or at some other place convenient to the purchaser agreed to by the parties provides an appropriate and defensible venue

and alleviates the concern that arbitration could take place at a location unreasonably inconvenient to the consumer.

9. The arbitration clause is silent with regard to how the expenses of filing and arbitration will be borne between the parties.

The issue should be addressed, with the dealer bearing as much of the expense burden as possible. Dealers frequently push back on this suggestion – you frequently hear things like, "Why do I want to pay for someone to sue me?" Unless the dealer is being deviled by one or more plaintiffs' lawyers who have learned to "game" the arbitration process, though, it's unlikely that a car buyer will ever request arbitration. The only time that the dealer will request arbitration is when he is facing a class action or a potentially hostile court. When that happens, the dealer won't mind paying the customer's arbitration costs if arbitration makes the threat go away.

10. The arbitration agreement doesn't address what happens if part of the arbitration agreement is held to be unenforceable.

The arbitration clause should contain a poison pill – a provision that states that if any part of the arbitration clause other than the waiver of class relief is found to be unenforceable, the remainder will be enforceable, but that if the waiver of class relief is found to be unenforceable, the entire clause is unenforceable. Recall that one of the primary reasons to arbitrate is to avoid class actions. Since no dealer wants to arbitrate a class action, the poison pill kills the entire arbitration process when the class action waiver is declared invalid.

11. Don't get greedy.

We've seen arbitration agreements that provide that the arbitrator cannot award punitive damages, or that "carve out" from the arbitration requirement dealer or creditor remedies like self-help repossession. Don't do it. Courts looking for reasons not to enforce arbitration agreements will seize on such provisions as a reason to refuse to enforce the agreement. The temptation for the dealer's lawyer in drafting an arbitration agreement is to make it as dealer-protective as possible. That's a mistake, or at least it's a mistake if you want courts to enforce the agreement. Instead, try to come up with an agreement that isn't only fair and balanced, but that perhaps bends over backward to favor the buyer. When it's class action time, you'll be glad you were generous.

12. Add an opt-out.

Think about adding a provision permitting the purchaser to opt out of the arbitration requirement by mailing an opt-out request to a designated address within a designated time. Make it a requirement for successful opt-out that all purchasers sign the opt-out request. Consumer choice regarding arbitration is a great way to defeat an unconscionability argument.

There are at least a gazillion ways to screw up an arbitration agreement. Sometimes the mistakes don't matter, but sometimes they can have serious results, such as a court's refusal to enforce arbitration when you really need it. If you haven't done arbitration agreements before, you might want to run your version by a lawyer experienced in preparing such agreements. Finally, you should schedule a regular review of the agreement. I would recommend no less frequently than annually, and semi-annually is better.

Happy drafting! ■

Tom Hudson (tbhudson@hudco.com, 410-865-5411) has written several books, available at www.counselorlibrary.com. He also publishes Spot Delivery®, a legal newsletter for auto dealers, and is Editor in Chief of CARLAW®, a monthly report of legal developments in all states for the auto finance and leasing industry. He is a partner in the Maryland office of Hudson Cook, LLP.

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Executive Director's Message

Erin H. Murphy
NADC Executive Director

Have you made your plans to travel to Chicago in October for the NADC Fall Conference? The 2012 Fall Conference will be held October 7-8 at the Trump International Hotel & Tower in Chicago, Illinois. The conference will kick off Sunday evening, October 7th with a cocktail reception sponsored by The Fontana Group. The program will begin early Monday morning, October 8th and will adjourn at 4:30 pm that day. For those of you spending the night in Chicago, please join Anderson Economic Group at HUB 51 for cocktails after the meeting adjourns.

The planning committee has lined up an excellent agenda with timely sessions that can't be missed! This year, we will be offering a 1 hour ethics credit. Stuart Teicher will engage the audience in an entertaining lunch plenary session on the ethics of social media. As the country's only **"CLE Performer,"** Stuart promises to use his entertaining and energetic style to make the topic of ethics engaging and informative. An entertaining ethics session? You will have to see it to believe it! A big thanks to Johnson Deluca Kurisky & Gould, P.C. and Newton, O'Connor, Turner & Ketchum, PC for sponsoring this plenary ethics session.

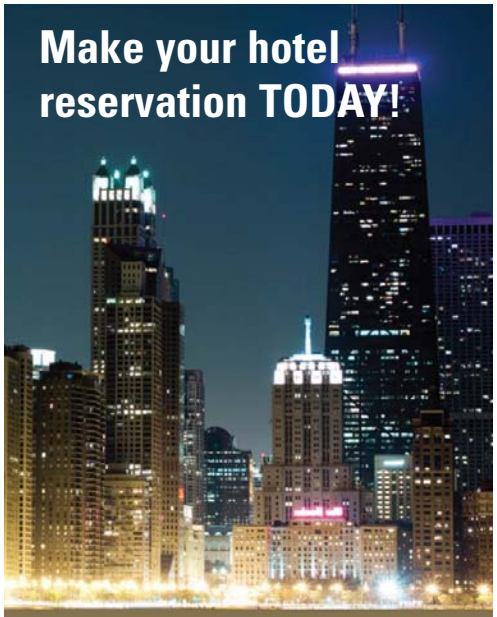
Other engaging sessions will include:

- Data Security Issues
- NADA Federal Update
- Advertising Pitfalls
- Legislative Trends in the States
- Succession Planning and Tax Issues
- Fair Lending

Please visit the NADC website to see full program descriptions and a list of speakers.

To register for the Fall Conference, please visit the Events section in our members' only section of the website at:

www.dealercounsel.com. ■



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THE CLOSING PROCESS

Part I—Pre-Closing

Feature Article

By Erin Tenner, *TennerJohnson LLP*

Representing a client in buying or selling an auto dealership is a process. After completing the negotiation of the purchase agreement and related documents and getting the purchase agreement signed and into escrow (if you are using one), the closing process begins. The closing process has three parts: pre-closing, closing and post-closing. This article is Part I of a three part series that will appear in the Defender examining the closing process (see the September and October issues of the Defender for Parts II and III). Part I focuses on what happens in the pre-closing process and how to prepare for the Closing. Part II will focus on what happens on the few days leading up to the Closing and on the day of closing. Part III will address post-closing considerations.

The pre-closing process involves getting all the approvals you need to close the transaction, publishing any public notices that are required by law, doing your due diligence, if you are representing the buyer, and making sure the dealership doesn't lose all its employees in the process. Although there will always be employee turmoil during any transition process, there are ways to minimize it, including thinking through the order in which you do things.

The Approval Process

Once the purchase agreement is signed the parties need to immediately commence seeking required approvals. Factory approval is usually the first consent requested. The seller sends a copy of the signed purchase agreement to the factory with a letter asking them to send the buyer an application package. The Buyer will need to be diligent in completing the application package properly. Often clients will ask attorneys to help with the application package. It is something the dealers usually do themselves. If your client asks you to do it for them you might want to make sure they understand this will significantly increase fees and it is something they can do themselves. Other consents may be landlord approvals, if the real property will be leased by the Buyer. The lease will need to be approved by the landlord and the factory, so getting it done and having it attached to the purchase agreement is a good idea. If it is not attached to the purchase agreement as an exhibit, it will need to be completed before factory approval will be forthcoming. These are typically the only approvals that will need to be sought immediately upon signing.

Notifying Employees

Employees need to hear about the deal from the dealer first. The factory will tell people about the deal and it will get back to employees. Dealers will tell you that the factory will keep it quiet, but it never works out that way. The same day the package is going to the factory the seller and buyer need to hold a meeting with all employees to announce the deal. The buyer should be at the meeting so the seller can introduce the buyer. Consider telling the general manager first, and letting the general manager tell the other managers immediately before the company wide announcement. Talk to your client about what the least disruptive way to announce the deal will be. The general manager might be the best person to make the announcement since the general manager is typically the person in charge of day to day operations. At some point the buyer will want to hand out employment applications to employees and begin getting to know the employees for purposes of determining who the buyer will keep. If the dealership is well run, the buyer

will likely want to get recommendations from the seller. Letting employees know this is going to happen could result in lawsuits. It needs to be made clear to employees that only the buyer can make hiring decisions. No information should be provided to the buyer about employees that could not be provided to a prospective employer under state law. For example, in California, the buyer cannot be given any information about employees other than job position, dates of employment and confirmation of salary information provided by the employee, unless the employee provides written consent to additional information being provided.

If specific obligations are going to be assumed by the buyer for purposes of satisfying the WARN Act or for other reasons, the purchase agreement needs to make clear that only those obligations are being assumed, and not others so the buyer does not inadvertently assume unintended obligations.

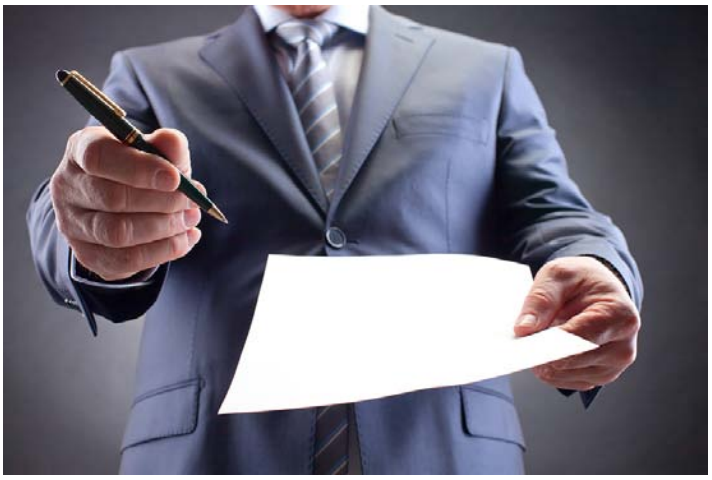
In order to support the seller's efforts at reducing disruptions prior to closing, consider having the seller appoint someone in the dealership that people can go to with questions when they hear rumors. The purchase agreement needs to include provisions supporting all of the foregoing so that the seller can enforce it during the closing process.

Publishing Notices

Shortly after signing the purchase agreement and announcing the deal to employees, public notices that are required by law will need to be given. If a bulk sale notice, WARN Notice, or Hart-Scott-Rodino notice must be given per the terms of the purchase agreement, the next step is giving required public notices. State laws need to be consulted to determine the requirements for bulk sale notices and state WARN Act requirements. The federal WARN Act provides that in the event of an asset purchase, if the buyer is buying the assets in place and in use, the buyer will be deemed to have the same employees after the closing, that the seller had on the closing date. This in effect eliminates the need for the seller to give a WARN Notice under federal law and shifts the burden to the buyer in many cases. Many states, however, have their own version of the WARN Act, often with more restrictive requirements. The purpose of the WARN notice is to give fair warning to employees and local government agencies that have to deal with unemployment issues, that they need to prepare for a mass layoff. The Hart-Scott-Rodino Act should be reviewed if you are handling a transaction that totals more than $50 million (including all asset and land being transferred). I usually check the Hart-Scott-Rodino Act whenever I am handling a transaction that totals $30 million or more for land or lease plus blue sky and fixed assets, because new vehicle inventories can bump up the total.

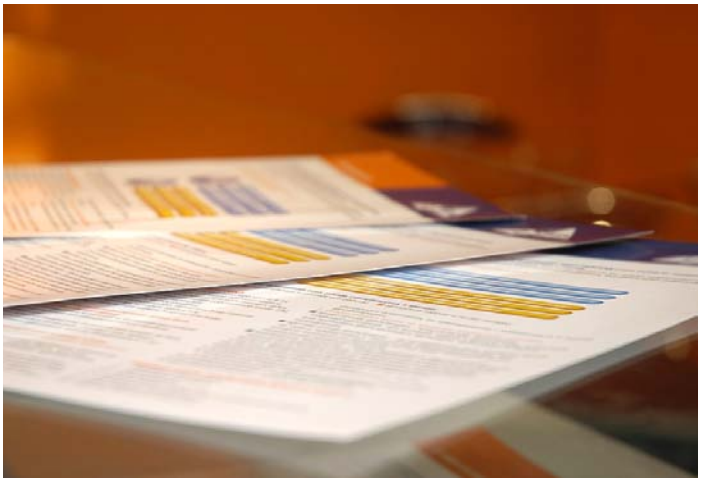
Due Diligence

Now that everyone knows about the transaction, the due diligence process will be much easier and should begin immediately after



announcement of the deal. There are typically time limits placed on due diligence and if you do not begin your due diligence right away you could lose those rights. If the purchase agreement limits the number of outsiders at the dealership on any given day to no more than two, it will reduce the interference with day to day business that the sale will inevitably create. There is nothing more disruptive than having a slew of accountants and lawyers infiltrating a dealership and asking questions. Also make sure the staff who will be providing access to information know which information should be provided and which information should remain confidential not only to protect the client if the deal does not close, but also to protect the client from running afoul of laws protecting non-public information. The due diligence will be dictated by the purchase agreement and what it permits. It will typically include environmental review, a building inspection, asset review, title reports, lien searches and verification of any information needed to confirm that warranties and representations are true and correct. The buyer should be performing its own environmental inspection, rather than relying on the inspection to be done by a lender or a prior inspection done by the seller. The company performing the investigation should be reporting to no one other than the buyer and buyer's counsel. If the purchase agreement permits it, the seller will want to obtain a copy of the environmental report. The environmental report will serve as a line in the sand for determining whether or not contamination later found existed at the closing and was caused by the seller or the buyer for purposes of any environmental indemnifications included in the purchase agreement.

A building inspection will also be performed during the due diligence period. This should not be performed by just any person calling themselves a commercial building inspector. The inspector needs to be a qualified structural engineer who also knows how to find and identify water damage and mold, plumbing problems, electrical problems, roof problems and HVAC issues. It may require more than one person, or a firm that has a crew with different qualifications.



Documentation

Most required documentation for closing will be completed either before the purchase agreement is signed or in the week or two before closing. The exception is any real estate leases or real property purchase agreements that were not completed and attached as exhibits to the purchase agreement. They will need to be completed as soon after signing the purchase agreement as possible, because the factory will want to see the leases as part of the approval process. Leases, assignments or subleases will also need to be completed for purposes of obtaining landlord approvals. In addition, an assignment and assumption of any vendor or maintenance contracts that will be assigned and assumed will need to be prepared. Vendor approvals usually will hold up the closing and don't end up causing problems, so one agreement to cover them all typically suffices. You can ask each vendor for consent to assignment as a condition to closing, but each may have their own forms and it is going to be very time intensive to get it done before closing if there are a lot of vendors. If you are doing it for your client, it is also going to run up fees. A good business manager should be able to handle it. Corporate resolutions authorizing the closing will need to be prepared, as well as any deeds, grant deeds, promissory notes, deeds of trust, security agreements, UCC termination statements or releases and state tax lien releases, if available will need to be obtained from relevant agencies. Some of this can be done by escrow, if you are using one. An appointment also needs to be made with Department of Motor Vehicles (or your states equivalent) by the Buyer so that the Buyer can obtain its dealer license. The buyer will also need to be thinking about other business licenses it will need to obtain prior to Closing. If a client has never purchased a dealership before, you might want to spell out all the various licenses for them and make sure they develop a relationship with someone at the state agency that will issue the dealer license in case there are last minute issues.

Inventories and Appraisals

Typically, four inventories will be required prior to closing – fixed assets, parts and accessories (which typically includes miscellaneous assets and work-in-progress), New Vehicles and Used Vehicles. Most will be completed on the day of, or in the days immediately prior to the Closing, and updated as of Closing. However, preparations will need to be made during the pre-Closing process to have inventory services lined up to complete inventories for closing. The fixed asset inventory and/or appraisal can be done well before the closing because fixed assets are not part of the seller's inventory that is changing day to day.

Once all this is done, you will be ready for the closing day. ■

Erin Tenner is a partner at TennerJohnson LLP and a member of NADC. She has handled hundreds of buy/sell transactions for auto dealers. In addition to her transactional practice she is also available as a private mediator and expert witness. She can be reached at 818-707-8410 or toll free at 888-501-0040.

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NADC
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Volume VIII, Number 7
JULY/AUGUST, 2012

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