NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL

# DEFENDER

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## In this Issue:




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# Strategic Vision of Dealerships in 2025 – *A Study into the evolution of the retail automotive industry*

By George E. Berry, Jr., CPA, *The Mironov Group, LLC*

Over two years ago, Auto Team America (ATA), a network of 11 CPA firms that serve over 2,000 auto dealerships nationwide, began a process to create a vision of the retail automotive industry a decade or more into the future. Over the two-year period, we assembled a steering committee of experts, created a focus group for the project, held numerous conference calls, surveyed dealers and presented the final paper in Las Vegas at ATA's 18th Annual CEO/CFO Forum in 2012.

Following are highlights of the predictions that were developed through our research. To download a complimentary copy of the full report, go to: www.mironovgroup.com./ata-white-paper-download/.

Based on what we know today, what is the retail automotive landscape going to look like for dealerships in the year 2025? Overall, we believe that operating profits for dealerships in the year 2025 will be driven by three main factors:

- The ability of a dealership group to expand its brand portfolio by leveraging greater economies of scale within geographic regions.
- Technology advances that will greatly expand vehicle throughput and reduce personnel costs.
- Changing real estate requirements as a result of faster inventory turnover and relocation of some departments to lower cost locations.


We decided that the best way to see how these factors will impact the dealership's operations is to follow them through each department and consider the overall atmosphere that dealerships will face in the future. While outside influences will impact operations, they are beyond the scope of our paper. Instead, we concentrated on dealership operations as they continue to evolve and focused on addressing the opportunities and challenges that lie ahead within the industry.

## Dealership Sales Environment

We expect that the use of Internet research, lead generation communications, and the ability to shop inventory and price vehicles electronically will accelerate into the year

2025 – with most of the shopping experience and vehicle research being primarily driven by technology. Through the increasing availability of various research tools, consumers will continue to be closer to a purchase decision before they walk into the dealership showroom. This increased use of technology will accelerate the pace of closing transactions; the future will see salespeople doubling their current rate of 12–18 vehicles per month. We predict that there will be smaller staffing requirements from the use of technology and efficiency improvements. The increased sales activity per salesperson will allow the average dealership to triple throughput and sell 175 new units a month.

When the consumer reaches the point of purchase, we believe the actual sales transaction, at its core, will be the same in 2025 as it is today. The purchase of a vehicle is a major decision, and it will take a skillful salesperson to guide the customer into a situation that is comfortable to them. Additionally, due to regulatory and manufacturer requirements, the actual closing process will still take place in the dealership, with all the required forms being completed electronically and vehicle delivery occurring at the showroom location.

The only efficient way to address compliance on every transaction will be to leverage technology. The Finance & Insurance department will once again be absorbed into the salesperson position. Since much of the customization of after-sale products and finance qualifications will happen prior to the close of the sale, the function of F&I will be reduced to compliance. New technology innovations will make compliance easier, so the final F&I compliance items will be performed with a delivery specialist or salesperson at lower cost to the dealership.

There will be larger payments from the manufacturers, giving them greater influence and control on how dealers conduct their business, including the areas of facility requirements, business practices, advertising

decisions, stocking guides and much more.

Moving to the pre-owned vehicle department, we see changes in the sales process and inventory. Technology has resulted in the commoditization of used vehicles; no longer is any dealership's inventory unique. Technology will make the department much more efficient. Program/remarketed vehicles will be sold via online bidding and wholesale buyers will bid on vehicles in an online marketplace, allowing the dealership to maximize wholesale profits. The market will continue to push manufacturers to maintain high residual/pre-owned wholesale values – forcing more vehicles into their branded certification process. Manufacturers will begin to recondition vehicles to certification status before remarketing them. And some manufacturers will take the next step in "certification" and begin to offer "refurbished" vehicles that will have more components inspected to a greater degree and replaced as necessary. The factory will expand its influence over the used department in order to maintain control over marketing pre-owned vehicles. To counter this, the dealership can go outside the factory channel to acquire used vehicle inventory. These options for the pre-owned department will allow it to be one of the areas where dealers will continue to chart their own path and be responsive to their individual market needs and business goals.

## Dealership Fixed Operations

Better logistics, improved demand analysis, careful selection of strategic warehouse locations and more common vehicle systems in 2025 will allow for more efficient control of parts inventory. Overall, manufacturers will control 90% of dealership inventory with guaranteed buybacks, eliminating much of the past obsolescence issues. With timely delivery of parts improving, the average turn of dealership inventory will improve to six to eight times a year. Parts gross profit will remain highest on most non-maintenance parts, and a variety of other factors will allow dealerships to maintain parts gross profit percentages.

The service department will continue to be the most profitable department for dealerships. This is in spite of a reduction in the maintenance requirements, extended maintenance intervals, and more manufacturers covering maintenance items under the new vehicle warranty. The growth over the next decade will be in customer repair work. This will not be due to a decrease in quality but an increase in the average vehicle's age, the complexity of systems and several new propulsion systems that will have limited repair expertise in the marketplace. Also assisting service department profitability will be increasing reliance on remote diagnostics, where vehicle monitoring systems will alert the driver of an error and automatically upload data files to the manufacturer and dealership. Such systems will also develop to the point that, under warranty repairs, required parts will be sent automatically to the dealership. Having a stream of information being fed to the service department directly from the vehicle will also aid the write-up process. This will allow the dealership not only to have electronic communication with the vehicle but also with the customer. Much of the repair order will be pre-populated upon arrival at the dealership, which will free up time for the service advisors to build a relationship with the customer.

## Dealership Facilities and Structure

Dealerships will be looking to have faster throughput of inventory, cleaner "retail" environments and more efficient operations. Future dealerships must sell more vehicles, with fewer salespeople at lower operating costs; that will cause dealership locations to shrink in physical size and footprint. The high priced rents and real estate frontage on desirable highway and premier retail locations will be cost-prohibitive, and the economics of the dealership will dictate that a more skillful use of space and capital resources will be key to survival. Efficient vehicle inventory management and service operations will curtail the need for storage space. Test drives will be accomplished by a true "demo" fleet, and vehicles will be sold out of the dealership's limited inventory or through more sophisticated locator programs. Satellite service facilities will become prevalent in lower cost spaces where allowed by the manufacturer or state regulations. When allowed by state franchise regulations, there will also be small satellite sales facilities for demonstration and presentation purposes only.

Given the current marketplace environment, with the capital requirements and needs for professional management, there is no doubt consolidation will be the largest factor impacting the face of dealerships by 2025. Consolidation will accelerate dealership buy/sell transactions over the next 10 years. Ownership will condense into 80 to 100 mega-dealer groups owning hundreds of dealerships. Initially, the pool of dealerships for sale versus the number of potential purchasers will be disproportionate, creating a buyer's market with stagnating prices. However, as the selling pool diminishes by 2020, a seller's market will take over. By 2025, the mega-dealer groups will control a significant number of dealership points.

### Other Influences of Dealership Business

There will continue to be pressures on dealerships from government regulators, consumer organizations and the manufacturer. These pressures cannot be discounted as they shape the way business is conducted.

It is expected that manufacturer influence through payments for increased sales volume, facility appearance, and customer satisfaction scores will increase in the future. By 2025, manufacturers will recognize that those that overstep the bounds of interference in the retail environment will harm their relative value of the franchise brand.

As the decade progresses, the multiple of earnings for the valuation on dealerships will increase. If the current multiple ranges from three to five times earnings (with thousands of factors influencing valuation to an individual buyer and seller), by 2025 the multiple will be four to six times earnings or greater. The injection of private equity against public companies, the ability of large groups to have a lower cost of capital and the ability to leverage their presence in the marketplace will cause values to rise. In addition to the franchise brand, the dealership's real estate position will be a key to the dealership's valuation.

Few industries are as heavily regulated as retail automotive, and no participant or observer of the industry expects that to change. As noted previously, when new regulations come into play dealerships will have to increasingly rely on technological solutions to ensure compliance. Technology will not be free, and only dealership groups of a certain size or scale will be able to comply economically. Such regulations will also certainly come at a cost of compliance and potentially reduced gross.

*George E. Berry, Jr., CPA, is a partner with The Mironov Group, LLC, a certified public accounting and consulting firm in Edison, NJ, that specializes in the retail automotive industry. George is also the firm's lead partner in Auto Team America, a network of 11 CPA firms that serve over 2,000 auto dealerships nationwide.* ■

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## President's Message

Patricia E.M. Covington
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*NADC President*

The mornings are brisk, with a slight chill in the air. The days are getting shorter and the scorching heat of the summer is behind us. Fall is around the corner, slowly but surely making its presence known. Generally, we welcome the change of seasons. But, sometimes it's hard to let go of the carefree days of the summer.

For dealers and their lawyers, the current regulatory and business environment is undergoing its own change of seasons. Gone are the days when dealers could be carefree about how they run their businesses. There is more regulation and change than ever and it's not about to stop or slow down.

For many of us, we'd say those carefree days are long gone – way back, in a time long ago. But even for us, the new pace of regulation and the onslaught of competitive pressures on dealers are disquieting. How can our clients make money in this environment? Well, it's going to be by staying informed on the law and the risks that threaten their businesses, together with educating themselves on what they can do to stay in compliance and competitive.

This is how we, attorneys representing dealers, can help - by staying apprised of developments in dealer law, forecasting the issues that dealers will be facing, and developing strategies to address these challenges to help them maneuver through the maze. We can prepare our clients to successfully react and even thrive. But, that takes time and effort on our part - setting aside time to keep informed, to study the issues, talk with our colleagues and contemplate solutions.

It's nice to do these things when our clients are paying us to do them, but that's not always possible or realistic. Generally, our clients don't call until there is a problem. What our clients need us to do is consider the issues before they become a problem. We can warn them of what's coming down the pike, and counsel them on how to prepare.

We at the NADC help you do these things. Reading this newsletter is one example of how to get ahead of the issues. Our fall conference is another very effective way to learn about current developments and get a preview of the next "hot" topics. Here's a preview of the conference schedule.

We plan to kick off the day with Andy Koblenz and David Regan reporting on federal developments the National Automobile Dealers Association is working on, and sharing their insights on the fall elections.

Then we'll be talking data security. This is an issue that's not "hot" in the news, but an undercurrent that is always there that can drown an unsuspecting dealer. While the media doesn't spend much time publicizing data breaches (that's old news), new technologies present new breach opportunities for the bad guys. Dealers need to understand and appreciate the risks. This is a good example of topic that is ahead of the curve. Why wait until someone suffers a data breach using new technology? Identify the risk and remedy it.

The next topic is fair lending. This is an issue that has not received much attention recently, but that will be big news, catching many dealers by surprise. Dealers may not know it, but dealers will be challenged on this issue, and we as counselors must be prepared.

We have an interesting addition to this fall's schedule – ethics. We will have an ethics presentation during lunch. Of course, we'll still have time to network and visit with friends, but we've added an interesting program on ethics and the issues we face with social media. This program will help each of us meet our state bar CLE requirements.

After lunch, we'll hear about state legislative trends. Representatives from state ATAEs will report on issues they'll be pushing for and fighting against in our state capitols. This is an excellent opportunity to find out what topics are on the horizon, and to learn about positions your dealers may be asked to get behind to protect themselves.

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Succession planning will be addressed in an afternoon panel. This is a topic you have repeatedly asked us to include in our program. The panel will talk about estate planning techniques, successor issues, exit strategies and even family dynamics. This topic has potential to reveal the drama of real life.

Finally, we'll discuss advertising, a fundamental dealer activity. The speakers will discuss key federal and state advertising requirements. Dealers frequently get into trouble in this space; so understanding the rules of the road is vital.

As with every other conference or event we've done, there will be plenty of networking opportunities – thanks to the support of our sponsors. Our welcome reception will be Sunday night, with great food, drink and company. Breakfast also offers an opportunity to catch up with folks as you get nourished for the morning sessions. Then during our breaks you can visit with colleagues and ask them how they are handling an issue that you are having a particularly difficult time resolving for a client. And to put a period (or exclamation point) on our time together, there will be a closing cocktail to give our minds some welcome rest and recreation. These networking opportunities are only possible because of our sponsors.

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I encourage you to visit with the sponsors, along with associate members with booths at the conference, to learn how they can help you and your clients. It's always nice to know where to point a client when asked, do you know where I can get X.

If you haven't joined us for a conference before, or you haven't gone to the fall one, you should give it a try. I can't tell you how many people tell me how much they enjoy these conferences. Not only do they learn a lot, but they have an enjoyable time with friends and colleagues. And in the mix of it all is the fantastic networking that goes on. Not to toot our own horns, but we really are a stellar group of folks (and attorneys, at that). And newcomers are welcome. Our group is not "cliquey," we're real friendly and love to bring new people into the fold.

So join us in Chicago. We'll be preparing ourselves for the issues our dealers will face … and having a lot of fun in the process! ■

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# Session Topics Highlights

**NADA Federal Update**
October 8th • 8:15-9:15 am
Andy Koblenz, *NADA*; David Regan, *NADA*
NADA's Legislative Affairs Vice President David Regan and Legal and Regulatory Vice President and General Counsel Andy Koblenz will provide insights on (1) the status of the fall elections (including both the presidential race as well as key Congressional contests); (2) implications of possible electoral outcomes for activities in the next Congress; (3) pending legislation affecting the auto industry; (4) prospects for a potential "lame-duck" session this year (especially in light of the looming "fiscal cliff"); and (5) the latest regulatory developments affecting dealers.

**Forewarned is Forearmed – Critical Consumer Data Protection Considerations, Strategies and Best Practices for Auto Dealers**
October 8th • 9:30-10:30 am
Brian McGinley, *Senior Vice President, Data Risk Management, Identity Theft 911*; Paul Metrey, *NADA*
The FTC made it clear in "In the Matter of Franklin's Budget Car Sales, Inc." that there are material expectations and significant consequences to automobile dealers for failing to properly assess risk and safeguard a consumer's personal data. Data breach events are increasing. What used to be a possibility is now a probability. Automobile dealers cannot afford to be caught short in matters of protecting consumer data, whether it is in paper form or resides on systems, networks or mobile devices. This session will explore the considerations, options and fundamental tools needed to assess risk and enhance development of an operational approach to protect personal information.

**Fair lending – It Needs to be on Your Dealer's Radar**
October 8th • 10:45-11:45 am
Patty Covington, *Hudson Cook LLP*
Fair lending is a priority for the federal government, and dealer practices will be scrutinized. This session will cover ECOA and Reg. B fair lending issues for dealers, including past enforcement actions, the current regulatory focus on fair lending, what dealer practices may be scrutinized and what dealers can do to lessen the risk and stay out of fair lending "trouble."

**Lunch and Technethics: The Ethics of Social Media**
October 8th • 11:45 am-1:00 pm
Stuart Teicher, *Teicher Professional Growth, LLC*
Social Networking is all the rage and attorneys are participating in record numbers. But our activities in Social Networking have both professional and ethical repercussions. Throw in the latest new technologies like cloud computing and smart phones and you've got a whole lot of confusion. In this one-hour program, the "CLE Performer," Stuart Teicher, reveals the pitfalls associated with social media and the latest technology and provides us with solid direction to avoid getting into trouble. Stuart teaches valuable lessons from the ethics rules as well as important opinions from around the country.

**Legislative Trends in the States**
October 8th • 1:00-2:00 pm
Sam Barbee, *Missouri Automobile Dealers Association*; Melissa Kuipers, *Brownstein Hyatt Farber & Schreck*; Shawn Mercer, *Bass Sox Mercer*; Jim Moors, *NADA*; John Policastro, *North Carolina Automobile Dealers Association*
A panel of NADA representatives and state association executives will engage in an interactive discussion of key challenges facing dealers as well as various state legislative measures that have been recently proposed and/or enacted in an effort to strengthen the automotive franchise system.

**Succession Planning for Franchised Motor Vehicle Dealers**
October 8th • 2:15-3:15 pm
Mike Charapp, *Charapp & Weiss, LLP*; Dave Ciambella, *Rawls Company*; Ken Rosenfield, *Rosenfield and Company*
The panel will discuss the issues that franchised dealers must consider as they develop their estate plans. The panelists will discuss some of the estate planning techniques available to dealers to minimize estate taxes, the pros and cons of various estate planning tools, successor identification / preparation, strategic planning, exit strategies and more!

**Advertising Pitfalls**
October 8th • 3:15-4:15 pm
Rob Cohen, *Auto Advisory Services, Inc.*; Tom Quinn, *Hudson Cook, LLP*
The FTC recently initiated a UDAP enforcement action against several dealers for advertising violations and many state AGs have conducted their own investigations into dealer advertising. During this session Rob Cohen and Tom Quinn will identify several advertising practices that may invite scrutiny from federal and state regulators.

# THE CLOSING PROCESS

## Part II – Closing

By Erin Tenner, *TennerJohnson LLP*

In the last issue of the Defender the pre-closing process was addressed. This issue will address some of what happens at the closing and explain what your client should expect to handle and what the attorneys will handle. The attorneys will be focusing on documents that need to be prepared or finalized for closing. The buyer and seller will deal with the inventories that need to be completed, employee payroll issues, employee questions, and other transition issues as described in more detail below.

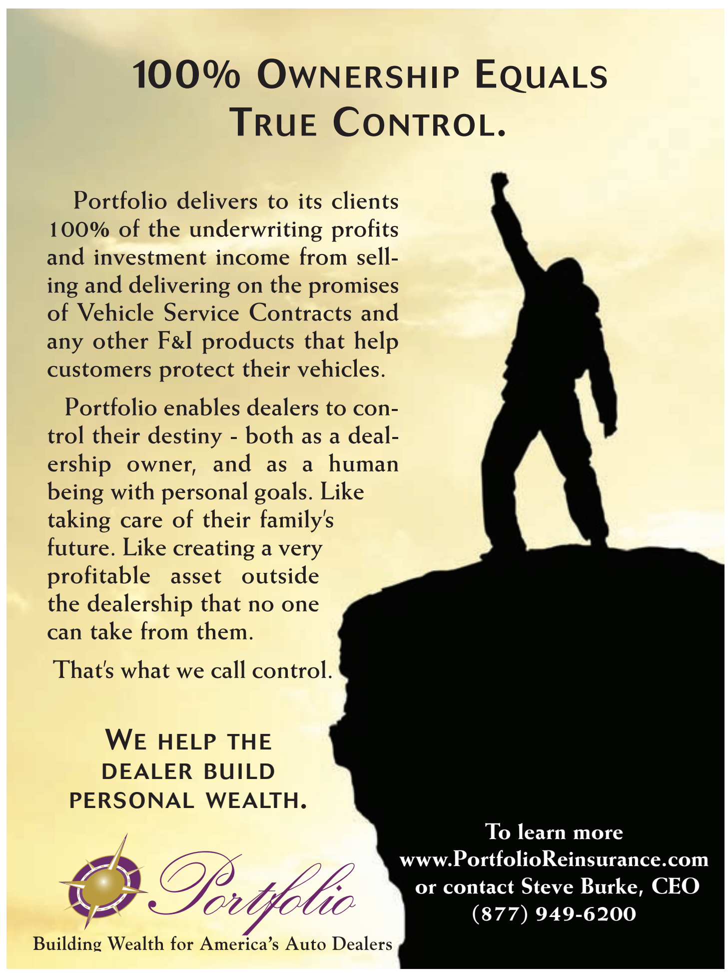
The closing itself typically takes a full day, although occasionally it can be longer or shorter. It starts with the flooring line representatives showing up at the dealership to inventory all new vehicles. If the parts inventory was previously completed it will need to be updated on the closing date for any changes in inventory between the time it was taken and the closing. The same is true for work-in-progress and miscellaneous assets inventories. The seller will need to deliver final pay checks and notices of termination to all of its employees effective as of the closing date, including all unpaid vacation pay.

If the attorneys have not already completed documents and submitted them to Escrow with blanks for inventory numbers, they will often meet at the Escrow to finalize documents while inventories are being completed. Some of the typical documents to be completed and signed at the closing are the bill of sale, any amendments to the purchase documents, an assignment and assumption of contracts the buyer will assume, final estimated closing statement, a promissory note (if one is being delivered), any security instruments securing any promissory note, any new leases and/or grant deeds if land is being leased or purchased, a lease termination agreement for any leases being terminated, corporate resolutions, documents stating that warranties and representations are true as of closing (or if they are not, stating amendments) and closing instructions. Closing instructions will list the final purchase price and instruct Escrow on: 1) which UCC liens, if any, need to be terminated and which do not; 2) what type of title insurance to purchase and whether to purchase endorsements to the insurance; 3) which documents should be recorded and in what order; and 4) any prorations to be made at Closing.

One of your most important jobs at closing, whether you are representing the buyer or the seller, will be to make sure that assets are delivered to the buyer free and clear of all liens and encumbrances. This means obtaining an updated UCC and tax lien search, an updated title report, tax clearance certificates from state agencies that collect sales, employment and franchise taxes if those taxes follow the assets as they do in California and making sure the parties have complied with bulk sales laws.

Some of the other things the buyer and seller will need to do, or have their accountants do at closing, are as follows:

Make sure the purchase price for new vehicles has been calculated in accordance with the terms of the purchase agreement. Arguments sometimes arise when one party tries to deviate from the terms of the purchase agreement. The purchase agreement should be consulted to resolve these disputes.Vendors need to be contacted and advised of the change of ownership, if they have not been already. Prorations to be made at closing will need to be determined. Any issues that come up on an updated UCC lien search or title search will need to be handled by contacting lien holders and obtaining lien releases. Any employment, sales and franchise taxes that are due



5. It will establish who will be responsible for paying taxes on fixed assets purchased and how the purchase price will be allocated for tax purposes.
6. It will provide what documents will be signed at the closing.
7. It will establish which of the seller's contracts the buyer is required to assume and which ones it is not, or how that determination will be made.
8. It will establish when and where the closing will occur and whether extensions are permitted to the closing date.
9. It will provide guidelines for due diligence including deadlines for completing due diligence and rights upon discovery of issues.

as of closing will need to be paid so they are not a lien on the buyer's right to the assets being sold after closing unless the buyer has agreed thy can be paid after Closing.

The buyer will need to obtain its dealer license and any other licenses that were not obtained prior to closing. The dealer license can be a bit tricky, at least in California, and having a contact at the licensing agency who is ready to help, can make a big difference. In California, the buyer cannot use the seller's dealer license without risking loss of both the buyer's and seller's license. Other states likely have similar laws. The seller will need to surrender its dealer license and franchise in order for the buyer to obtain documents needed to obtain the new dealer license. The seller cannot be expected to terminate its rights until all documents are in Escrow and signed for closing.

Much of what happens at the closing will be dictated by the terms of the purchase agreement. If drafted to protect the parties, it will, as long as they adhere to it. Ignoring the terms of the purchase agreement can be costly. Here are just a few of the ways a well written purchase agreement will protect your client:

1. It will enable Seller's attorney to cut off claims based on termination made by the seller's employees after closing before they are filed and turn into costly lawsuits. This includes claims for wrongful termination, discrimination, violation of wage and hour laws, violation of the WARN Act, the labor code or the myriad of federal laws giving employees rights.
2. It will enable the buyer's attorney to cut off seller's creditor claims against the buyer. This includes unsecured creditor claims and secured claims against the buyer for the seller's obligations.
3. It will ensure assets the seller did not intend to sell are not transferred.
4. It will establish either the purchase price to be paid for all assets being purchased, or instructions for determining the price at closing.

The closing process, and how smoothly it goes, is highly dependent on how well the purchase agreement is written, especially if one party tries to change the terms of the agreement at closing. There are different schools of thought about how involved the attorneys should be in the actual closing. One way to avoid being involved in any of the issues that inevitably come up, is to get most documents signed in advance and into escrow before closing. If you give the escrow the authority to fill in the blanks and obtain final signatures and don't ask the parties to attend the closing, you won't need to involve yourself in the issues that arise. Of course, this approach does not eliminate the issues. It just forces the parties to work them out without you, which may or may not be in your client's best interest. Often clients don't even realize that the purchase agreement contains provisions governing the issues that come up so they make agreements that cost them money that they didn't need to spend. Leaving closing to escrow often also results in loose ends. If the loose ends are not tied up after closing (and often they are not either because the attorneys get too busy and forget or because the client does not want to pay any more fees after closing) your client may be left vulnerable to potential litigation.

My preference is, and always has been, to attend the closing, finish up final documents at the closing while the parties are finishing inventories, get all documents signed at the same time after all issues are resolved, and add any final agreements arising out of the issues that come up to an amendment to closing escrow instructions. That way there are no loose ends, no unresolved issues and very little work left to be done by the attorneys once the deal is closed. The next issue of Defender will discuss post-closing issues. ■

*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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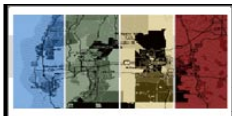
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