



In this Issue:

Feature Articles	1, 7
President's Message	3
New Members	4
Advertising Opportunity	12
Board of Directors.....	13

NADC 2017 Annual Member Conference

April 23 – 25

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Indemnification and Defense of Finance Sources in Consumer Litigation – Potential Pitfalls and Best Practices

By Bob Weller and Kristen Baiardi, *Abbott Nicholson, P.C.*



Weller



Baiardi

When a consumer files a lemon lawsuit, it is common for the consumer to name as defendants the manufacturer of the car, the dealer who sold the car, and the finance source that provided financing for the car. While plaintiffs' attorneys say that this facilitates settlement of these types of cases, dealer lawyers should be aware that this practice of including the dealers often practically results in increased costs and potential liability for the dealer.

When dealer clients are served with a lemon lawsuit, most are aware that the lawsuit should be tendered to the manufacturer for defense and indemnification pursuant to the sales and service agreement and/or statutory provisions. Unfortunately, although the dealer may be indemnified by the manufacturer, the dealer also may be contractually obligated to defend and indemnify the finance source in the same litigation. Dealer clients often do not understand that the manufacturer

is under no obligation to defend the dealer against contractual claims brought by the finance source. Additional confusion often arises because manufacturers sometimes will indemnify claims brought against their captive finance sources but not against unaffiliated finance sources.

A dealer will typically learn of a demand for indemnification when it receives a demand letter from the finance source. Often, the demand letter will enclose a copy of the plaintiff's complaint and a copy of the dealer agreement between the dealer and the finance source. If a copy of the dealer agreement is not included and it is not in the client's possession, a copy should be requested. The letter will recite the allegedly applicable sections of the dealer agreement and claim that the allegations in the plaintiff's complaint constitute breaches of the dealer's representations and warranties in the dealer agreement.

Most dealer agreements will require the dealer to indemnify the finance source for any damages (including attorney's fees) incurred, because a retail installment sales contract was not entered in full compliance with all applicable laws. A dealer agreement likely will permit the finance source to insist that the dealer buy back the

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contract based upon the alleged breach of contractual representations. In most cases a dealer will not want to buy back the contract and risk a default by the customer. However, if the customer is making payments in accordance with the contract, the financing company will rarely demand a buy back.

Instead, the finance source looks to the dealer for indemnification in the event that the lemon lawsuit results in liability against the dealer. As a practical matter, this will not happen, because the dealer is being indemnified by the manufacturer. The finance source also looks to the dealer to either pay for the defense of the finance company in the lawsuit or to defend the finance company in the lawsuit. In our experience, it is to the dealer's advantage to agree to defend the finance company's interests in the lawsuit. Generally, lemon cases settle without much discovery or motion practice, so the costs of litigation can be minimized. Most finance sources will agree to have the dealer's counsel assume the defense of the finance company in the lawsuit pursuant to a simple indemnification agreement. Dealers should be aware, however, that some finance companies obstinately refuse to allow the dealer to choose the counsel that will defend the finance company and instead assert a contractual right for the finance company to choose its own counsel at the dealer's expense. As ridiculous as this may seem, it may be technically permissible under some dealer agreements.

Until recently, finance sources (and in particular the manufacturer captive finance sources) rarely made a demand for defense and indemnification against a dealer in a lemon lawsuit. Presumably, there was a tacit understanding that the plaintiff was not making any claims of independent wrongdoing against the finance source and that the claims against the finance source were based solely upon holder liability. However, in the last several years, we have noticed: (1) more onerous representations and warranties in dealer agreements with finance sources; and (2) more aggressive actions by finance sources to seek defense and indemnification against dealers in lemon lawsuits. To mitigate expense and risk to the dealer, we recommend the following:

- Counsel your clients to be proactive by forwarding dealer agreements to counsel for review whenever a relationship with a new finance source is being considered or a finance source is proposing an amendment to an existing dealer agreement.
- If the finance source's demand for defense/indemnification is arguably appropriate under the dealer agreement, agree to provide defense and indemnification expeditiously.
- Propose entering into an indemnification agreement that defines the terms of the defense and indemnification and waives any conflict arising out of counsel's representation of the dealer.
- Keep the finance source updated on the progress of the case and send appropriate communications closing out the file once the matter is concluded.

Updated Member Contact Information

Please make sure to notify NADC Staff (info@dealercounsel.com) if your contact information has changed so that your records can be updated accordingly. We will begin to list updated contact information in *The Defender* so all members can be aware of the change.



Updated Information:

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Dealer clients are often skeptical when advised to pay their own counsel to defend a finance source in a lemon lawsuit for which the dealer is being provided a defense and indemnification by the manufacturer. Nevertheless, it will be much less expensive for the dealer to agree to provide the defense and manage the costs of litigation by relying upon the expertise of its counsel. Dealer counsel can efficiently manage the defense of the finance source through their knowledge of common characteristics of lemon law cases and through their relationships with plaintiffs' attorneys who often file lemon cases. Failure to timely respond to a legitimate request for defense and indemnification or a refusal of a legitimate request for defense and indemnification is an almost certain path to litigation with the finance source and the dealer may be compelled to pay the finance source's costs and attorneys' fees incurred in enforcing the dealer agreement. Counsel should advise their clients early of these potential pitfalls related to lemon lawsuits and the applicable provisions of dealer agreements should be negotiated to be more favorable/fair to the dealer if possible.

These trends related to finance source indemnification are a timely topic for dealers, and they represent a way for dealer attorneys to provide valuable counsel to their clients. Dealers may have developed a practice of "out of sight, out of mind" when it comes to lemon law cases due to reliance upon manufacturer indemnification programs, but it is even more important now for dealers to understand their potential obligations to indemnify and defend finance sources. ■

Robert Y. Weller II is a shareholder and co-chair of Abbott Nicholson's Motor Vehicle Dealer Practice Group and concentrates on commercial litigation and business counseling, with an extensive background in law governing the rights and responsibilities of automobile dealers.

Kristen L. Baiardi is a Partner at Abbott Nicholson, P.C. and devotes a substantial percentage of her practice to representing and counseling motor vehicle dealerships in litigation, regulatory, and other matters.

President's Message



Steve Linzer
Tiffany & Bosco, P.A.
NADC President

It's hard for me to believe, but this President's Report is my "Last Hurrah." My two year term as President will end this month at our 13th Annual Member Conference. It has been both an honor and a privilege to serve the membership of NADC. I was fortunate to be supported by a hard-working, dedicated Board of Directors. The list of the Board members is too lengthy to include in this report (it is included at the end of the *Defender*) so I will just say my sincerest thanks to all of the members of the Board who so ably assisted me and the organization during my term. I benefited greatly from your efforts and your always thoughtful advice. Also, I want to thank AMS and particularly our Executive Director, Erin Murphy, who guided me throughout my term. Erin, as well as the AMS staff, contribute greatly to the success of NADC.

It is gratifying to reflect on NADC's progress. In addition to our conferences (which set attendance records) and the success of our publication (*Defender*), we implemented our weekly *Dealer Counsel Alert*; obtained federal registration of the NADC trademark and tradename; established a branding trademark policy using the NADC logo; continued the Database/Website Integration Project; debuted our new 10' by 20' booth at NADA; established needed policies regarding document retention, conflict of interest and whistleblowers; and most significantly made substantial gains in membership and membership participation. We currently have almost 600 members! Clearly, our sustained growth has confirmed the foresight of our founder, Jonathan Harvey, and the other founding members who shared his vision that an organization for dealer counsel was needed in the automobile industry.

And now a few updates. The Standing Board Membership Committee chaired by Eric Baker recently finished its nomination tasks. It will present a slate of three new Board members to the Board and then the membership at the General Meeting of Members at the Annual Conference this month. Other members of that committee include Michael Dommermuth, Melinda Levy-Storms, Ron Smith, and Jonathan

Harvey. Thank you for your participation. The slate the committee has nominated is impressive and reflects the broad range of our membership. I have no doubt that the Board and your new officers will continue as capable shepherds of NADC in the future.

Our 2107 Annual Member Conference will be held from April 23-25 in Dana Point, California at the Ritz Carlton, Laguna Niguel. The planning committee has once again



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put together a timely, informative program featuring both an NADA update and an NAIDA update and a new Sunday afternoon introductory course for those attorneys who are new to practicing auto dealer law or those attorneys who want a refresher on dealership operations. The conference program planning committee consisted of Johnnie Brown, Andy Weill, Bob Weller, Scott Silverman, Ron Smith, Melinda Levy-Storms, Eric Baker, Diane Cafritz and Kevin Hochman. Thanks to each of you for a job well done.

My wife Maggie and I look forward to seeing everyone in beautiful Dana Point at the conference. Travel safe. Linzer out! ■

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- NIADA Update
- Top Legal Issues for Dealers in 2017
- Tiered Margins, Market Stratification, and Project Pinnacle
- The Politics of Employment Law: Understanding L&E in a New Administration

Travel Plans

Conference attendees and guests are invited to join NADC for a cocktail reception on Sunday, April 23 from 6:00 – 7:30 pm. The conference will conclude on Tuesday, April 25 at 2:00 pm.

NEW MEMBER AND FIRST TIME ATTENDEE WELCOME RECEPTION

New members and first time conference attendees are invited to join the NADC Board of Directors at a welcome reception immediately prior to the conference opening cocktail reception on Sunday, April 23. The welcome reception will begin at 5:30 pm. New members and first time conference attendees will receive an invitation email after registering for the event.

NEW THIS YEAR!

NADC Dealer Counsel 101:

Basic Introduction to a Typical Retail Automotive Dealership

Jim Neustadt will provide the audience with a general introduction and 30,000 ft view of a typical retail automotive dealership. Jim will discuss the various departments of a dealership, how they are organized and some of the unique challenges they face. The audience will learn how the various departments operate with a focus on regulatory compliance issues. Jim offers great insight into the day-to-day operations, having managed all aspects of several different dealerships. This session will serve as an introductory level course for those attorneys who are new to practicing auto dealer law or those attorneys who want a refresher on dealership operations.

This session is free for all members. Registration is required.

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The War Over Tesla and the Direct Sales Model

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

Tesla¹ just lost the latest battle in the war over the future of the retail automotive network, with a recent ruling by the Utah Supreme Court, that a wholly owned subsidiary of Tesla could not sell Tesla vehicles by means of direct sales to consumers in Utah.² The Utah decision continues the running battle between Tesla and existing retail automotive dealers.³ Ironically, state statutes which were designed to address abusive practices by traditional manufacturers, which would include direct sales by a manufacturer, are now a weapon for both dealers and traditional manufacturers seeking to preserve the benefits of the existing automotive retail network against the Tesla direct sales model.⁴⁻⁵ News coverage of the recent decision reported that it was a narrow one, but a thorough reading of the decision reveals that is a broad ruling, which if followed by other high courts, will severely restrict the direct sales model.

The Utah Supreme Court's decision was, in its own words, narrow in scope, but it is in fact, a well-crafted shot across the bow of Tesla. First, the Court specifically declined to rule on the broader policy questions raised by Tesla that the direct sales method would benefit Utahans and that the direct sales method improved the car-buying experience.⁶ Next, the Court did not find that the Utah statutes banned direct sales by Tesla, Inc., because Tesla was not the petitioner in the case.⁷ Finally, the Court swept aside any constitutional infirmities to the statutory scheme and the power of the regulating agency to make its decision⁸.

In dispensing with any challenge to the statutory scheme and declining to consider a challenge to direct sales generally, the Utah Supreme Court held that the plain reading of the Utah statute was that no franchisor (*i.e.*, a manufacturer) could "directly or indirectly" "own an interest in a new motor vehicle dealer or dealership."⁹ The Court found that the precise prohibition in the statute existed, as Tesla owned an interest in the subsidiary seeking the license to operate the franchise.¹⁰ To allow a license to be granted to the subsidiary would thus violate the proscribed conduct; the manufacturer would have an ownership interest in a new car dealership. Tesla argued that the statute only prohibited a manufacturer from receiving a license and was not intended to bar a subsidiary, which did not own an interest in the manufacturer-parent, from obtaining a license and that the mere relationship that was created by the parent-subsidiary relationship was not one that would cause any harm requiring protection under the statutes.¹¹ The Court disagreed. Its reasoning was that the plain reading of the statute was paramount under the State's Constitution and that the laws passed by the legislature must be honored. Finally,

in a stab at the heart Tesla, the Court ruled that Tesla's view of the statute's purpose as only protecting dealers was flawed. The Court stated, "Hardly any statute is enacted for only one purpose."¹² The Court then made the conclusion that the law was designed to not only protect dealers, but also manufacturers as well, such as delineating the respective responsibilities of dealers and manufacturers. Moreover, the Court presumed (apparently with no evidence in the record), that one of the purposes of Tesla's establishment of a subsidiary company was to limit the parent-manufacturer's liability, which protection the statute provided.¹³

It is somewhat ironic that a court has now held that a statutory scheme, which historically has been interpreted to have been enacted to protect dealers from the abuses by manufacturers¹⁴, can be the source of law to be used as a sword against a new entrant to the marketplace. The decision in Tesla Utah is an example of the vagaries of judicial interpretation. It should certainly give both dealers and manufacturers pause about how the battle will play out. I suspect this decision was surprise to all the parties and speaks to the adage, "Be careful what you wish for". ■

References

1. Tesla's stock market capitalization (\$50.84 BB) recently surpassed that of GM (\$50.79BB) and Ford (\$44.8BB) to become the most valuable carmaker in the United States. Tesla sold a total of 25,000 vehicles in the first quarter of 2017; GM sold 690,000 vehicles in the same period, just in the United States. Tesla lost \$675,000,000 in 2016, while GM's net income in 2016 was \$9,430,000.00.
2. *Tesla Motors UT, Inc. v. Utah Tax Commission*, 2017 WL 1231771 (Utah 2017). The opinion has still not been released for publication and is subject to revisions or withdrawal.
3. This map provides a broad overview of the state of play in the United States regarding Tesla's bid to engage in direct sales: <http://www.autonews.com/article/20140301/RETAIL/140229855/teslas-state-by-state-battle-with-dealers>.
4. *Cf. Ford Motor Company v. Darlings*, 151 A.3d 507 (Maine 2016) (Maine dealer act enacted to address disparity in bargaining power between automobile dealers and manufacturers that were perceived as abusive or oppressive). The Federal Dealer Day in Court Act (15 U.S.C. §1522 *et. seq.*) was intended to address this disparity. *New*

Motor Vehicle Bd. v. Orrin W. Fox Co., 439 U.S. 96, 102, n.4 (1978) (“[V]ast disparity in economic power and bargaining strength has enabled the factory to determine arbitrarily the rules by which the two parties conduct their business affairs.”), *citing* S. Rep. No. 2073, 84th Cong., 2d Sess. (1956)). In practice, the Dealer’s Day in Court Act has been ineffectual as it requires “actual coercion, intimidation, or threats” to plead and prove a cause of action. *Bob Maxfield, Inc. v. Am. Motors Corp.*, 637 F.2d 1033, 1038 (5th Cir. 1981).

5. Traditional manufacturers are not sitting still. Cadillac’s new subscription ride sharing service is arguably a violation of the ban against direct sales. See <http://gmauthority.com/blog/2017/01/book-by-cadillac-program-lets-subscribers-drive-v-series-platinum-models-for-1500-per-month/>. In addition, Ford and GM have been supportive of efforts to curb Tesla’s activities, although they have relied on state dealer associations to fight the war. Chrysler has to date remained ostensibly neutral.

6. *Id.*

7. *Tesla*, 2017 WL 1231771, at *1.

8. *Id.* at *8-*12.

9. *Id.* at *7; Utah Code Ann. § 13-14-201 (West 2017).

10. The Utah Statutes, as do many state statutes, use the word “franchise” to define the relationship established by an automotive manufacturer’s sales and service agreement granting the dealer the right to distribute the automotive manufacturer’s brands. The term “franchise” can be somewhat confusing, as a dealer sales and service agreement and the relationship between a manufacturer and a dealer is not a “franchise” under the Federal Trade Commission’s Franchise Rule governing traditional franchises. 16 C.F.R. Part 436.

11. *Id.*

12. *Id.* at *8.

13. *Id.* at *7.

14. See note 4, *supra*. Although beyond the scope of this article, the question of whether the dealer protection scheme is beneficial or harmful as an economic matter is hotly debated. Compare Maryann Keller & Associates, LLC, *Consumer Benefits of the Dealer Franchise System* (2017)(dealer distribution system retains unique ability to add value and goodwill to automotive manufacturer’s products) with Daniel A. Crane, *Tesla, Dealer Franchise Laws, And the Politics of Crony Capitalism*, 101 Iowa L. Rev. 573 (2016) (historical dealer distribution system is not sustainable; represents capitulation to political pressure for protectionism).

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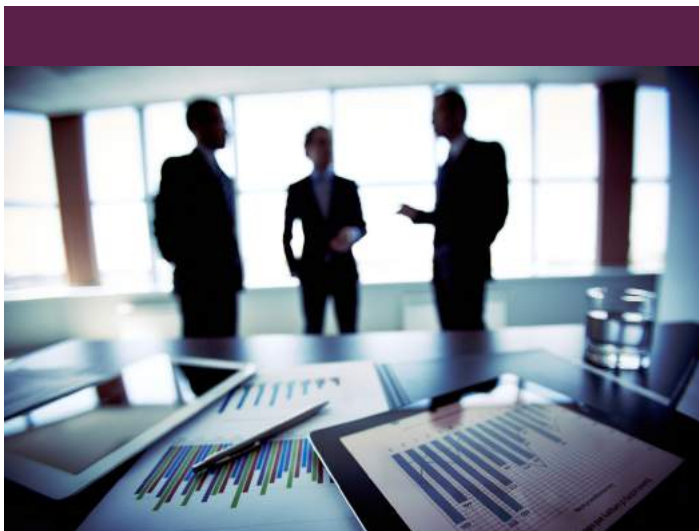
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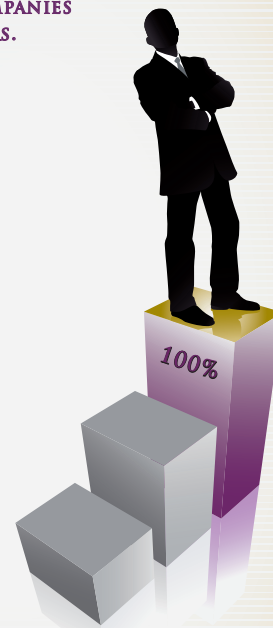
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