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2018's Top Twenty Legal Trends for Automobile Dealers

By Eric L. Chase
Bressler, Amery & Ross, P.C.

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2018's Top Twenty Legal Trends for Automobile Dealers

Feature Article

By Eric L. Chase
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INTRODUCTION

If what is right, fair, and lawful matters in U.S. carmakers' stewardship of their franchised auto dealers, the next year or two could witness a sea change in how they evaluate and police dealer sales performance, and the way they ride herd over dealers characterized as "low or under-performing." This trend moves to No. 1 for 2018, as it affects profoundly every franchised auto dealer in America.

In my opinion, any of this year's top ten trends could vie for #1, and even 10-20 could be dark horses. For reasons to follow in this article, 2018 might be a year of extraordinary good fortune for dealers, not only in sales, profits, and store values, but also in legal and regulatory reform. At the same time, counter-developments in political and investigatory arenas could profoundly undermine some of the upbeat initiatives and developments. My overall assessment for American dealers weighs in favor of optimism, that 2018 will be a year for dealers to celebrate for financial, legal, and regulatory reasons.

Trend #1 informs us that, in their governance of dealer sales performance, auto franchisors err dramatically in at least four important ways. First, their conceit of scientific accuracy in determining dealer sales efficiency and "expectation" numbers, and in establishing fair minimum sales benchmarks is baloney. Second, and more important, the factories craft their methodologies to make certain that a significant percentage of dealers in a given brand will always be deemed "under-performing."

For auto franchisors, the reasoning is simplistic: High sales penetration percentage (in comparison with average) equals a good dealer, franchisors argue. Low penetration percentage equals a bad dealer. Third, even if factory methodology and metrics yielded statistically sound assessments (which they do not), any franchise system devised to assure the "failure" of dealers with lower penetration numbers is unfair. That is because franchisors should aspire to maintain reasonable standards that all dealers at the same time may reasonably satisfy. Fourth, auto franchisors use their flawed methodological results as a cudgel. Based on unreliable and unfair metrics, dealers reap substantial rewards or suffer punishments. For much too long, American auto franchisors have taken their dealers for a bumpy ride. It is time to redress what has become a scandalous inequity in the policing of dealer sales performance.

Why now? The problems of factory sales evaluation methodologies are years old. To be sure, some dealers are now pushing back in an unprecedented way at this manifest injustice carried out by automakers. As I expressed in an op-ed in May 2017, the "industry standard" for measuring dealer sales performance is inaccurate, unfair and, in my opinion, unlawful. Chase, Eric. "Automakers must scrap metrics for dealers," *Automotive News,* May 15, 2017. So, the answer is that the cure for unfairness is long and should be accomplished now.

Consistent with the 2016 New York Beck decision (*Beck Chevrolet Co., Inc. v. General Motors, LLC,* 27 N.Y.3d 379 (2016)), state lawmakers, courts, and administrative tribunals have been moving in the right direction, no longer accepting the factory dogma. The National Association of Dealer Counsel (NADC) has appointed a task force (which I chair) to address this issue that affects every franchised dealer in America. In this article, I suggest a way for franchisors to revamp their evaluation procedures for the benefit of both them and their dealer networks. Accordingly, the #1 trend is the subject of a thorough essay, below, in this Top Trends issue.

Many industry analysts argue that the self-driving phenomenon is the year's hands-down winner, but I am placing it at #2. It embraces the meteoric rise of an anticipated era of autonomous vehicles. Arguably, the legal, the business, and the operational changes could be vast and unprecedented in the American (and world) economy and legal system. Indeed, some very smart industry professionals forecast the end of franchised dealers as America's auto retailers. Already, the industry is betting billions of dollars – tens of billions –on vehicles and systems that will define a sea change in America's personal and professional ground transportation.

Trend #3 follows closely behind. A year ago, profound changes affecting dealers for 2017 stemming from an altered legal and regulatory landscape in the new Trump administration ranked #1. To a certainty, federal regulatory changes from the prior administration are already dramatic, and ongoing. Moreover, since the November 2016 election of President Donald J. Trump, investigations, controversies, and partisanship have stymied much of the Trump agenda, and there will be no letup of legislative and political turmoil during 2018.

As ever, issues of importance to dealers are both numerous and profound. Measured in page numbers, this year's annual article describing 2018's 20 top legal trends for dealers is the longest ever. In addition to the increased number of pages in this edition, the 20 ranked trends could easily expand to a top 25, or even 30. That is because, in 2018, the relative significance to dealers of multiple legal issues, both old and new, is extremely high. Every dealer needs to take a hard look at which of these could impact his or her retail auto business in the legal arena, and to plan accordingly.

The ranking of the top twenty legal issues/trends is based on three factors: (1) the likely number of dealers affected; (2) the probability of change from the current situation; and (3) the seriousness of a trend/issue impact on the lives of dealers.

1. Franchisor Sales Performance Standards and Pressures on Dealers: The Time Has Come to End the Way Manufacturers Unfairly, Unlawfully, and Inaccurately Measure and Police Dealer Performance. A "Modest" Proposal for a Better Way (3)

It must be remembered that there is nothing more difficult to plan, more doubtful of success nor more dangerous to manage than the creation of a new system. For the initiator has the enmity of all who profit by the preservation of the old institution and merely lukewarm defenders in those who would gain by the new one.

– Niccolo Machiavelli

Who would have guessed that in the sixteenth century, Niccolo Machiavelli would cogently frame the most challenging factory-versus-dealer issue for 2018? For too many years, America's automotive franchisors have purported to evaluate, identify, and enforce dealer sales objectives and requirements under a profoundly misguided pretense of scientific validation and reliability. Their metric-obsessed rationales turn the truth upside down. Manufacturers tell dealers that they merely measure (and require) dealer sales performance to be consistent with a scientifically derived "expectation."

They will not readily or willingly cure their metric monster, even though it drives an unfair and inaccurate gauge of whether a dealer may be in material breach of the dealer agreement. "Average," factory experts testify, is merely "a C grade," a fair standard for all dealers. Carmakers even tell dealers who sell at "below average" sales penetration levels that they are thereby breaching their dealer agreements, rendering them subject to possible adverse actions, including franchise termination. As but one example of all auto franchisors' policies, American Honda says this in official policy provided to all its dealers: "State average is the standard utilized by American Honda to determine whether a Dealer is meeting its contractual obligation for minimum sales performance."

U.S. auto franchisors measure dealer sales efficiency by applying metrics that are almost indistinguishable from brand to brand. It goes something like this: they compute an "average" sales penetration benchmark for all the same-brand dealers in the applicable region or state (or other area). Then they compare <u>each</u> dealer's sales penetration in its area of responsibility measured against "opportunity" or "expected" or "average." Dealers whose sales penetration falls below "average" of all same-brand dealers in the comparative geography are deemed "underperforming." Consequently, at <u>any</u> given time, about half the dealer network of an auto franchisor is unsatisfactory, and in material breach of the dealer agreement! Although, for illustrative purposes, this summary is simplified, it nevertheless shows how the factories claim an ability to make such measurements and calculations in a scientific and statistically reliable way so that they can grade all dealers' sales performances and assert that those falling below the average benchmark are in breach.

As a practical matter, the dreaded termination notice is a rarity, and mere "below average" sales performance usually will not generate such a notice. Nevertheless, sales performance evaluations often partially drive eligibility for levels of bonuses that can determine a dealer's profitability or competitiveness. Also, if a dealer is looking to acquire another dealership, below average sales of existing stores can be an automatic disqualifier.

In recent years, auto factories have routinely sent letters to "underperforming" dealers, demanding that they agree that they are in breach. They tell such dealers to acquiesce in a "cure" to bring sales up to at least average penetration, usually within 90 or 180 days, and maintain that level or above at all times thereafter. They admonish those dealers that failure to cure could result in termination, and that the dealer's signature confirms that the factory's assessment is reasonable.

Unfortunately, many dealers understandably do submit to their suppliers' demands. This acquiescence is understandable, because auto franchisors wield enormous, disproportionate power in their relationships with dealers who fear reprisals, often subtle ones, when they challenge factory orthodoxy, no matter how unfair or unreasonable. Courts have long characterized standard dealer agreements as "contracts of adhesion" because of the factories' one-sided, coercive bargaining power, and the take-it-or-leave-it "choice."

In the past, when confronted with contests over factory "metrics," courts often avoided turning over the rocks to see what is underneath, to ascertain whether the "generally accepted" "metrics" have an underlying scientific basis in reality or science. Courts have also not inquired much into whether an "average" sales penetration or other threshold is reasonable. Recently, however, some tribunals have taken a more discerning approach. The factories' "industry standards" for retail sales evaluations, their flawed methodologies and "metrics" may be, at last, unraveling. In *Beck Chevrolet Inc. v. General Motors, LLC,* 845 F.3d 68, 71 n.4 (2d Cir. 2016), a prestigious federal appellate court said:

> [T]he [New York State] Court of Appeals determined that it is unlawful not only to terminate a dealer on the basis of a below-average RSI, but also 'use' that standard – alone or in connection with other metrics – to assess an automobile dealer's compliance with its franchise agreement.

Moreover, in the past two years, several states have amended their auto franchise laws to require demonstrable proof of scientific reliability in the imposition of standards grounded in sales metrics (*e.g.,* Florida, Illinois, Maryland, Montana, and Ohio). Additional states are considering similar possible enactments. This is a simple and reasonable proposition to the automakers, consistent with these new laws: If you want to use metric-based statistics in determining dealer sales performance efficiency, you must first demonstrate scientifically the validity and accuracy – of both the metrics themselves and their statistically demonstrable relationship to sales performance of individual dealers. The National Association of Dealer Counsel (NADC) has established a task force to further the dealers' cause in rectifying these serious problems of inaccurate and unfair factory methodologies and standards in assessing and enforcing dealer sales benchmarks.

Because this annual Top Twenty publication principally serves an audience of dealers, not just lawyers, I try mightily to avoid getting too legalistic. Nevertheless, with any study of factory metrics that purport to measure scientifically the sales objectives of dealers, some legal observation is necessary. In cases across the country, courts, commissions, and boards hear expert testimony in support of factory methodology and metrics, as well as testimony by experts on behalf of dealers who contest those assertions. In the expert witness arena, three U.S. Supreme Court cases from the 1990s embody the requirements for expert testimony, and by extension, the requirements of the underlying science that may – or may not – be at the crux of such testimony. These cases have spawned a cottage industry of court determinations about what may be admissible scientific evidence and the requisites for expert testimony. *See Daubert v. Merrell Dow Pharmaceuticals,* 509 U.S. 579 (1993); *General Electric Co. v. Joiner,* 522 U.S. 136 (1997); *Kumho Tire Co. v. Carmichael,* 526 U.S. 137 (1999).

More specifically, courts have established "reliability criteria [to] exhort scientists to do good science and require them to be scientists first and expert witnesses second." Lorandos, Demosthenes."Expert Evidence Post-Daubert: The Good, the Bad and the Ugly," 43 Litigation No. 3 (Spring 2017), pp. 18-24. The applicable case precedents establish "a set of 11 reliability criteria applicable to all expert testimony: *Reasoning-Methodology-Validity-Reliability-Empiricism-Hypothesis Generation-Falsification-Testing-No More Ipse Dixit-Validity of Qualifications-Intellectual Rigor." Id.* at 18.

When applied to the auto franchisors' industry methodologies to ascertain "expected" retail sales on a dealer-by-dealer basis, the many fallacies destroy factory claims of satisfying any of the eleven listed criteria. Although seductive and seemingly straightforward and simple, the formulation of "expected unit sales" falls apart because there is nothing scientific or statistically supportable in the factory methodology that connects the prediction of expected sales to on-the-ground reality.

In part, these fallacies in factory methodology will seem obvious to seasoned dealers and their counsel. Here is why: To establish statistical consistency in comparing dealer sales, metrics, the automaker or its experts would have to control for innumerable "variables." But, every dealer is uniquely situated, and "controls" for statistical purposes would be challenges. Varying geographies and locations are, by definition, unique. Moreover, the urban science-driven assignment of census tracts to dealers, based almost entirely on a dealer's proximity to those tracts, has proven to be far from a reliable indicator of where a dealer enjoys a competitive advantage.

Even same-brand dealers within a single town have different thoroughfare ingresses and egresses for customer access; surrounding businesses and interbrand auto sales competition are never the same for different dealers. For any two dealers – not to mention for a host of dealers across a region or state – nearby customer preferences and habits often vary widely, as do demographics that influence consumer choices. And so on. To my knowledge, no auto franchisor has commissioned (or revealed) an independent study to statistically validate its methodology – with controls for all relevant variables—to assess and compare dealer sales performance, much less predict accurately what sales numbers should be. According to experienced experts – statisticians, CPAs, and economists – any effort to validly control for all these variables is probably a lost cause, because of their abundance, complexity and differing circumstances. Even the variables vary from dealer to dealer, from location to location.

There is more. On top of the clear fallibilities of the factories' "metrics" obsession, using an "average" penetration threshold (or a derivative from average) as a minimum passing grade is both absurd and unreasonable on the face of it. No franchisor should construct a network plan that assures the automatic failure of about half (or any percentage of) its franchisees at a given time. But that is what auto franchisors do. As set forth above, they exploit fallacious metrics to assert dealers' breaches.

With an "average" benchmark for all dealers, the failure rate never gets cured. That is because "average" will move up or down along with a brand's sales trends. Thus, even if a brand's sales double in a year's time, the number of "below average" dealers will stay fairly constant. An enlightened, reasonable franchisor should deploy evaluative systems that increase the likelihood and assure the possibility that every franchisee can comply with reasonable standards at the same time. Factory standards, however, guarantee the opposite.

A Modest Proposal to Bring Sense and Fairness to the Automaker Evaluation of Dealer Sales Performance

So, in revamping their current methodologies, what should auto franchisors do instead? They surely have a right and responsibility to evaluate dealer sales performance using fair, consistent, and reasonable standards, to ensure that dealers are doing a responsible and competent job in carrying out their part of the bargain, *i.e.,* to sell and service the brand's vehicles in a professional manner.

The proposal here has two components. First, factories should "custom tailor" dealer evaluations and jettison their adherence to unreliable metric measurements. Instead of incomprehensible and inherently discriminatory "one-size-fits-all" metrics that depend on convoluted and artificially devised comparisons among dealers, they should establish discerning on-the-scene standards for dealerships as primary evaluation criteria, so that each store is assessed on its own compliance with those standards. These would include, but not be limited to, adequate facilities, well-trained professional sales and service staffs, customer friendly policies and practices, reasonable capitalization, regular suitable advertising in local media, appropriate and adequate inventories of vehicles and parts, etc.

Second, it is foreseeable that the factories will contend that they cannot properly govern their franchise networks without reference to actual sales numbers. How many units did this dealer retail, over what period of time? How do those numbers stack up reasonably against what the dealer should have retailed? Neither this author nor the experienced members of an ongoing NADC task force take issue with this proposition in theory. We recognize that sales performance evaluation using metrics might be useful if the factories could fashion a statistically proven methodology to scientifically determine how many units a given dealer should sell or should have sold.

However, it is unlikely that auto franchisors can formulate such a scientifically based metric-methodology. A daunting challenge for the factories is and would be to develop and demonstrate statistically reliable methodologies to assure reasonable accuracy and to make sure that a dealer's unit sales, compared with the sales penetration of others, would be only part of a much broader overall analysis. After all, not only are retail sales numbers and penetration comparisons now deployed by franchisors to claim material breach of the dealer agreement, but also they are the data upon which they purport to calculate dealer bonus monies and incentives, and to establish "gateway" criteria for dealers aspiring to acquire new stores. Thus, if they insist on a reliance upon metrics, it is critically incumbent upon franchisors to develop methodologies that are fully explained, openly expressed to dealers, and proven to be statistically valid. Again, experts advise that such proof is elusive, if not illusionary. The *Beck* court admonished GM that it could not rely on metrics based upon the ease of the methodology, nor was it appropriate to use "average" benchmarks to measure or discipline dealers, according to the U.S. Court of Appeals for the Second Circuit. Instead, franchisors need to be both reasonable and demonstrably accurate.

Accordingly, in a new and much more enlightened and fairer regime of sales performance analysis, the factories should adopt the "custom tailored" approach, above. And, if they continue to use comparative metrics, such information – if proven accurate and reliable – should only be a piece of the evaluation of dealers' sales performance but not the exclusive or even the primary consideration. Taken together, these factors should be assessed in a way that all dealers in a franchise network can, at the same time, pass muster in an overall sales evaluation. Categorically, a metric methodology that mathematically and automatically sentences half or any set number of dealers to failure is itself a failing methodology. No franchise system should be built upon such a destructive foundation. On the contrary, factories should foster systems that aspire to boast of the success of all dealers in a brand's network.

This proposal aspires to finally realize the "partnership" that franchisors always assert characterizes their relationship with dealers. At the same time, reasonable standards would assure that each dealer is doing what is needed in all areas of the dealership operation. With either the abandonment of spurious metric-based standards or the requirement that accurate and proven statistical evidence be developed and applied, it becomes reasonably possible for every dealer to succeed. All properly run dealerships can pass these "custom" tests, and if they do, they will "move the metal."

Bottom line: It is long past time that auto franchisors should be applying reasonable, reliable, consistent, and non-discriminatory standards in evaluating dealer sales performance. 2018 could be a year of such positive upheaval. Dealers should not be subjected to termination threats or other sanctions, based upon the phony science of current metric-based standards and methodologies. Certainly, using a calculated metric benchmark of "average" for a minimum passing standard offends any sense of fairness or reasonability.

Instead, to fairly oversee their dealer networks in the retail sales arena, factories must take into account a well-reasoned and business-related set of considerations, to include a "custom assessed," on-the-premises evaluation of each individual dealership. If comparative metric-based statistics are to be used at all, based on overall brand sales in geographic areas, they should be demonstrably reliable – and scientifically proven – gauges of each dealership's sales performance – and just one non-dispositive factor among several. Factories must be transparent about the statistical reliability of their numbers. If they cannot prove the reliability and scientific accuracy of metric-based sales penetration assessments, they need to abandon them. That would be good news for dealers, and a commitment to fairness, because the existing factory methodologies are deeply flawed. And, paradoxically, that step would be good news for franchisors as well, as they would shed their pervasive adversarial image, and become their dealers' true "partner."

2. Autonomous Cars: A Threat to Dealer Survival, or a Major Growth Opportunity? Changing America's Motor Vehicle Landscape, and the New Laws Needed to Govern It. (5)

If some forward-looking industry observers are right, this trend might move to No. 1 on this ranking by 2019 or 2020. That is because some heavyweight thinkers in the auto industry forecast that the autonomous car phenomenon will soon so revolutionize American car ownership and driving habits that the transportation shift across the country will be as profound as the change from "the horse [as] the prime mover of humans," to today's total reliance on the automobile. It is now foreseeable that, by 2019, the U.S. public in large numbers will be able to ride in driverless taxis in selected cities. See Boston, William. "Volvo Promises Uber Fleet of Self-Driving Taxis by 2019," *Wall Street Journal,* Nov. 20, 2017. "Ride-sharing" options are on the drawing boards of major manufacturers. *See, e.g.,* Wayland, Michael. "GM expects to launch autonomous ride-sharing within 2 years," *Automotive News,* Nov. 30, 2017; *see also,* Sedgwick, David. "Ride-hailing firms will be giants in 2030," *Automotive News,* Dec. 5, 2017 ("By 2030, dealerships will showcase vehicles that are electric, connected and automated – vehicles powered by technologies beyond any automaker's experience."). What seemed unimaginable only a few years ago (or even one year ago) is on our doorstep.

In the legal arena, such a dramatic product metamorphosis in the automotive industry, as well as in the overall American economy, would spawn an entirely new body of laws, regulations, and, eventually, litigated precedents. We are already witnessing a flow of legislative and regulatory enactments across the country. Today's complex legal architecture of dealer licensing, individual drivers' licenses, operational laws, sales and advertising practices, emissions standards, and a bevy of other items will undergo an ocean of change, likely in a short time. Indeed, that process has already begun in earnest.

Even the general press has bubbled over with the futurist possibilities, including the ongoing reality that this "future" is already upon us. *The New York Times,* for example, devoted an entire Sunday Magazine issue to the subject: "Life After Driving: Imagining A World of Autonomous Cars," Nov. 12, 2017. The articles in that edition portray the self-driving phenomenon from a number of perspectives. Pair autonomous driving units, up to and include level 5, with the ascending electric vehicle and "greening" trend, and individual American traveling practices and patterns in a few years could be almost unimaginably different from today. (Even traditional gas stations might go the way of pay telephone booths.)

The venerable former automaker executive Bob Lutz (now age 85) predicts that "in 15 to 20 years – at the latest – human-driven vehicles will be legislated off the highways." *See,* Lutz, Bob. "Kiss the good times goodbye," *Automotive News,* Nov. 6, 2017. In specific terms, he asserts:

> Now we are approaching the end of the line for the automobile because travel will be in standardized modules.
>
> The end state will be the fully autonomous module with no capability for the driver to exercise command. You will call for it, it will arrive at your location, you'll get in, input your destination and go to the freeway.

According to Lutz (and some other forecasters), "this is the demise of automotive retailing as we know it." *Id.* He foresees that the transition will not <u>immediately</u> render the retail auto dealer extinct, but in ten or fifteen years, he says "dealerships are ultimately doomed." *Id.* Lutz's bottom line: "the era of the human-driven automobile, its repair facilities, its dealerships, the media surrounding it – all will be gone in 20 years." *Id.*

I am not entirely convinced, nor are many U.S. auto industry stalwarts. For example, Carlos Ghosn, chairman of the Renault/Nissan/Mitsubishi Alliance, sees the coming autonomous car development as an "<u>addition</u>" not a "substitution." "The traditional business of building cars and selling cars and owning cars is going to continue," he says. *See* Lippert, John and Craig Trudell. "Ghosn says car ownership is here to stay," *Automotive News,* Nov. 9, 2017. Ghosn surely has a good point: while autonomous cars will enable many people who cannot or should not operate a vehicle to nevertheless travel regularly in one, they will not necessarily motivate most drivers to always cede their operational control.

With self-driving vehicles, travelers with disabilities, age-related infirmities, and inebriation, for instance, will not be banned from the road or required to rely on public transportation. This new reality suggests that the demand for more vehicles will spike upward in the millions of units to serve those who cannot or should not, or choose not to drive themselves. But, as Ghosn observes, such a trend will be additional cars, not necessarily substitutions.

The questions are not whether in several years there will be autonomous vehicles on America's streets and highways (there will), nor whether such units will number in the millions (they will). Rather, the questions are whether such vehicles will displace altogether America's car-and-driver addiction to human control, <u>and</u> whether today's franchised distribution network will be diminished or displaced. In my opinion, they will not. *See* Krisher, Tom and Dee-Ann Durbin. "Autonomous Cars (No Human Backup) May Hit the Road Next Year," *Associated Press,* June 7, 2017. Even if vast numbers of self-driving "modules" storm the vehicle marketplace in the next decade or two, today's dealers should continue as the principal retailers and fleet marketers of the new units in a modernized and reconfigured distribution system.

Today's perceived "delay" in the developing autonomous movement seems to stem from four issues: (1) according to some polls, public receptivity remains skeptical, although open-minded; (2) safety concerns are paramount; (3) research and development for wholly new products usually takes years or decades; and (4) policy and legal development are complicated and product roll-outs could stretch over a long period. *See* Kulisch, Eric. "Self-driving policy vacuum: Pressure grows on Congress to set uniform regs," *Automotive News,* Jun. 19, 2017. There is growing impetus for federal laws and regulations to preempt most state laws to avoid a patchwork of different state-by-state rules that would be complex, inconsistent and confusing. Even before we see an influx of no-driver cars, look for lots of new laws to address the many needed changes to the existing regulation of vehicle ownership, licensing, operational limits and so on.

Right now, in the testing mode, thousands of self-driving vehicles are on the roads, mostly at levels 2, 3, and 4. (These "levels" go from level 0 – no automated vehicle control, to level 5 – in which no human operation is required.) The financial gambles are already enormous, and there are apt to be, over a long time, a few winners but many losers. *See, e.g.,* Naughton, Keith."Billions Will Be Blown in Race to Field First Self-Driving Cars," Bloomberg.com, Jul. 12, 2017. ("You've got 50 major players trying to develop autonomous software and you'll probably get three or four of them who win," according to John Hoffecker of AlixPartners, LLP.) *See also* Wayland, Michael. "GM: We can dominate in autonomous," Automotive News, Dec. 4, 2017; LeBeau, Phil. "Ford makes room for new self-driving vehicle, moving EV production to Mexico," *www.cnbc.com,* Dec. 7, 2017.

<u>Bottom line</u>: *Yes, the self-driving car era is underway. In many cities, there are already growing numbers of autonomous test vehicles on the streets. Legislators and regulators are pumping out draft legal language at a frenetic pace, even as all major manufacturers plan, experiment and hire. But there's not going to be a sudden huge burst of production and retail sales in the millions of units, nor will private ownership or human-operated cars disappear anytime soon, if ever. Rather, starting within no more than two years, there will be a year-to-year increasing growth rate of autonomous cars, manufactured and in operation in the U.S. All existing carmakers will produce them, with a corresponding growth in green, electrically powered vehicles. Like Lutz, some contend that Americans will see lots of "shared use" vehicles, with minimal individual private ownership, and "vehicle sales" marketed through means other than franchised dealers who will become rarities.*

I am a skeptic about a <u>total or near-total</u> migration to autonomous cars, much less to an end of private ownership, anytime soon. Polls show that most Americans want their self-operated cars, even as most also welcome the availability and benefits of self-driving vehicles. Those polls are not self-contradictory. Most respondents want access to <u>both</u> kinds of cars. It is not an either/or proposition. There is no reason why the availability of autonomous cars must erase demand for self-operating vehicles. Americans have ample interest in access to <u>both</u> at the same time, and as Carlos Ghosn predicts, total operating units in the U.S. could rise appreciably as a result of the self-driving phenomenon. Two-and-three car families have been commonplace for decades, and adding an autonomous vehicle to the garage will likely be a popular choice. Dealers will adjust and adapt, if they have to, to a different or enlarged marketing scheme and to public demand. Carmakers are already competing in research and development, and in capturing the public imagination. Further, it is a good bet that the autonomous market will be primarily green, dominated by electrically powered vehicles with ever-increasing mileage-per-battery charge. Innumerable new charging stations will change America's highway landscape.

The greater competitive threat for dealers' retailing dominance, in my opinion, is the potential growth of online and/or "department store" retail sales, not to mention direct factory sales. See Trend No. 4. A robust self-driving industry will develop over time, and 2018 could see the beginning stages, but do not buy into Bob Lutz's doom-and-gloom forecast for the end of the franchised retail car dealer industry within 10 or 15 years. I am with Carlos Ghosn. Today's franchised dealers can thrive for the foreseeable future, even though they may offer a very different mix of inventory than today, as well as a different set of F&I offerings and service. If self-driving cars saturate the highways in 2030, most of them, I predict, will still be sold by dealers.

The <u>legal</u> ramifications of autonomous cars will be profound and plentiful. The breadth and scope of necessary legal initiatives will generate a breathtaking array of new enactments. Dealers retailing such vehicles will have to study and understand how they could be impacted and how they must comply.

3. One Year Later: The Impact on Dealers of the Changes in Government and the Push-Back Against Regulatory Growth; Trump's Legal Problems; Stay Tuned for the 2018 Election Cycle (1)

The anticipated battles over presidential appointments and federal legislation have hit unprecedented lows of partisanship. Without doubt, the glacial pace of presidential executive appointments did not help the Trump pledge to cut back federal regulatory power. The fight over "repeal-and-replace Obamacare" was a setback of major proportion for the Trump administration. As of the date of this publication, the Trump agenda is hardly an unmixed success story, and his legal problems loom. For legislation and regulations affecting dealers, 2018 will be a year of both uncertainty and some gains. The presidential imbroglios over serial twitters and gaffes, and especially the unfinished work of an independent counsel, some say, even threaten the viability of the Trump presidency itself. With four filed prosecutions in 2017, including two guilty pleas, this maelstrom shows no sign of abating as we go into 2018.

The development of "Russian interference" and "Russian collusion" investigations, including congressional oversight and special counsel, Robert Mueller, could profoundly impact the presidency and the legislative and regulatory agenda. Criminal prosecution of prominent Trump personnel made headlines in late 2017. The reach of investigations now seems to go well beyond the starting questions of whether the Russians tried to impact the 2016 presidential race, and, if so, whether there was collusion with the Trump campaign. The investigatory process remains a wild card that could stymie much of President Trump's plan to change how things happen in regulatory governance. If the 2018 mid-term election cycle goes poorly for Republicans, 2019 legislative initiatives and federal judicial and other appointments could drop or change precipitously. A serious impeachment initiative with a new Congress in 2019 could derail the American economy. Such political developments, if they occur, could so influence the overall economy to cause the retail auto market to tumble. The U.S. might then fall into a recession. Even without intervening problematic political events, some economists warn that a major market correction is long overdue.

A thorough federal regulatory overhaul requires direct congressional action, with the passage of new laws and the repeal of old ones. Congressional cooperation, however, is an oxymoron as political partisanship, with a few exceptions, continues. Regulatory cutbacks are happening administratively and by executive order in many areas without new laws enacted by Congress. Federal judicial appointments are on a record or near-record pace.

The President "needs to find smart ways to reconcile Americans' desire for regulatory protection with their distaste for its burdens…. Making the task even more difficult, the regulatory statutes are ridiculously obsolete." Schoenbrod, David, "Only Congress Can Undo Its Regulatory Mess," *Wall Street Journal,* June 19, 2017. Some observers credit Trump with making the effort. Laing, Keith,"GM's

Barra applauds Trump for cutting regulations," *www.detroitnews.com,* June 19, 2017.

Bottom line: As this article goes to press, special counsel Mueller's investigation and other questions of propriety threaten to stymie significant parts of the Trump agenda. Nevertheless, there does continue to be meaningful regulatory reform, and even if the positive impact on businesses is modest, it is nevertheless welcome. At the same time, the "mid-term" election cycle is already upon us, and the specter of even more gridlock awaits the results of November 2018, and a new Congress in January 2019.

4. Retailing by Non-Dealers: Tesla Impact, EV, and Factory Sales; Is the Door Opening for Online and "Department Store" Sales? (4)

The way of new car retailing could be changing. Maybe soon. Amazon, Wal-Mart, Costco, and other non-dealer entities are chomping at the bit to be direct vehicle retailers. Tesla and many others continue to push the envelope with EVs. This observation dovetails with the prospect that autonomous vehicles could be retailed outside dealer networks. *See* Trend No. 3.

This subject blends the aspirations of an ever-growing number of businesses and citizens to achieve two enormous goals: (1) the "greening" of motor vehicles; and (2) the coming era of autonomous vehicles. In 2030, according to some in the industry, "automakers won't be calling the shots. Instead they will manage uneasy alliances of suppliers, giant ride-hailing fleets, mega-dealers and internet behemoths – all with their own agendas." Sedgwick, David, "Follow the Fleets," *Automotive News,* Dec. 4, 2017. Tesla, in particular, sees itself in the driver's seat to accomplish multiple missions – and soon. Vivek Wadhwa, "a prominent tech entrepreneur and Tesla enthusiast," predicts:

> After five years, Tesla will become the Apple in the industry . . . Tesla will be the iPhone of cars – more elegant, better designed, maybe even safer.

Gertetener, Jon, "What Tesla Sees," *The New York Times Magazine,* Nov. 12, 2017.

Bottom line: An attorney friend and colleague of many years – who went from being a distinguished attorney for dealers in private practice to a senior executive in a major mega-dealership company – asserts to a certainty that the era of franchisees as the sole American retailers of new cars is about to be over. He makes a compelling and reasonable case. I agree with him.

On the other hand, I align myself with those who contend that department store and online sales by nationwide or regional vendors are likely, but so is the expansion of products and needed services, tailor-made for the brick-and-mortar dealership.

5. After the GM Ignition, Takata, VW Emissions, and Many Other Scandals, Are Brand Integrity and Brand Reputation Recovering? Not So Fast (2)

The Volkswagen emissions scandal appeared to be a high watermark in carmaker scandals (or a low one, depending on how one views it). This scandal followed the GM ignition defect revelation. The Takata airbag mess affected public confidence in many brands to which Takata supplied parts deemed the epitome of safety devices.

As of the Fall of 2017, VW had shelled out $30 billion as a result of the scandal which came to light in 2015. *See* Boston, William and Max Bernhard, "Volkswagen Takes New $2.9 Billion Hit From Diesel Scandal," *Wall Street Journal,* Sept. 29, 2017. After a raft of multi-billion dollar settlements, however, the industry seemed to be on a path of righting the ship.

Recently, VW's parent company, Volkswagen AG, created an "anti-corruption czar," Kurt Michels, who "seeks to eliminate the culture that helped its diesel emissions cheating remain undetected for years." Hetzner, Christiaan, "VW reforms compliance system to avoid another scandal," *Automotive News,* Dec. 11, 2017. Is this compliance effort the end of an era of scandal at VW and elsewhere? Not so fast. It turns out that German manufacturers – all of them – have been, for decades, meeting and colluding on hosts of issues in apparent violation of competition laws in Europe and America. Here is a snippet of one press report:

> German news blog *Der Spiegel* said that it had received information that last summer, Volkswagen had submitted a self-report suggesting that since way back in the 1990s, all the major car makers of the country including Volkswagen, Audi, Porsche, BMW and Daimler have been a part of agreements ranging from technology to flout emissions to setting of prices.

"German Auto-Makers May Have Colluded In Biggest Cartel Scandal In History," *Team Motoroids,* July 23, 2017. The European Commission, with powerful governmental powers under the European Union, could fine the alleged conspirators nearly a half trillion dollars! That amount is reached by calculating ten percent of the total revenues for the co-conspirators for a single year. In the U.S., the Department of Justice is investigating, and nationwide consumer class actions against all the German brands are consolidated in a single venue in San Francisco before the same judge who presided over the VW emissions lawsuits. Several dealer class actions are now pending in the same court, and the "German auto cartel" proceedings will generate major industry interest, here and abroad, in 2018.

Egregious factory misconduct and cover-ups have occurred (or have been exposed) with troubling frequency in the recent past. The VW emissions and German Cartel scandals suggest a pervasive, decades-long contempt for honesty and transparency. Hopefully, even if manufacturers are not motivated by doing the right thing for its own sake, they will see the wisdom of avoiding spectacular business losses, along with reputational harm.

Bottom line: It remains to be seen whether pervasive carmaker (and parts supplier) scandals and episodes of brazen dishonesty will so tarnish their images that reputations of offending brands cannot recover for years, if ever. This prospect is especially problematic for the dealers who retail those brands, but who did nothing to cause a backlash from the consuming public. It is surely perplexing when these events occur, especially in such grave magnitude, but, hopefully, 2018 will be different – and better. One skeptical dealer asked the author, "Don't they ever learn?"

6. Taxes and the Positive Impact on Dealers of a Federal Tax Overhaul (16)

Federal tax issues are front and center now. Most Americans and companies will pay less in federal taxes in 2018 and for years thereafter (with increases by 2027), but there is plenty of controversy about who is most benefitted. Predictably, this measure will incentivize an upward spike in new car sales.

With a party-line majority, and without a single Democratic vote for the bill in either house, on December 20, 2017, the Congress passed the first major overhaul of the Internal Revenue Code since 1986. When all factors are taken into account, the newly revised Code lowers net income tax payments for individuals (those who pay federal income taxes) at all income levels, and cuts the corporate rate from 35% (among the highest in the world) to 21%. For a Republican view, see Paul Ryan's article, "Tax Reform Means Your Paycheck Will Grow," *Wall Street Journal,* Dec. 20, 2017: "The centerpiece of the bill is the most sweeping pro-growth reform of our tax code since the Reagan era or perhaps ever." The Tax Foundation summarizes the basics this way:

> The Tax Cuts and Jobs Act represents a dramatic overhaul of the U.S. tax code. Our model results indicate that the plan would be pro-growth, boosting long-run GDP 1.7 percent and increasing the domestic capital stock by 4.8 percent. Wages, long stagnant, would increase 1.5 percent, while the reform would produce 339,000 jobs. These economic effects would have a substantial impact on revenues as well, as indicated by the plan's significantly lower revenue losses under dynamic scoring.

This is good news for dealers, as increases in personal and corporate disposable income will likely motivate more new car sales in 2018 than there would be otherwise. Nevertheless, pre-passage antagonism abounded, and Democrats charge that the wealthiest taxpayers will be the primary beneficiaries of the new law. Dealers, however, have every reason for optimism about sales and profits, stimulated by this new tax law.

This short article does not "get into the weeds" of 500 pages of legislation, and dealers should consider consulting with a knowledgeable professional in the tax field. There are still seven brackets, the highest bracket lowering to 37% from 39.6%. The "widening" of brackets serves, in general, to lower individual tax liabilities. At the same time, taxpayers will see new limitations on deductions, notably for state and local taxes and mortgage interest. The NADA-led charge to preserve 100% floor plan interest deductibility is a win for America's dealers.

Bottom line: For now, tax reform is the Trump administration's signature legislative achievement, and dealers will be among the many business beneficiaries. Some observers right and left (mostly left) bemoan what they see as inadequacies or even injustices in the new law. I agree with some of the criticism, especially in observing that there will be continuing growth in the national debt. Nevertheless, the provisions will benefit most taxpayers, and the successful legislative initiative will impact profoundly and positively nearly every American car dealer. As a result, the industry will enjoy a "boomlet" in retail sales across all brands in 2018 and beyond. Dealership valuations will trend upward, especially for luxury brands.

7. Franchisor Programs: Incentives, 2-Tiered Pricing, Stair-Steps, and More: "We are not our dealers' enemy." (NR)

In defending Cadillac's controversial (and often changing) "Project Pinnacle," the brand's president, Johan de Nysschen, asserted, "We are not our dealers' enemy." Wayland, Michael, "Cadillac's Pinnacle Project loosens up," *Automotive News,* Sept. 25, 2017. When a factory executive expressly denies being an "enemy" of dealers, it is a telltale sign of a franchisor's profound disconnect. Although the particulars of Project Pinnacle are more complicated than most factory incentive programs, they illustrate the kind and quality of control that franchisors seek. As de Nysschen puts it: "Pinnacle is designed to reward those who play a part. Those who do not will not get the rewards. That has always been the approach." The program has five possible "tiers" for dealers and qualifications vary, but suffice it to say that the Pinnacle "standards" require substantial investments and commitments.

Routinely, automakers fashion a bevy of "programs" that they hope will boost the retail sales of their vehicles. On the face of it, this aspiration sounds reasonable, as vehicle sales represent the core of every auto franchisor's business. As ever, though, the devil is in the details. The aim is to "encourage" dealers to sell more units by paying them additional monies in "incentives" or "bonuses." With Audi, for example, "bonuses" and "incentives" are such that dealers cannot expect to be profitable without compliance, according to dealers who discuss the question. In certain programs the per-unit payment to the dealer goes up at specified benchmarks in retail sales. This is the situation with a variety of "stair-step" programs.

But this kind of tinkering with incentive programs means that high performing dealers will have more money per vehicle than their lower performing same-brand peers. That complaint is the essence of "two-tiered pricing." Not only is that discriminatory result unfair, say critics, but it turns off customers. For example, in his October 2017 address to the Automotive Press Association, 2017 NADA Chairman Mark Scarpelli carefully enumerated the negative "unintended consequence" of certain incentive programs, such as stair-step plans.

For years, a few dealers have challenged "two-tiered pricing" unsuccessfully, on the basis of anti-discrimination and antitrust laws. But dealers also contend that such programs may be counter-productive as a practical matter. Scarpelli explains that the resulting retail price differences "destroy consumer confidence," and cause the opposite of what the factories want: fewer retail sales, not more.

Bottom line: *It is beyond argument that auto franchisors will continue to roll out incentives and programs, because they believe that dealers are thereby spurred to retail more cars. There is evidence to support that assumption. It is also certain that many dealers will continue to challenge many of the existing or newly-fashioned programs. As with "Project Pinnacle," changes may be made, but programs – and the debates over them – will continue.*

8. State Franchise Laws (4)

For over a decade, material revisions to franchise laws have been enacted in about twenty states per year. State associations and the ATAE are both vigilant and proactive in confronting what they perceive as factory overreaches. 2018 should continue this trend, hopefully, with some emphasis in seeking to address the auto franchisors' flawed methodology in the evaluation of dealer sales. See Trend No. 1. Elimination or reduction of auto franchisors' power to exercise their contractual ROFRs should be a priority for amendments to state laws.

Bottom line: *Despite aggressive efforts by the factories to limit the scope and reach of state franchise laws, dealer associations continue to combat the excesses and overreaches of franchisors with state legislation. 2018 will be no different. There will be more success this year in addressing franchisors' overreach in their methodology for evaluating dealer sales performance.*

9. Privacy and Identity Theft; Cyber Security (9)

Just when we think the threats of hacking and identity theft may be abating somewhat, or that protective software is prevailing, along comes the Equifax disaster (September 2017), exposing over half of American adults (143,000,000) to thievery by sophisticated hackers. Then comes an announcement in October 2017 that three billion Yahoo accounts had been compromised (not the mere one billion announced in December 2016). These recent large scale cyber nightmares should signal to small businesses that vulnerability to criminal actors is a problem for everyone that relies on computers, and that the problem will not get better anytime soon.

Dealers are finding that many customers, in response to the Equifax exposure, have frozen businesses' access to credit reports from Equifax and others. Thus, dealers cannot readily obtain customers' credit reports . In such circumstances, the customer must unfreeze the credit report so that the dealership can access the report. Unfortunately, this kind of delay and inconvenience, along with some added expense, will need to be endured for the foreseeable future.

As an overall proposition, auto dealers must remain especially vigilant as they obtain, safeguard, and store large volumes of sensitive customer information, both in hard copy form and in electronic storage. Constant updating of cyber security is important, because computer invaders become more sophisticated all the time. 2018 is bound to see more examples of brazen hacking, cyber-attacks, and identity thievery. Every dealer is well-advised to have a well versed IT employee to oversee continuing and updated safeguards.

Bottom line: *Cyber security is now an industry unto itself for American businesses – and indeed it is a worldwide phenomenon in all aspects of life that are "connected." Identity theft, when it happens, is a nightmare for the victim, and consequences for any business that exposes customers to hacking or identity theft risks is tempting fate. Every dealer, therefore, is well advised to become and stay current in all reasonable ways to secure and protect sensitive and personal data and information. Dealers should regularly update best practices by, among other things, accessing online FTC recommendations for cyber security. See, e.g., www.ftc.gov sections on "Protecting Small Businesses," which links to several specific topics on identity theft, computer security basics, privacy and security; etc. For many dealers, it is worthwhile to pay for a "cyber security audit." You cannot make cyber security absolutely foolproof, but you can and should take prudent measures to minimize the risks and be able and ready to take remedial action swiftly in the event of a hacking or other cyber breach. The potential downside for a lack of vigilance in protecting customer information may be horrific, as illustrated by Equifax and other notable examples.*

10. Recalls (12)

No question about this: Recall numbers will continue their historical upward trend, yet the public will take such news in stride. In late 2017, for example, the headline "BMW recalls 1.4 million vehicles due to fire risk," *Chicago Tribune,* Nov. 3, 2017, was met, relatively speaking, with a public "ho hum." It's so commonplace now to see recalls of vast numbers of models that they rarely get lasting headlines (unless there is also an issue of deliberate misconduct). As one prominent story put it on November 13, 2017:

> Vehicle recalls are regularly in the news, warning of inadvertent air bag deployments, faulty door latches, even risks of fire, not to mention the ongoing Takata air bag recall that dwarfs all others.
>
> But the steady stream of recalls masks the fact that about 30% of recalled vehicles remain unrepaired on America's road, according to federal statistics.
>
> Last year was a record for U.S. vehicle recalls – more than 53 million in 927 separate recalls – but those numbers are only the latest, with the total number of recalls increasing in each year back to 2011 when the number stood at 13.6 million, according to information from the National Highway Traffic Safety Administration.

Lawrence, Eric D.,"Car recalls are at an all-time high, but 30% remain unrepaired," *Detroit Free Press,* Nov. 17, 2017.

It is not that larger numbers of cars now have more defects, or more serious defects, than in earlier years. Quite the opposite is true. So why all the recalls? In large measure, the recall trend is so proactive because both automakers and state and federal government agencies want to avoid the negative impact of highly publicized failures, especially if they threaten lives and safety generally.

Thus, a very small percentage of defective cars within a model group is apt to spur a model-wide recall. For example, if only ten cars out of 100,000 manufactured vehicles of a certain model are shown to have a serious safety defect, you nevertheless could see 100,000 recall notices – to the owners and lessees of <u>all</u> those models. This is demonstrably true – and prudent – even when the odds of a serious defect in a particular car are very low. In this hypothetical, only one hundredth of one percent of recalled vehicles would have the defect.

For dealers, recalls do generate service and parts income, at no cost to the customer. But downsides can include factory delays, generating stress for both dealers and their customers. What is a dealer to do with new inventory in the face of recall notices? What about used inventory under recalls? What about the irate customer who receives a recall notice, but the factory is short on parts? What about consumers who ignore recalls altogether, choosing instead to drive with defective vehicles? According to Eric Kulisch, in his article, "Recall system is still in need of its own fix," *Automotive News,* Dec. 4, 2017:

> [T]oday, the process for identifying vehicle owners, informing them about a problem and completing the necessary repairs remains disjointed at best, with few reforms to improve recall efficiency and better protect public when the next vehicle safety crisis hits.

Dealers need to know the recall status of their inventory, and due diligence in keeping up on a continuous basis is a good practice. To be doubly certain, a dealership employee should regularly match vehicles in stock to the available public information about recalls. The National Highway Traffic Safety Administration is an indispensable tool for recall information. *See www.nhfsa.gov* to search for relevant recall information by make, model, and year.

<u>Bottom line</u>: Dealers must stay informed and vigilant when it comes to recalls. Although the factory is at fault when defects trigger recalls, it is the dealer who often hears the brunt of customer dissatisfaction with delays in getting parts and completing the fixes. Dealers must be the customer's advocate in working with the factory. Dealers are prudent <u>not</u> to retail vehicles with uncured recalls.

11. Alternate Dispute Resolution (15)

The Consumer Financial Protection Bureau ("CFPB") has continued to assert itself in this area. On July 10, 2017, under Obama holdover director, Richard Cordray, it published a rule that purportedly protected consumers' ability to bring class action lawsuits. However, that rule has been effectively overturned, and the CFPB is definitively moving in a different direction under a new acting boss, appointed by President Trump. Perhaps a new day has dawned, and dealers can rely on contractual provisions with customers that require arbitration and bar class or mass actions. See Trend #16.

<u>Bottom line</u>: The big ADR question for dealers continues to be the viability of mandatory arbitration clauses in contracts with consumers, especially where a customer signs away any right to initiate a class or mass action. From the dealer's viewpoint (and, I believe, the customer's as well), the availability of such provisions is a good thing. Hopefully, 2018 will see more clarity and consistency on this important issue.

For now, the previous CFPB mission to thwart consumer arbitrations is in tatters. Therefore, dealers who want arbitration clauses with consumers should monitor developments in state and federal law, including relevant court decisions to assure legal compliance. State associations have done an excellent job in staying current, and are generally reliable resources for dealers looking for guidance on arbitration provisions.

This is a turbulent and fast-moving area. Dealers and their lawyers should review the superb article by Christian Scali and Monica Baumann in the October 2017 issue of <u>Defender</u>: "New Developments in Arbitration Law Require Auto Dealer Counsel to Assess Several Issues: What Do You Need to Know?"

12. Workforce Issues and Unionization; NLRB Developments (6)

The Obama era of one-sided pro-labor, anti-business initiatives is receding, but is hardly vanquished. Businesses generally, and dealers in particular, should be cautious about becoming overconfident in dealing with unionization (or decertification) issues.

Caution: A number of states now prohibit asking job candidates for hire about pay history. Hiring practices are under more and more scrutiny today than in the past. In addition, incidents of sexual harassment in the workplace will be met with fierce legal repercussions. A "zero-tolerance" policy for such misconduct is a must.

<u>Bottom line</u>: Look for a year of gradual transition to more fairness for employers on basic economic issues and for a more "enlightened" National Labor Relations Board ("NLRB"). Already, by a 3-2 vote, the short-lived threat of expanded "joint employment" in the franchise arena is dead. Hopefully, the era of "disparate impact" is over as well. State laws vary considerably in employment requirements. Stay current on your jurisdiction's workplace laws and regulations!

13. Environmental Issues (11)

Industrial waste and hazardous material are always subjects for dealers' attention and vigilance. EPA Chief Scott Pruitt argues, however, that President Obama's Clean Air Plan went too far (and its impact was stayed by the U.S. Supreme Court). In defending the coal industry, Mr. Pruitt said:

> The EPA and no federal agency should ever use its authority to say to you we are going to declare war on any sector of our economy . . . That rule really was about picking winners and losers.

Harington, Rebecca, "EPA chief Pruitt is killing the centerpiece of Obama's climate-change arsenal," *Business Insider,* October 9, 2017. The overarching environmental philosophy of Mr. Pruitt and the Trump administration appears to be to ease those restrictions on industries and businesses that arguably provide nothing meaningful to protect or conserve the environment. A more laissez-faire regulatory policy is likely to make administrative burdens down at the dealership level considerably less onerous. This easing regulatory approach will not cause harm to the environment or foul water or air.

Bottom line: Dealers may draw some comfort from the probability that 2018 will see an easing of bureaucratic tasks associated with environmental matters. Nevertheless, dealers must be sticklers in complying with existing requirements, and assure that employees heed best environmental practices.

14. Involuntary Termination (7)

Auto franchisors continue to threaten "death penalty" sanctions against their dealers in large numbers, but the delivery of an actual termination notice to a targeted dealer is still a relative rarity. The trend of such threats seems to be way up when it comes to "below average" sales penetration. See Trend No. 1. In all instances of franchisor termination threats, a dealer needs to respond in writing – promptly, civilly, accurately, and firmly.

Bottom line: When a dealer receives correspondence that mentions or threatens termination, best practices require that dealer's written response. It should be factual and professional. It should contest the basis of the threat, and invite the franchisor to discuss all issues further. It is never a sound strategy to ignore such a serious matter. Of course, if you receive a notice of termination, call your experienced franchise attorney immediately.

15. Rights of First Refusal ("ROFRs") and Buy-Sell Activity (8)

For 30 years, I have contended that ROFRs limit buy-sell opportunities and tend to drive selling prices down. That is because prospective buyers are wary of wasting time and effort, only to be thwarted by a factory exercising its contractual ROFR. Five states now prohibit ROFRs, and there may be a minor state law trend to follow suit. ROFRs, or even their threat, have become serious impediments to buy-sell activity, especially when franchisors try to "cherry pick" their brand out of multi-brand deals.

Bottom line: Any dealer or lawyer in need of a comprehensive understanding of ROFR issues, and how best to deal with them, is well-advised to read Joe Aboyoun's excellent and meticulously researched article, "The Franchisor's Right of First Refusal," Franchise Law Journal, Vol. 36, No. 2 (Fall 2016). At the same time, legal events can move fast, and dealers should make sure they or their lawyers research the current ROFR landscape. In 2018, there will be robust buy-sell activity. In this area, dealers (buyers and sellers) are well advised to retain counsel early to assist in strategy.

16. Consumerism (10)

"The consumer is king" is still an applicable maxim, and dealers are well advised to walk the extra mile in directly resolving customer gripes at the earliest possible time. In dealer versus consumer disputes, the deck remains heavily stacked in favor of the consumer, and dealers should stay mindful of this reality. Many states have consumer fraud statutes that call for treble damages against businesses found liable for prohibited practices, plus attorneys' fees.

Of course, there are situations where the dealer should take a stand. Sometimes, a customer will act irrationally and greedily, making a sensible settlement impractical. In those cases, dealers should fully document all the facts, make sure that: (1) It is worth the cost of a legal contest; and (2) all the facts line up favorably.

At the federal level, for several years now, the Consumer Financial Protection Bureau ("CFPB"), which emerged from the Dodd-Frank legislation in 2010, was the 500-pound gorilla of consumerism. Now, the bloom is off the rose. The CFPB was hardly neutral about anything of consequence that it did, or tried to do. Again and again, through its Obama-appointed Director, Richard Cordray, it tried to cast businesses and banks as villains out to cheat or discriminate against various classes of consumers. It tried to stop altogether consumer arbitration agreements. Even at the very end, when Mr. Cordray resigned, he tried to pick his own successor as acting director Leandra English who made the argument in court that the President lacked the power of appointment. That is, this was a federal agency that had rights of its own, to perpetuate its own leadership with no ability of the executive branch to fill that vacancy. In very quick order, a federal judge denied any relief to Ms. English, and Mick Mulvaney continued as the acting director, as the President's appointee. *See* Silver-Greenberg, Jessica, and Stacy Cowley, "Trump Appointee Moves to Yank Out a Consumer Watchdog's Teeth," *New York Times,* Dec. 6, 2017.

For dealers, these events and trends are positive. That is not because they portend any disservice to consumers. Rather, they suggest that there will be fairness and reasonableness in how the federal government approaches consumer-based issues. The CFPB had unlawfully tried to grab legally prohibited jurisdiction over dealers through the "back-door" when dealers make loan applications available to consumers.

Bottom line: A sound message for dealers: Don't fight consumers "on principle." Instead, settle the small ones, and do it as soon as possible in good spirit. Save the consumer battles for the rare instances of being faced with no reasonable alternative.

On a number of fronts, dealers in 2018 will see some relaxation of the unfair onslaught by consumer groups and state and federal regulators.

17. Encroachment and Franchise Modification (20)

There may be fewer encroachment and modification cases in 2018, but they will be important nonetheless. The establishment or relocation of a competing same-line store near you may potentially cause grievous harm to your ability to remain profitable, retain your trained staff, and even your viability as a growing concern.

With "modifications" of franchise agreements, a bevy of state laws now allow dealers to protests of unilateral changes.

Bottom line: Auto franchisors usually visit protest-eligible dealers to try to coax them not to protest the establishment or relocation of a nearby competitive store. Now, they do the same if a modification law is in play, i.e., a law that permits challenges to material modifications of franchise agreements. Usually, factory reps amiably tell the dealer that the proposal is either good for, or indifferent to, the eligible protesting dealer. Such representations, however, are generally not true. If you receive a notice from the factory stating the intention to put a competing dealer near you, or to change your dealer agreement in an important way, it is a good time to call your lawyer to explore your options. And do that right away, because statutory time limits for filing a protest are usually very short.

18. Natural Disasters, Terrorism and Unrest (13)

Hurricanes Harvey, Irma, and Maria and major California wildfires stand as recent horrific reminders to America's auto dealers that calamities far beyond their control can have a profound impact on them, their businesses, and their employees, as well as their communities, friends, and neighbors. "There have been no reports of any dealerships being destroyed, but the spate of wildfires in California have put a dent into sales – to the extent that Wells Fargo analysts wrote…that fires pose a downside risk to December U.S. auto sales results." Jibrell, Anisa, "Wildfires rattle Calif. dealership community," *Automotive News,* Dec. 18, 2017.

Of course, human beings cannot control natural disasters – hurricanes, tornados, earthquakes, floods, fires, etc. But they can and should take precautions to try to lessen the repercussions on themselves, their employees and customers, and to recover in the aftermath. I do not want to place a gloss over tragic circumstances, but dealers can and should benefit from recoveries in post-disaster recoveries. After Harvey, for example, hundreds of thousands of damaged and destroyed vehicles needed to be replaced.

Bottom line: Every employee manual for every dealership should have a section devoted to what steps should be taken in the event of a serious emergency, including natural disasters. Also, dealers are prudent to consider business interruption insurance, and other applicable types of coverage.

19. Warranty Reimbursement (14)

About thirty states now prohibit auto franchisors from surcharging dealers to recoup high warranty parts expense. A small number of states have amended their laws to stop carmakers' practice of charging dealers for "add-on" warranty work and parts.

Bottom line: This old chestnut will not go away for a while, despite a series of dealer victories in court. Look for a few more contests, with more dealer wins.

20. Factory Audits (18)

Dealer fears of and suspicions about factory audits are often overblown. In nearly all instances, such audits are legitimate, and, in any event, auto franchisors have the right to audit dealers for compliance with basic contractual requirements. Most audits relate to oversight of work done and/or sales made and dealer claims for factory money: bonuses, incentive payments, warranty work, etc. To be sure, they must abide by state law and dealer agreement timing, but, unless there is a truly objectionable overreach, dealers must simply cooperate with auditors. Of course, the results of an audit, including chargebacks, are often reasonably disputable. In those instances, dealers can and should challenge questionable chargebacks.

Bottom line: Factory audits will continue to annoy or plague understandably suspicious dealers, but, usually, there is no valid basis under standard dealer agreements or state laws for preventing them. In most instances, dealers should simply bite the proverbial bullet, welcome factory auditors and cooperate with them. In rare situations where there is a genuinely reasonable basis for suspecting impropriety, a dealer in such a case should call his lawyer. ■

Eric L. Chase is an attorney and a member of Bressler, Amery & Ross, P.C., a law firm with six offices in four states and the District of Columbia. [973.514.1200] Mr. Chase devotes a significant part of his practice to the representation of franchised automotive dealers nationwide, and he has been lead counsel in numerous landmark decisions. He has authored over 100 articles in this field, and is a frequent guest speaker to dealer and professional associations and other automotive-related audiences. His biography appears in Who's Who in American Law, Who's Who in America and other similar publications. For many years, Mr. Chase has continued to be selected by his peers as a Super Lawyer. He holds a B.A. from Princeton, a J.D., cum laude, from the University of Minnesota, and a Graduate Certificate in International Security from Stanford. The views set forth in this article are his own and do not necessarily reflect the views of his firm or any of its clients. Nothing in this article is intended to constitute legal, financial or tax advice. Each reader should consult with his or her professional advisor regarding any such advice.

NADC Member Announcements

Do you have an announcement or accomplishment that you would like to share with the NADC community?

Please send any news that you would like to share to: jcoffey@dealercounsel.com.

NADC Welcomes New Members

Full Members

Joseph Bennett
Evergreen Limited
Duluth, MN

Mark Randolph
The Khoury Group
San Antonio, TX

Associate Members

AutoGravity Corporation
Daniel Kim
Irvine, CA

Performance Brokerage Services, Inc.
Moshe Stopnitzky
Irvine, CA

Fellow Members

Alfrado Donelson
Baker, Donelson, Bearman, Caldwell, & Berkowitz, PC
Jackson, MS

Meghan Finnerty
Offit Kurman
Philadelphia, PA

William Fischbach
Tiffany & Bosco, PA
Phoenix, AZ

Clay Walker
Haynsworth Sinker Boyd
Columbia, SC

Vice President's Message

PLEASE NOTE: OUT OF OFFICE
Executive Director Erin Murphy is out on maternity leave through April 2nd. Please contact Justine Coffey, Interim Executive Director, at jcoffey@dealercounsel.com or 202-868-4423 in Erin's absence.

Johnnie Brown
Pullin, Fowler, Flanagan, Brown & Poe PLLC
NADC Vice President

2018 has come in like a lion, but I would like to take the time to tell our great members how excited I am about the upcoming year for the NADC. We have great educational conferences planned at wonderful locations, webinars planned, and a new website in the works.

Before I begin, I would be remiss if I did not thank the NADA and our executive team for arranging the webinar training on the Military Lending Act. That event is a perfect example of the value that exists within the NADC.

Like many of you, I belong to several professional associations, but the NADC provides my practice more value than any other association to which I belong. Where else can we learn of new changes to the Military Lending Act, receive training within approximately a week of those changes, and have this new information conveyed to us so promptly and effectively? Kudos again go out to Andy Koblenz and Paul Metrey from NADA, and our preeminent member Mike Charrapp.

The list-serve emails continue to provide such wonderful support for our members. Reviewing the questions and answers on the NADC emails consistently provides thoughts, ideas, and suggestions on how to handle problems that arise in our everyday practice from some of the most talented legal minds across the country. I constantly use these emails as a source to communicate suggestions to clients and to help in the drafting of various compliance and disclosure forms.

While it is presently impossible to search the NADC list-serve emails, I am happy to report that one of our more significant projects, the development of a new website and database, appears to be coming to fruition in 2018. The new website will allow emails to be searchable. Unfortunately, we were not able to add this feature to prior emails, but all emails prospectively communicated after the launch of our new website will have this new additional feature.

While the NADC email system is used 99.99% of the time to share knowledge and information, we occasionally have the inadvertent use for solicitation. This normally occurs with our fellow members who are obviously letting us know about their available services. Please be assured that the team at AMS and the Board of Directors diligently attempt to make sure that these types of emails do not occur. The NADC Executive Committee and AMS are quick to respond when we see emails that migrate into this category. We urge all members to maintain the integrity of the list-serve for gathering and sharing information freely among our members. This is so important since the NADC email system is truly one of our most valuable assets.

What wonderful conferences we have. I have never left one of our conferences without learning numerous things and realizing how little I truly know. I am consistently impressed with the knowledge and information willingly shared within our organization. We represent an industry which faces an unknown future. Dealers will be challenged as their very business model will be attacked. Attending conferences and receiving the information to face these challenges will be of the utmost importance as the NADC and its members guide and support our clients in the future. I encourage all to attend our conferences. To not attend is to be without this knowledge and support needed by our dealer clients.

On a less serious note, who can ever complain about the wonderful venues that are selected by the AMS team and the NADC Board of Directors. As we teach and learn together, we do so at wonderful venues. The NADC will continue the high standards for our conference locations and to request member input.

Although the NADC has been in existence for approximately 13 years, it has proved its value time and time again. We should never forget how valuable this organization was during the bankruptcies of 2008 and 2009. More importantly, as our Association moves forward, I encourage us to consider how challenging the motor vehicle dealer industry will be over the next 10 years. We will continue to face constant attacks on our clients' franchise system, and the evolution of automobile business model. What does all that mean for our clients? Unfortunately, I do not have answers. However, I know that with the depth and scope of the intelligence of the NADC, we will be able to counsel together to assist our clients.

The NADC will continue to be strong and grow because of our ability to face these challenges for our dealer clients and provide effective counsel. The NADC is a wonderful source of information and support. Don't miss out, your clients could pay the price.

I look forward to seeing everyone in Naples in April. ■

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 list updated contact information in *The Defender* so all members can be aware of the change.

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Matthew P. Stone
Stone Kalfus LLP
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- ☐ June 2018
- ☐ July/August 2018
- ☐ September 2018
- ☐ October 2018
- ☐ Nov/Dec 2018

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BE A CONTRIBUTOR!

We are always looking for submissions to publish in the Defender. Please send your contributions or proposals for articles to:

jamifarris@parkerpoe.com

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