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## VPP Chargebacks

By Mike Charapp, *Charapp & Weiss, LLP*

Dealers report an increase in chargebacks from finance and lease sources related to cancellations of voluntary protection products like extended warranties and GAP. Some finance and lease sources are going back three to five years and imposing chargebacks claiming VPPs should have been cancelled because of the early termination of retail installment or lease obligations.

### What Is Going On?

#### Contractual Obligations

The responsibility for refunds on cancellation relate to contractual requirements of the VPP agreements between the product administrator and the customer, and the dealer obligations are contained in indirect finance and lease agreements between dealers and finance and lease sources.

The obligation to provide a refund upon cancellation of a VPP is contained in the VPP documentation. That agreement should follow state law and provide for the calculation of and payment for the refund amount upon cancellation. Cancellation generally comes because the customer pays off the retail installment or lease obligation early, the customer defaults, or the vehicle becomes a total

loss. When the customer no longer has a finance obligation, finance protections such as GAP should be cancelled, and when the customer no longer has the vehicle, extended service or maintenance agreements should be cancelled.

Between the dealer and the finance or lease source, the obligation to provide a refund is contained in the indirect finance or lease agreement which governs the assignment of retail installment sale contracts by the dealer to the finance or lease source. Generally, these agreements provide that upon termination of the financing, or lease obligation, the dealer will be responsible for the refund. Here is an example from a typical indirect finance agreement:

**(b) Refund of Unearned Charges.** Dealer agrees that upon prepayment, repossession, or total loss, Dealer shall refund any unearned charges for aftermarket products to the Buyer or finance source, as appropriate. In the case of prepayment, unless applicable law requires finance source to process such refunds, this is accomplished either by notifying the customer to make application to Dealer for the refund, or by Dealer authorizing

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finance source to make the refund on Dealer's behalf. When there is repossession, total loss, or in those jurisdictions where applicable law requires finance source to process such refunds, Dealer authorizes finance source to debit Dealer's DFI Account for the unearned charges.

When dealers assign the retail installment sales contracts or leases to the finance or lease source, the dealer is no longer involved in servicing the accounts. Dealers will not necessarily know if the financing or lease obligation has terminated early.

A major exception to this is an early trade in at the dealership. For example, if a customer with sixty month financing trades in the vehicle at forty-two months to the dealer from which he or she bought it and buys a replacement vehicle, the dealer should know that any VPP should be cancelled on the trade. Dealers should have in place a process to cancel the products, providing for refunds that may even be included as a downpayment in the new deal.

In all other cases, where a finance or lease obligation is terminated, a dealer may not know to process a VPP cancellation. Finance sources may contend that reports to dealers regarding reserve should have given them a heads up, but finance and lease sources have not always had a practice of notifying dealers of finance or lease obligation terminations, and reserve reports may not provide this information on so-called "split reserve" relationships where the dealer earns only a portion (*e.g.*, 70%) of the reserve with the balance of the reserve being kept by the finance source to fund what used to be chargebacks to reserve accounts for those early finance or base obligation terminations.

### **Importance of Dealer Knowledge of the Termination of the Obligation**

Dealers should know of the termination of a customer's finance or lease obligation. Dealers do not service their own VPPs. Most dealers do business with VPP suppliers. Even where dealers may have their own reinsurance companies, the actual servicing of the VPPs is done by the supplier.

Suppliers must calculate and provide refunds upon notification of cancellation. Where there is no notification of the cancellation, the VPP continues in effect until it runs out naturally. If the VPP supplier is notified months or even years later that the policy should have been cancelled, its response may be that it did not know of the cancellation of the VPP, and it continued in full force and effect with the VPP supplier earning the premium on the VPP. Remember that where the VPP was sold to the customer at a retail price but the wholesale price was funded to the VPP supplier, the dealer may be responsible for its portion of the refund.

### **What Changed?**

Apparently, there have been threats of class actions against finance and lease sources for failure to credit customers with refunds upon early terminations of their finance or lease obligations. Besides resolving

those situations, finance and lease sources are taking two steps. First, they are putting in place processes to notify dealers of early terminations of finance or lease obligations that should lead to VPP cancellations. Second, they are charging back dealers, as much as three to five years later, for VPP refunds when customer finance or lease obligations terminated early.

### **How It Should Work**

The process being put in place to notify dealers of the cancellations of the customer's finance or lease obligations is the way the process should work. When a dealer is notified, the dealer can contact its supplier. The supplier can then process the refund and provide some funding for refunds for which the dealer is obligated under the indirect finance or lease agreements.

### **The Way It Should NOT Be Done**

Some finance and lease sources are now billing dealers for refunds on VPPs for customers' terminated finance and lease obligations when they never notified dealers of those terminations contemporaneously. Dealers understandably object that if they did not know of the cancellation--how can they be responsible for the refund?

The finance sources contend that under the indirect finance or lease agreements, a dealer is responsible to process the refund--sort of a strict liability argument. However, dealers say that does not seem right, and the dealers have a point. Where the finance source never made the dealer aware of the termination of the finance or lease obligation when it occurred, the dealer likely did not know to cancel the VPP. Dealers can contend that finance or lease sources interfered in the proper operation of the contractual provision requiring the dealer to refund the unearned VPP balance. A finance source should not benefit from its own inattention, especially when a dealer is damaged by that inattention. That is what lawyers call estoppel, which is a bar or impediment which precludes a person from asserting a fact or a right when the hindrance is due to that person's actions, conduct, statements, or failure to act.

### **What a Dealer Should Do**

Given the newfound energy of finance and lease sources, dealers should institute processes for identifying the need to cancel VPPs, appropriately cancel them, and arrange refunds.

1. If a customer trades a vehicle previously sold by the dealership before the end of the finance or lease period, the dealer should have in place a policy to process the VPP refunds, which may even include a process whereby the customer is given credit for the refund in the new deal.
2. If a finance or lease source notifies the dealer that a customer's finance or lease obligation has been terminated, the dealership should check to determine what VPPs may be outstanding and process any necessary refunds.

3. When notification by some other means comes to the dealership of the termination of the finance or lease obligation, have a process to determine whether there are VPPs in effect and process the refunds.
4. In the event of threatened chargebacks to the dealership for cancellations where the dealership says that it never knew of the termination of the finance or lease obligations, the dealer should marshal its facts. Was it a deal where the early termination resulted from a replacement deal by the dealership? Were there notifications from the finance source? Was there other information from which the dealership should have determined the early termination of the finance or lease obligation?

A dealer facing a chargeback demand from a finance or lease source it considers improper should seek advice from legal counsel to determine whether there is overreaching because the source should be estopped by its inattention to its obligations to keep the dealer aware of the termination of the customer's obligation. ■

*Michael G. Charapp is a lawyer in the Washington, D.C. metro area who represents car dealers and dealer associations. He is a founding board member and past President of NADC.*

## NADC Member Survey

### We need your help!



The NADC is currently engaged in a strategic planning project to explore potential ways to further enhance the value of the organization and offer maximum benefits to our members.

As part of the process, we are asking our members to participate in a survey of NADC. The survey will take less than 10 minutes to complete and the responses to this survey will be a critical component in the strategic planning process. You should have received the survey via email from Executive Director Erin Murphy.

**The survey will be open until July 15, 2019.** Thank you in advance for your participation!

If you have any questions or comments about the survey, please contact Executive Director Erin Murphy at [emurphy@dealercounsel.com](mailto:emurphy@dealercounsel.com) or John Flatley (AMS President and strategic planning project lead) at [jflatley@amsamc.com](mailto:jflatley@amsamc.com).

[NADC Member Survey...Please Click Here!](#)



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## President's Message



Johnnie Brown  
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Before your summer begins with family vacations and outdoor activities, I would be remiss if I did not thank everyone for another great annual conference. The speakers, sponsors, members, and AMS, as usual, were nothing less than impressive, as was the wonderful location of Dana Point, California, and The Monarch Beach Resort. Our annual meeting's attendance continues to grow, and the quality of our conference speakers and their presentations continue to always improve. I know our program planning committee works very hard to ensure timely and quality topics. For example, at the annual conference, we had over twenty-five presentation proposals and approximately nine time slots for presentations. A notice has already been emailed to the membership for presentation proposals for the NADC Fall Conference. I encourage you to participate with a timely and relevant topic. If you were unable to attend the annual conference, please remember that the NADC saves all conference presentations for members on our NADC website.

To continue the NADC's high quality meetings, please provide your feedback. We take membership comments and evaluations quite seriously. We look forward to reviewing those from this year's annual meeting. Moving forward, the NADC has started strategic planning for our organization. Our last strategic plan was over five years ago, and it is time again to self-evaluate. The last five years have been tremendously successful. The NADC has seen significant growth of members, constructed a new website, prepared an annual Dealership 101 meeting, and provides a weekly news update for all members. The next five years can continue to be just as exciting, but we need your help. The NADC will be emailing a short survey in the next month or so, please take ten to fifteen minutes to compete. The NADC strives to be able to support a membership that serves a fast, evolving industry with uncertain future challenges. To do so, we need your input on how best to accomplish this goal. Please be constructive and thoughtful with your comments and suggestions on how the NADC can continue to provide the highly quality educational services, networking opportunities, and additional benefits that make the NADC so valuable to its members.

Please take note of our newly updated membership criteria and pledge. Please take five minutes to update yourself. The Board of Directors worked to make it more clear and concise. I hope you find it improved.

## Questions to NADC Membership Pledge

1. In the past three years, have you or any attorney in your firm performed any legal services for a Vendor, Affiliated Lender, or Manufacturer adverse to a Dealer, including Dealer termination proceedings and negotiations on behalf of a Vendor, Affiliated Lender or Manufacturer?  
If so, please explain below the type of legal services performed.
2. In the past three years, have you or any attorney in your firm provided Opposing Representation to any party, other than a Dealer, in a matter adverse to a Dealer?  
If so, please explain the basis of the matter.
3. In the past three years, have you or any attorney in your firm provided Opposing Representation for any party, other than a Dealer in a dispute with a Dealer, including but not limited to those arising from consumer transactions, lemon law claims, and employment disputes or claims?  
If so, please explain below the basis of the dispute.
4. Do you or any attorney in your firm currently represent any party whom you believe is likely to have interests that will cause you to represent them in a way that is adverse to the interests of Dealers?  
If so, please explain.

## NADC Membership Pledge

- I certify that I represent the interests of Dealers.
- I do not represent, and agree that I will not undertake to represent in the future, the interests of consumers in lemon law claims or lawsuits, in other claims or lawsuits against Dealers arising from consumer transactions. I agree that I will not represent the interests of Manufacturers, Affiliated Lenders in Opposing Representation against Dealers, or the interests of employees against a Dealer.
- It is possible that from time to time a law firm with which I am or may be associated with may represent a manufacturer in the defense of a consumer or product liability claims. I acknowledge that, in the defense of such claims between the manufacturer and a consumer, other members of the law firm with which I am or may be associated may be called upon to assert claims against dealers in defense of the manufacturer clients on such claims. I agree that I shall disclose to the NADC whether any other members of the law firm(s) that I am associated with are engaged in the defense of claims on behalf of the manufacturers, and agree that, to the extent applicable, I shall inform each such member engaged in defense of such claims of my NADC membership and obtain their acknowledgment that they shall not, under any circumstances whatsoever, attend or participate in any NADC

meetings or workshops, access any portion of the NADC website and/or the NADC list-serve, review any publications of NADC including, but not limited to, the Defender, or any printed or computer generated materials utilized in connection with any and all membership presentations or seminars held at any membership meetings or workshop meetings of the NADC. I acknowledge and agree that it will be considered a breach of our commitment to NADC members if we communicate NADC information to any of our manufacturer clients or otherwise use such information against Dealers.

- I understand that my membership is subject to termination in the event I engage in such consumer, employee, Affiliated Lender or manufacturer representation in the future. (Not applicable to Trade Association Executive Members.)

That's it. Have a great summer, keep fighting for our dealers, and enjoy your time off with your families. The Fall Conference in Chicago will be here soon. I look forward to seeing you there. ■

## 2019 NADC Fall Conference October 27-29, 2019

The Ritz-Carlton, Chicago  
Chicago, IL

### HOTEL RESERVATIONS

The NADC room rate at the Ritz-Carlton, Chicago is \$295.00 per night plus applicable taxes. Reservations can be made [here](#). You may also call the hotel's reservations line at 1-800-542-8680. Please reference the NADC Fall Conference to get our special rate.

All reservation requests will require a credit card and a deposit for one (1) room night. Deposits will be refunded for rooms cancelled more than seventy-two (72) hours prior to arrival.

**Last day to officially book is Friday, October 4, 2019**  
(if the hotel room block does not sell out earlier)!

## 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: [emurphy@dealercounsel.com](mailto:emurphy@dealercounsel.com).



## NADC Welcomes New Members

### Full Members:

#### **Tracy Jack Crane**

Dennis Dillon, Office of General Counsel  
*Boise, ID*

#### **Zach Luea**

BacklotCars, Inc.  
*Kansas City, MO*

#### **Shireen Meshkati**

BN Dealerships Management, Inc.  
*Emeryville, CA*

#### **Andrea Rosati**

Sunroad Enterprises  
*San Diego, CA*

#### **Thomas Vangel**

Murtha Cullina LLP  
*Boston, MA*

#### **Douglas Walker**

McAllister, DeTar, Showalter & Walker, LLC  
*Easton, MD*

### Fellow Member:

#### **Erin Pell**

Enterprise Holdings, Inc.  
*St. Louis, MO*

### Associate Member:

#### **MarketSource**

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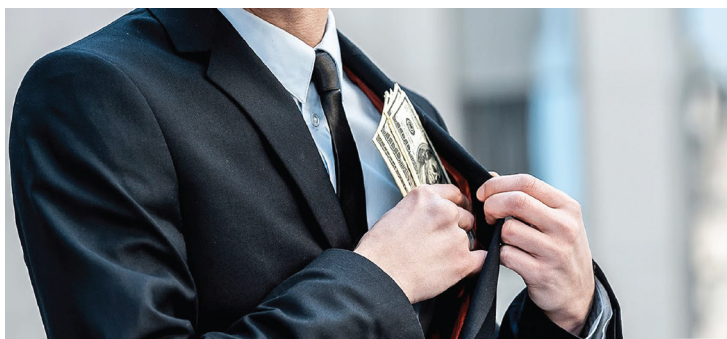
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# Preparing your Dealership for Financial and Tax Due Diligence

By John Seymour, *Partner, DHG Dealerships*

As dealer consolidation continues, chances are many dealers will become a buyer or seller in the near future. When purchasing a dealership, whether an asset or stock transaction, buyers will need to administer a thorough review of the company to ensure they know exactly what they are buying—this process is commonly referred to as “due diligence.” Likewise, many sellers of automotive assets are small owner-operators not typically experienced with a transaction process. Buyers and sellers should seek out providers of financial and tax due diligence services to help clients overcome the common issues associated with any given transaction, so that they may navigate such complexities with ease.

The multi-pronged process of acquiring another dealership involves due diligence on both sides of the purchase and will often result in a “quality of earnings” (Q of E) report. A quality of earnings analysis tells the narrative of the company’s business and its operations while highlighting certain factors that would be helpful in determining the buyer’s decision to move forward with the deal. A quality of earnings analysis involves a great deal of work and includes, but is not limited to, analyzing key reconciliations like bank reconciliations and floor plan reconciliations, analyzing trends throughout the balance sheet and income statement, analyzing detailed schedules, and thorough discussions with various parties. The quality of earnings should represent normalized historical earnings.

## Preparation for Due Diligence

Conducting buy-side due diligence allows the buyer to assess the quality of the dealership’s earnings and cash flows, and to identify potential issues or risks associated with the seller’s business. Sellers should also conduct their own due diligence before they make their final decision to sell the company as this may greatly decrease the chances of a derailed transaction.

Dealership transactions are different than any other business transaction, and an automotive (or even dealer) business owner typically does not sell his or her company very often, so due diligence is an uncharted process for many. The varying tax provisions, types of assets, relationships with manufacturers, and value determination specific to the industry are some of the peculiarities that make these transactions challenging to navigate.

In order to gain a better understanding of the target business, a buyer needs to receive comprehensive and factual financial information, including assets, liabilities, and future earning potential from the seller.

Sellers are also better positioned to obtain maximum value and reduce the risk of unexpected purchase price adjustments or surprises by investing in sell-side due diligence. Below are some items to consider as the potential seller:

- It is common practice to inform a limited number of employees about the potential transaction, but it is essential to include the controller or person responsible for the accounting records, as he or she will likely be responsible for providing the necessary information for the due diligence and will likely have the answers to many of the questions that will arise during the process.
- Understanding the dealership’s financial statements will prove advantageous throughout the lifecycle of the transaction. Sellers should be prepared to discuss trends and variances, such as performance, inventory mix, gross profit margins, operating expenses, location by location analysis, and items hidden in other income and expenses.
- Be sure to accumulate any non-recurring or unusual items that have occurred in the recent past that might skew your numbers, in a positive or negative manner. This is the sellers’ opportunity to identify all “management adjustments” that should be factored into the Q of E report. Some examples of management adjustments are certain expenses running through the company’s records that are unrelated to the business; professional fees incurred preparing for the transaction; and market adjustments such as compensation and rent.
- Prepare to discuss any hidden liabilities. Think about any exposure that a future buyer would inherit from a transaction including, but not limited to, any for-life programs such as oil changes and tires for life which may not properly be recorded on the balance sheet. The buyer would have to honor the program’s future costs with the customer base it is inheriting or run the risk of immediately ostracizing customers. We see time and time again that this causes a transaction to be significantly delayed or to fall through.
- Identify any reinsurance or other income items that are not recorded in the company’s records by either being paid directly to the owners or other related companies.
- Although financial due diligence is focused on the accounting records and numbers, sellers should still ensure the appearance of their dealership is acceptable. Perform a facilities walkthrough of your dealership, not only the show room, but the parts warehouse, service bays, accounting office, and exterior parts of the building.



## Departmental Responsibilities

- Human Resources – Gain a full understanding of the current benefits position including the related employer costs associated with the following: (i) medical, dental, and vision insurance coverage; (ii) 401k plans; and (iii) vacation/paid time off. Also, from a personnel perspective, have a game plan in place to properly inform the company employees about the transaction after an agreement has been reached and discuss the changes that will be forthcoming. Lastly, it is important to note that even if it is an asset purchase transaction, the buyer is typically acquiring the current processes and people so it is helpful to understand the talent pool and key employees as well as attempt to avoid having significant turnover immediately following the transaction.
- Legal – Have a complete understanding of the legal situation including potential claims and where they stand.

## DHG Tips for a Smooth Transaction

- Be patient and prepared to dedicate time and effort before, during and after the transaction.
- Understand and anticipate the detailed historical operating results and complexities in order to keep the transaction on the right course.

## Updated Member Contact Information

Please make sure to notify NADC Staff ([info@dealercounsel.com](mailto: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.



- Sellers should perform sell-side due diligence to prevent surprises and provide opportunities for increased value.
- Buyers should perform buy-side due diligence, especially if new to the industry, since significant adjustments to reported EBITDA often lead to important considerations for deal negotiations. ■

*John is a Partner in the DHG Atlanta office with over 11 years of experience serving clients in the automotive, heavy truck, and marine dealership industries. John focuses on an assurance and consulting practice that includes financial statement audits, financial statement reviews, employee benefit plan audits, internal audit, financial due diligence, and buy/sell advisory engagements. He serves dealership companies ranging in size from single point stores to dealerships with more than 80 locations and \$9 billion in revenues.*



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