

General Motors' Network Consolidation Hits a Snag

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The easy ones are out of the way now for General Motors. The Pontiac, Buick and GMC dealers that were ready to sell out have done so. The more difficult market alignment situations remain. General Motors is struggling with the stand-alone dealer who has had the franchise in the family for 30 years and has the land and building paid off. This Pontiac, Buick and/or GMC dealer turns a nice profit on modest sales volume without having all three franchises. He or she has no interest in selling the family business. What is GM to do in this situation? More importantly, what is the local dealer to do who needs the franchise(s) that this dealer has in order to round out his product offering and remain profitable thanks to GM's unilateral reduction in models in each franchise?

One thing we see General Motors doing is substantially increasing its financial contribution to the purchase of the "hold-out dealer." We recently became aware of a Buick franchise being sold, with GM's participation, for seven figures! GM's willingness to bring lots of money to the table is certainly to its credit. However, there is a nasty little consequence of GM's increased financial participation in these deals. The dealer receiving the franchise, as is always the case, is being asked to sign GM's onerous Exclusive Use Agreement. The consequence of the enhanced financial participation by GM is that the penalty clause in the Exclusive Use Agreement increases accordingly. Thus, if GM is willing to throw in "crazy money" to get a deal done, the dealer receiving that franchise is not only asked to contribute financially but is then asked to agree not to add any other franchise to the dealership property, no matter how bad things may get for Pontiac, Buick and GMC down the road, with a penalty, which is over the top. The penalty clause in the Exclusive Use Agreement uses GM's financial contribution as the base penalty amount and then triples that amount if the Agreement is violated within the first 10 years, doubles that amount if there is a violation within the second 10-year period and requires the dealer to pay back the base amount if there is a violation within the last five years of the 25-year term.

The problem is, of course, that the dealer purchasing and receiving the missing franchise(s) is already coming out of pocket to pay what would, in normal market conditions, be considered a reasonable blue-sky number or more and then is told they will be subject to a penalty in the seven figure range due to GM's participation to meet the selling dealer's unreasonably high demand. More power to the dealer selling out, but the dealer receiving the franchise shouldn't be hit with a "double-whammy." GM should pay whatever it takes to accomplish the consolidation since it has unilaterally created the need for consolidation in order for dealers to be viable going forward. The dealer coming out of his own pocket to comply with GM's consolidation plan shouldn't then also be asked to sign onto an unbelievably onerous Exclusive Use Agreement, the terms of which have no bearing on realistic purchase prices. We are advising our dealer clients in this situation to insist that the penalty amount be substantially reduced so that it is brought into line with reality. For example, if the hold-out dealer discussed above has a franchise worth \$400,000 using a traditional earnings multiplier, and the dealer receiving the franchise is contributing \$300,000 and GM is contributing, say, \$700,000 (in order to meet the selling dealer's demands) for a total purchase price of \$1,000,000, then the penalty clause in the Exclusive Use Agreement should be no more than \$100,000. This is the amount GM is contributing over and above the buying dealer's contribution but no more than the fair value of the franchise being purchased. After all, these Exclusive Use Agreements are bad enough as it is without substantially increasing an already unreasonable penalty clause.

What is Honda up to?

We continue to be surprised at the major shift in attitude toward its dealers that we have seen from Honda

Motors. Honda began showing up on our radar screen about 18 months ago when it started performing market studies with an eye toward adding new dealerships. Honda continued on the Myers & Fuller radar screen when it began telling some dealers that they weren't performing up to par. These dealers had always been performing at an "average level" with no significant change, which would justify drawing the sudden ire of Honda. We believed then and it is proving itself out now, that the sudden interest in certain dealers' sales performance coincides with Honda's desire to add dealerships in a flawed attempt to keep up with Toyota.

We don't pretend to know what Honda or any manufacturer is thinking, but based on correspondence we have seen from Honda, it is clear that Honda has become obsessed with equaling and surpassing Toyota in sales. Our written objections on behalf of our Honda dealers as to why a new Honda dealership in the market is not warranted have been met with "Toyota has X number of dealerships more than Honda in the market" or "Toyota dealers are outselling Honda dealers in the market." Last time I checked, Toyota had a significantly greater number of product offerings than Honda. Using a strict comparison of Honda dealer performance versus Toyota dealer performance in a given market is simply not a rational analysis. The question should be, and historically has been, how is a given Honda dealer performing as compared to other *Honda* dealers in the district, region and nation? This analysis is then combined with a look at any unusual circumstances occurring with the Honda dealer's market, which may explain the *appearance* of deficient performance.

As if the faulty comparison to Toyota was not bad enough, Honda also appears to be ignoring the fact that the economy has come to a grinding halt and new car sales across the boards are flat. To make matters worse, Honda seems to be showing no interest in offering the new dealership point to the existing Honda dealer in the market. Honda is generally steadfast in following its policy of no contiguous market ownership.

Honda dealers finding themselves in the position of being challenged on sales performance, being told a competing dealership is going into the market or both need to document their concerns and ask questions. Dealers should be insisting they receive copies of the market studies completed by Honda. They must ask if Honda has studied how a new point will impact sales at your existing store and what the planning potential is for the new store. Dealers should be asking Honda for details on the sales performance formula being used to judge them and describe any circumstances unique to your market, which would explain the appearance of deficient sales performance. If a dealer has completed an imaged facility in the last five years, the fact that the dealer has made a large investment in its facility and requires time to obtain a return on that investment should be pointed out to Honda. Most importantly, dealers must let Honda know that you will not take this new attitude sitting down.

Richard Sox is a lawyer with the firm of Myers & Fuller PA, with offices in Tallahassee, Florida and Raleigh, North Carolina. The firm's sole practice is the representation of automobile dealers in their quest to establish a level playing field when they deal with automobile manufacturers.