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# NADA PREVIEW

A special section about issues, strategies and players as the nation's auto dealers meet Jan. 29-Feb. 1 in New Orleans for their annual convention

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INSIGHT

## Side issues

### Supplemental agreements become new battleground

Donna Harris

Dealer Michael Forrest has waited four years for the seven-figure check he says General Motors owes him for killing Oldsmobile. Before GM will pay, Forrest says, the automaker wants him to agree to upgrade the Chevrolet-Cadillac-Oldsmobile and Buick-Pontiac-GMC stores he operates in Cleburne, Texas. Under the proposed agreement, those dealerships could sell only GM vehicles for 25 years. If he were to violate the contract, he would face a penalty of more than \$1 million.

Forrest says he isn't signing. "My franchise agreement is only for five years," he says. "If I signed an exclusivity agreement for 25 years, what would keep GM from waving its magic wand and zapping Buick?"

The dispute arises from a "side contract" — a confidential agreement between factories and dealers apart from



ANDREW SCOTT

Dealer Michael Forrest refuses to sign a proposed agreement with General Motors promising to upgrade his two Cleburne, Texas, dealerships.



*"If I signed an exclusivity agreement for 25 years, what would keep GM from waving its magic wand and zapping Buick?"*

— Michael Forrest  
Forrest Chevrolet-Oldsmobile-Cadillac

standard franchise agreements. Most side contracts outline steps to improve a dealership's performance or conditions for financial aid from an automaker to a dealership.

Factory lawyers say these supplemental agreements ensure dealers' commitment to brand integrity. But dealers and their lawyers say side contracts can impose unreasonable burdens on a small business.

Both sides agree that factories' demand for the agreements is growing.

"If we pay a dealer  $x$  dollars, we want an agreement that the dealer-

ship will only be used as a GM dealership," says GM lawyer Joe Lines. "You can't decide a few years later to acquire a Nissan franchise and locate it on the site we helped you buy."

Dealer lawyers say dealers can get into financial and legal trouble if they don't understand the terms of a side agreement. They add that some dealers may not realize they can negotiate those terms — or, like Forrest, reject them.

"I've seen such agreements tied to mergers and the opening of new dealerships," says Wayne Mack, a dealer lawyer in Philadelphia. "I have also seen such side agree-

ments with dealers who are accused of not meeting the manufacturer's standards. I am aware of one instance where the dealer's territory was reduced as a condition."

A performance agreement imposed on a dealership by Nissan North America Inc., for example, requires the store to sell factory service contracts to at least 35 percent of its vehicle buyers.

## Growing trend

Supplemental agreements are becoming more prevalent for several reasons.

First, the cost of building and remodeling dealerships has soared. That has caused dealers to seek more factory help to expand and upgrade stores. "With the price of real estate in some markets, it's necessary that we provide assistance," Lines says.

But automakers can attach strings to that aid. To get money to improve their facilities, dealers often must agree to handle a manufacturer's franchises exclusively, says Rich Sox, a dealer lawyer in Tallahassee, Fla.

At the same time, tougher state laws make it harder and more time-consuming for factories to change broad franchise agreements that govern sales, service and dealer performance. As a result, automakers rely more on side agreements with individual dealers.

"Some state laws allow a dealer to formally protest any amendment to a franchise agreement," Sox says.

Many automakers have introduced strict standards for dealer operations and facilities in recent years. As factories raise the bar, more dealers are likely to fall below it. That leads to new demands by factories for performance agreements.

Factories often require publicly held dealership groups and large, rapidly growing privately owned dealership chains to sign strict performance agreements. The agreements are designed to ensure that owners of multiple dealerships don't let quality slip. They also seek to limit the number of dealerships a single corporate entity owns.

## Factory pressure

Dealer lawyers say they don't object to supplemental agreements as long as dealers voluntarily accept their terms. But they claim some factories place undue pressure on dealers to sign.

"The dealer wants something out of the factory, such as approval to relocate," says Mike Charapp, a dealer lawyer in Washington. "The factory says: 'Yes, it's approved, but you have to build a separate showroom (for the brand).'"

"The factories have a hot button the dealer has to comply with. You can be sure that approval will be held up until they agree."

Attorney Sox says one of his clients proposed a change in designation of dealer operator from one of the store's owners to the other. DaimlerChrysler tried to get the dealer to sign an exclusivity agree-

ment in return, he adds.

"Fortunately, DaimlerChrysler backed down," Sox says.

Sox warns that dealers must closely examine the provisions of a side contract governing an acquisition or relocation. The prospect of a big check from the factory can distract them, he says.

"Courts generally enforce contracts that appear to have been entered into voluntarily," he says. "It is virtually impossible to extract a dealer from the terms of any side agreement for which the dealer was compensated by the manufacturer."

Some performance agreements

automatically terminate a franchise if a dealer fails to meet stiff factory goals. This provision "forces a dealer to waive any right he or she has to take advantage of the protections provided by their state law," Sox says. "They have no opportunity to explain any alleged deficiency in performance."

Many agreements suggest dealers must meet or exceed performance standards at all times. "Every dealer has good months and bad months," Sox notes.

Exclusivity agreements can be lengthy. In some cases, says a factory attorney, who asked not to be

identified, they're perpetual. And the agreement can invoke large damages if a dealer violates it.

Another type of side contract addresses "site control." Such an agreement gives a manufacturer the option to buy and take over a site if a dealer wants to relocate or convert the property to another use, such as a used-car lot.

### Arbitration loophole

Federal law prohibits franchise sales and service agreements from requiring dealers to submit to binding arbitration rather than litigation to settle factory disputes.

But many side contracts — including the performance agreements that publicly held dealership groups must sign to acquire franchises — include arbitration clauses.

In late 2002, two dealers got financial help from GM to move their dealerships and acquire other GM stores. In return, the automaker required them to sign contracts with binding-arbitration clauses.

The dealers — J. Thad Naquin, owner of Tom Naquin Chevrolet Inc. in Elkhart, Ind., and Charles Haselwood, owner of Today Chevrolet Co. in Bremerton, Wash. — sued to invalidate the clauses.

### Sticking points

Here are some provisions of side contracts between dealers and factories.

- Nissan requires a dealer to sell factory service contracts to at least 35% of his customers. Failure to do so is "just cause for termination."

- Nissan requires a dealership and all future owners of the store to "provide new, exclusive, separate and distinct stand-alone Nissan sales, parts and service facilities."

- General Motors requires a dealership to sell only GM vehicles for 25 years. If the dealership violates the agreement, it must pay GM triple damages if the breach occurs in the first 10 years, double damages in the second 10 years and actual damages in what's left of the contract period.

- GM requires a dealer to "submit to final and binding arbitration" to resolve any dispute that arises with the automaker.

- A DaimlerChrysler agreement allows the automaker to take over a dealership's lease for 25 years — or the remaining term of the lease, including renewal — if the site no longer is used by an authorized DaimlerChrysler dealer.

But in both cases, courts ruled the side contracts were separate from franchise agreements and ordered the dealers to accept arbitration.

Dealer lawyers want the National Automobile Dealers Association to lobby Congress to broaden the federal ban on mandatory arbitration. NADA franchise attorney Jim Moors calls that request premature. He notes that judges have ruled for dealers in other arbitration cases involving side contracts.

Lawyers also urge dealers to seek expanded state legislation that would protect them from some provisions of supplemental contracts.

For example, Wyoming prohibits manufacturers from requiring franchise exclusivity. North Carolina forbids automakers from discriminating against dealerships that have dual-franchise operations.

Both states prohibit manufacturers from pressuring dealers to sign a side agreement by threatening to cancel their franchises. And Virginia requires performance standards in supplemental agreements to be "reasonable and objective."

Most important, lawyers say, dealers must be ready to bargain hard with factories over side contracts.

Says Sox: "Our concern is that dealers don't know their rights, but instead trust their manufacturers when told they have no choice but to agree." □

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