The Wheels of Justice

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What Happens to Your Franchise if General Motors or Ford File for Bankruptcy Protection?

The answer will surprise you

Everyone is asking the question: What could happen to my dealership if the manufacturer files for bankruptcy?

The answer to that question derives from an old law school saying, "Bankruptcy judges are the most powerful judges in the world." Why is that? Bankruptcy judges have the power to reject certain contracts the bankrupt entity has with others. These contracts, otherwise known as "executory contracts," are ones that have not been fully performed by the parties. The bad news is that your Dealer Agreement most likely falls within this category.

As an executory contract, GM or Ford could ask the bankruptcy judge to reject your Dealer Agreement, thus making it null and void. If the manufacturer argues that there will be a cost savings as a result of consolidating or eliminating line makes, the bankruptcy judge is likely to agree to reject the Dealer Agreement. You read that right: *Your franchise can be taken from you by the bankruptcy judge without cause simply by GM or Ford asking for it as part of their reorganization plan.*

Your only recourse is an appeal, which will not only be costly but also has a slim chance of prevailing. You also read correctly that GM or Ford could pick and choose the dealers who are terminated. There is no requirement that all dealers within a line make, for example, must be terminated for any one dealer to be terminated.

If the bankruptcy judge can take your franchise from you, don't the termination provisions of your state franchise laws provide you with protection? No. The reason bankruptcy judges are the most powerful judges in the world is because federal bankruptcy laws trump every state law in the land. As a result, your state law's termination protest rights will not apply, nor will the termination benefits called for by your state's automobile franchise laws.

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A Dealer's Right to Freely Buy and Sell New Motor Vehicle Dealerships

[Editor's note: Last month, we began a discussion of factory-related horror stories that have happened to dealers. We discussed attempted terminations and constructive terminations. This month we continue with a discussion of the rights of dealers or prospective dealers who are turned down by a manufacturer when they attempt to purchase or sell a dealership.]

Many states have laws that are designed to make sure that a manufacturer can only turn down a proposed buy-sell for legitimate reasons such as

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THIS ISSUE

Lender Acquisition Fees: Pointers on how to Properly Incorporate them into Deals

How do you properly account for and disclose acquisition or assignment fees lenders charge you to accept a deal?

Unfortunately, a clear-cut answer is not readily available because the actual line between required disclosure and non-disclosure of acquisition fees has not been clearly drawn in most jurisdictions. As a result, the better practice is to err on the side of caution.

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CORRECTION

Due to a printing error, the last portion of the "Protect from Unfair Termination, Part II" article was not printed in the November Issue of TWOJ. Below are the remaining two paragraphs from that article.

We learned in our Oldsmobile termination litigation that the manufacturers will argue that judges have no right to hear a termination case until the manufacturer provides dealers with a formal notice of franchise termination or the non-renewal of a franchise agreement. In the Oldsmobile cases, GM made this argument even though it had told the world that it was "discontinuing" Oldsmobile, which resulted in a rapid and immediate decline in sales for Oldsmobile dealers.

Every judge ruled in our favor, saying that the circumstances surrounding the manufacturer's actions, and not a formal written notice from the manufacturer, will determine if a termination or proposed termination has occurred. Even so, codifying these rulings within your franchise law's termination provision will thwart factory attempts to provide to avoid giving formal notice of a termination when its actions demonstrate the contrary.

By: Richard N. Sox, Jr., Esq. and Loula M. Fuller, Esq.

Bankruptcy Protection, continued from page 1

Practically speaking, if GM or Ford use the power of the bankruptcy judge to eliminate dealers, logic tells us that for an otherwise profitable line make the small rural dealer or poor performing metro dealer would be cherry-picked for elimination. For an unprofitable line make or one that overlaps with another (think Pontiac, Buick, GMC, Saturn, Saab and Mercury), the entire line make could be eliminated in the bankruptcy court. If you are a selling an adequate number of cars and trucks via a line make that is profitable for the manufacturer you can probably sleep soundly. If, however, you are a dealer that falls within one of the above categories, you need to do some hard thinking.

A dealer that falls within the category of happening to have a line make that is not profitable for the manufacturer cannot, unfortunately, do anything to avoid rejection of your dealer agreement except continue to maintain your performance. However, such a dealer can and should think very seriously before investing any additional monies into your dealership other than what is absolutely necessary from an operational/profitability standpoint. Despite the financial condition of GM and Ford, they are continuing to cajole their dealers to bring their facilities up to the latest image standards, agree to exclusive use agreements and site control agreements. If GM or Ford approaches you with any of these, you must review them with an eye toward the risk of spending the money and/or tying up your dealership property and subsequently having your franchise taken away from you in a bankruptcy proceeding. There is, of course, a strong argument that if your franchise is ultimately taken away the exclusive use and site control provisions of your dealer agreements will no longer be applicable. However, if you have other GM line makes at your dealership that are not eliminated, the argument becomes more difficult. The bottom line is that you don't want to even reach the point of having to argue that those agreements don't apply. Think it through ahead of time.

"Your franchise can be taken from you by the bankruptcy judge without cause simply by GM or Ford asking for it as part of their reorganization plan."

Although dealers that are performing well may not need to worry about an elimination of their franchise altogether, those dealers must still view any request to invest additional monies into their GM or Ford franchises and/or enter into a side agreement with a jaundiced eye. There is a very good chance that the GM or Ford that comes out of bankruptcy will have a substantially lower market share for the traditionally profitable lines (Ford, Chevrolet and Cadillac) than they do now.

When considering whether to bow to the pressure of upgrading your facility or entering into an exclusive use or site control agreement, run your numbers based on a drastically lower amount of new car sales before committing. If the numbers still make sense, demand that certain provisions be included within these side agreements that will give you an out if one of your line makes is eliminated or sales of an existing line make fall below a certain level.

By: Richard N. Sox, Jr., Esq.

Article summary

- By filing for bankruptcy protection, GM or Ford could have the judge reject your franchise agreement.
- A bankruptcy judge does not have to eliminate an entire linemake but could eliminate the franchise of a dealer that is underperforming or doesn't fit within a retail channel strategy.
- If your franchise is rejected by the bankruptcy judge, chances are good that the termination benefits under your state franchise law will not apply.
- If your franchise is eliminated, you will have a strong argument that your exclusive use or site control agreement should no longer apply.
- Before investing funds in your GM or Ford dealership, beyond day to day expenses, consider the risk involved with possibly losing your franchise.

Buy/Sell Agreements: How to Make Sure You Don't Short-Change Your Own Interests

For several months now, we've reviewed what a prospective buyer or seller of a motor vehicle dealership should do when you move to sell or acquire a dealership.

- Buyers and sellers need to acquaint themselves with applicable factory initiatives to understand the dynamics and potential economic effects on the value of a particular transaction.

- Buyers and sellers also need to engage experienced and knowledgeable legal counsel to study and analyze the applicable provisions of the state franchise laws to determine what, if any, leverage will be available in the event the manufacturer pushes back on the deal.

- Buyers may want to compare and contrast applicable franchise transfer laws in several states to determine the geographic areas for locating a store that will offer the most favorable franchise transfer protections. Some states have more dealer-favorable franchise laws than others.

- Finally, buyers and sellers need to have a mutual understanding of their respective roles to preserve the franchise protections that will cover the transaction.

Once the foregoing tasks and other due diligence activities (i.e., accounting and financial inquiries) are thoroughly completed, it is time to put pencil to paper (or fingers to keys) and work toward preparing a definitive agreement for a buy/sell deal.

While many dealers may have in the past scratched out an agreement for the purchase and sale of a dealership on a cocktail napkin, it is foolish to take that approach in today's business environment. These agreements typically allocate risk between buyers and sellers. Today, more than ever, it is critical that you adequately identify, negotiate and allocate those risks in a manner that both a buyer and seller can agree to.

Which side should prepare the transaction documents?

Here is a fundamental rule of buy/sell transactions and related documents: *The party who advances the documents and initially controls the contract language ultimately controls the deal.*

While there are those who say it is customary for the purchaser to produce the initial draft of a buy sell transaction document, in my personal opinion nothing is customary when it comes to negotiating and protecting your own interests. Whether you are a buyer or a seller, it is critical for you to take the reins and try to control the deal by initiating the drafting of deal documents. (There are a few minor exceptions to this rule, but you should only allow such an exception after careful consideration with your legal counsel.)

"You should also avoid the trap of believing that if the other side drafts the documents, you are going to save money."

You should also avoid the trap of believing that if the other side drafts the documents, you are going to save money (although you might use that line to get the other side to allow you to initiate the drafting). It takes just as much time to critically review and comment on a proposed asset purchase agreement as it does to draft one. Consequently, legal fees are not saved and, moreover, the dynamics of the transactions often tilt in favor of the other side because the edits and responses your attorney makes often reveal weaknesses or vulnerabilities on your side of the transaction.

As you take on the drafting of deal documents, you should get the help of legal counsel who are experienced and competent in auto dealership buy/sell deals. Not every lawyer who has provided services with respect to the sale or purchase of a business is equipped to provide effective counsel when it comes to a dealership transaction.

Similarly, you take the same approach to selecting the financial advisors who will help you protect your interests in a buy/sell deal. Time and again, we've seen transactions in which one side's team lacks sufficient experience and, invariably, money gets left on the table to the detriment of someone as one or more key issues—say, for example, F&I contract terminations and charge-backs—are not properly addressed. It is these unaddressed issues that often lead to troubles down the road and sometimes they result in a deal breaking apart. These transaction disasters will cost you a substantial amount of money and aggravation. No buy/sell transaction is without its occasional hiccup, but building a team of knowledgeable advisors is critical to minimizing these problems.

In the coming issues, we'll break down the elements of an effective, definitive asset purchase agreement (the most common form of a transaction for the purchase and sale of a dealership). Along the way, we'll make reference to tips that address stock agreements and help you avoid errors that commonly occur in buy/sell deals—and how these missteps and deal dynamics can affect both buyers and sellers.

by Robert A. Bass, Esq.

Article summary

- Invest the time and money to craft a thorough dealership transaction document.
- Build an experienced team. Competent and experienced legal and financial counsel will prepare agreements that not only protect your rights but also result in a successful closing.
- The party who advances the documents and initially controls the contract language ultimately controls the deal.

A Dealer's Right to Freely Buy, continued from page 1

experience, good moral character and capitalization. These statutes are very important because many times the manufacturer may have a plan for a dealership, such as transferring it to another dealer that the factory would like to purchase and operate.

We have been warning dealers that several of the factories are attempting to eliminate small dealers in rural areas completely. In metro areas, the same factories are attempting to eliminate small dealers by consolidating the smaller dealerships with larger more profitable dealers. Also, the GM Channel Strategy and Chrysler's Project Alpha, by their very nature, require that single line dealers, such as a Dodge dealer, either buy a Chrysler and Jeep dealership or sell to someone who owns the other two line makes. The same scenario is in effect for GM's Channel Strategy. Therefore, if you attempt to sell your dealership to someone that does not fit with these plans then chances are good that the factory will attempt to turn down your buy/sell deal.

Increasingly, manufacturers also have alternative motives such as closing dealerships that they have designated as non-viable. We recently had a client who received a letter designating his point as non-viable. The letter stated that the dealer could continue to run the dealership but that he could not sell the dealership or even pass the dealership to family members through estate planning. The dealer was understandably upset. Fortunately, the dealer's state franchise law protected him through its termination and turn down provisions. The provisions provided that the dealer could only be terminated for good cause. (Designating a dealership as non-viable and destroying a dealer's life long investment does not constitute good cause.) Also, the state law only allowed the factory to turn down a buyer if he did not meet the requirements of experience, good moral character and capitalization. We wrote a letter to the manufacturer and informed them that state law prevented the designation as non-viable and dealer should be able to sell the dealership if he chooses. Once again, knowing the state law and responding to the problem in writing is essential when the manufacturer attempts to enforce a term such as this.

If you attempt to purchase a dealership and the factory turns you down, you as the buyer and/or seller, must learn what protections are available under state law and file a protest within the time prescribed by the statute. If you are turned down and do not file a protest, you have given up the right to have the turn down reviewed by a decision maker. In many states, if you are wrongfully turned down you may be entitled to monetary damages as well.

"The bottom line is that you must file a protest to protect your rights."

One area of the turn-down law that varies from state to state is whether the potential purchaser has standing to protest the turn-down. All states that provide protection of a dealer's right to sell obviously give standing to the seller. A much smaller number of states give standing to the proposed purchaser to protest a factory's refusal to approve the buy-sell. Some of these states specifically give the purchaser standing and other states have language that provides that "any person" damaged by a violation of the statute—which would include a purchaser—has standing to file suit against the manufacturer. Also, in states in which the purchaser does not have standing, the factory may have violated other laws that will still allow the scorned buyer to file suit.

The bottom line is that you must file a protest to protect your rights. We have found in many cases where a buyer is turned down because of a reason other than experience, good moral character or capitalization that factories are open to negotiating a settlement with dealers who have filed protest suits.

In a recent case, the son of a dealer was operating the store after his father died. The estate plan called for selling the store to the son, who would become the dealer operator. The store was not performing well by the manufacturer's standards but there were many factors other than poor management, not the least of which was the popularity of the line make in the area. The factory's plan was to force the family to sell the dealership to (guess who?) the factory's chosen dealer. After negotiations, we convinced the factory to place the prospective buyer's sister as the dealer operator and allow the son to manage the dealership. After a period of time, the son proved his worth and earned the appointment as dealer operator.

Another nightmare occurred recently when a very experienced dealer made application to purchase a dealership and during the application process the zone manager said "welcome aboard." While the application was being processed, the zone manger retired and the new zone manger turned down the proposal without ever talking with the purchaser. This case is now in litigation.

Now, more than ever, the factories have network plans that are not made with the dealer's best interest in mind. Know the manufacturer's network plan before you attempt to buy or sell a dealership and know your state law. There may be protections that allow contracting parties to buy and sell a dealership regardless of the factory's desires for the market.

By Dan Myers, Esq.
and Martin Hayes, Esq.

Article summary

- If you attempt to purchase a dealership and the factory turns you down, you as the buyer or seller, must understand and use the protections available under your state law.
- Know your manufacturer's network plans if you are considering buying or selling a dealership.
- If you think the factory wrongly turned down a buy-sell proposal be prepared to file a protest to protect your rights and provide you with a strong negotiating position.

Lender Acquisition Fees, *continued from page 1*

If you are doing business with a lender that charges acquisition fees, there are some key questions you should consider: Must those fees be disclosed to the consumer? How are they disclosed? How would those fees affect the maximum finance charge rate allowed under applicable state law?

The following analysis is a conservative approach to addressing these issues that is intended to protect you dealer in the event that the courts take a strict view of these fees in the future.

"In states where courts have addressed acquisition fee issues, they have ruled that raising the sales price of a vehicle to absorb the acquisition fees creates an indirect imposition of a finance charge on the consumer."

Are you passing on the cost to customers? It's best to disclose the practice

In general, you must disclose the acquisition fee to a consumer if you choose to pass the cost of that acquisition fee on to the consumer, either directly or indirectly. When you pass this bank charge on to the consumer, then the amount of the acquisition fee is deemed to be a "finance charge" and must be represented as such on the Truth-In-Lending statement.

"The actual line between required disclosure and non-disclosure of acquisition fees has not been clearly drawn in most jurisdictions. As a result, the better practice is to err on the side of caution."

That finance charge will be treated the same as all other finance charges in determining the annual percentage rate that is reflected on the Truth-In-Lending statement. Accordingly, if a transaction, after the addition of the acquisition fee, climbs above the maximum finance charge rates allowed by state Retail Installment Sales Acts (RISA), then you and the lender will be in violation of RISA. Great care must be taken in those circumstances where the consumer of marginal credit is seeking financing.

You can also choose to absorb the cost of the acquisition fee. However, keep in mind that in states where courts have addressed acquisition fee issues, they have ruled that raising the sales price of a vehicle to absorb the acquisition fees creates an indirect imposition of a finance charge on the consumer. Some courts in other jurisdictions have found that if the existence, or possible existence, of an acquisition fee at all affects the dealer's pricing of a vehicle, then that will be deemed to be a "finance charge" and must be disclosed to the customer. If, on the other hand, a dealer quotes a price to a customer that remains static regardless of whether the customer pays in cash or finances the transaction, then there will be no resulting "finance charge." Some dealers are now building expected acquisition fees into their lot charge as an across the board cost of the vehicles.

Dealers may wish to consider the following course of action with respect to acquisition fees:

- Do not show the fee on the buyers order;
- Do not tell the customer the fee is being passed along and that is why the vehicle price is higher than it would otherwise be;
- Do not increase the cost of the vehicle to cover the fee;
- Do not sell the vehicle at a price higher than advertised because of the fee.

In light of the legal uncertainties regarding acquisition fee disclosures, it is imperative that you include the fees as a finance charge and disclose it on your Truth-in-Lending statement if you intend to pass along the charge to your customers. This is true whether the customer would pay the fee directly or indirectly. These charges should also be factored into the calculation of the annual percentage rate for purposes of Truth-In-Lending and RISA. The dealer must further make certain that the acquisition fee will not result in a violation of state usury laws.

You should contact your legal advisor should a question regarding treatment of acquisition fees arise at your dealership.

By Shawn D. Mercer, Esq.

Article summary

- Err on the side of caution when it comes to disclosing lender acquisition fees.
- If you pass along acquisition fee costs to customers, you should disclose it.
- State laws do not provide clear-cut guidance on how to address acquisition fees in deals.

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