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CLIENT ALERT

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LEGAL TRENDS IN THE AUTOMOTIVE INDUSTRY

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TRANSFER APPROVALS AND SUCCESSION PLANNING

As part of an estate planning program, you may decide to slowly gift company stock to your children who have worked at the dealership. Alternatively, you may decide to reward or motivate a general manager by offering him or her the opportunity to buy into the dealership over time. Both are perfectly good options; however, if not properly handled, these minor changes in ownership or gifting (of normally insignificant amounts of stock) can cause major disputes with your manufacturer.

The Massachusetts franchise statute (Chapter 93B)- like most state franchise laws - prohibits manufacturers or distributors from unreasonably withholding their consent to any transfer. In theory, this should prevent situations where they deny the transfer of stock to a son, daughter, or a general manager who has experience in operations and has a demonstrated ability to run a dealership. In reality, however, the manufacturers have the right to exert broad discretion over any change in ownership - no matter how small or insignificant.

Manufacturers have detailed this right in most franchise agreements; it is also endorsed by state law. More to the point, transferring, assigning, or selling an ownership interest in your dealership without prior manufacturer approval may be a violation of your franchise agreement and state law. In the end, the manufacturer gets to choose with whom it does business. This reality impacts all dealers, whether you are on the verge of selling or plan on passing your dealership down to the next generation.

Most often, a manufacturer is completely unaware of changes in ownership so long as the majority stockholder remains the same. However, disclosure of ownership status is always necessary at any transition stage, such as a buy/sell transaction or upon the death of a dealer operator. If not preapproved, arrangements such as those described above can give the manufacturer a foothold to demand various other changes - such as facility improvements - before approving what would have normally been a simple request.

Court decisions are mixed on the issue of transfer disputes. There is some recent precedent in Massachusetts supporting a manufacturer's right to demand concessions in exchange for succession approval. For example, if a manufacturer has historically requested relocation to a new site, a court is likely to side with the manufacturer when and if it conditions succession approval on the dealer's commitment to the relocation. There is also some precedent in Massachusetts and other states (most recently Texas) where courts have questioned a manufacturer's decision to deny a transfer request to a seller based upon sales performance and customer service scores (CSI), finding these benchmarks to be arbitrary and incomplete measurements.

The bottom line is that it is advisable to always have a pre-approved successor. This is an essential element of basic estate planning for any dealer operator. Unlike other assets that you own and pass along to your kin, your ability to transfer your dealership through a trust, a will, or otherwise will always depend on whether you have something left to pass on. Essentially, while you may have built millions of dollars in blue sky/good will that you could sell on the open market, the ability to transfer your dealership will always be controlled by your franchisor/manufacturer or distributor and you need to properly manage this process.

FRANCHISE AGREEMENTS ARE NEGOTIABLE

Relocations, buy-sells, and successions are supposed to be celebratory events. Manufacturers and distributors, however, invariably use these happenings as an opportunity to squeeze dealers for concessions that they normally would not be entitled to demand. These "trigger" events are often

linked to occasions when the dealer must obtain the manufacturer's consent (similar to transfers described herein), and as a result, dealers may feel as if they are between a rock and a hard place during these negotiations.

Nevertheless, do not rely on the manufacturer to explain your rights and obligations. The manufacturer is never going to present options; rather, it will present "letters of intent" and spin the situation as a "take it or leave it" proposition. While there will always be some dealers that sign the deal as originally proposed by the manufacturer, you can avoid putting yourself in the position of feeling as if you left something on the table that could have been negotiated.

Laws do not protect those who do not protect themselves. More to the point, and as all dealers are well aware, manufacturers and distributors do not protect those who do not protect themselves. When new agreements are proposed in any situation, dealers should not expect that the manufacturer or distributor has already conformed the proposal with applicable law. A common misconception is how the law handles certain offensive provisions, such as a right of first refusal or a manufacturer's demand for exclusive facilities.

Many dealers believe that if they are presented with a renewal agreement containing an exclusivity provision or a right of first refusal, the revised 93B protects them and deletes, removes, or voids these provisions allowing them to sign without worries.

However, this is not how the law operates. Rather, the law provides the ability for the dealer to say "No," to strike the provision, or to negotiate some additional consideration for agreeing to take on such an obligation. Any dealer that signs an agreement without requesting changes consistent with his or her statutory rights will have voluntarily agreed to the terms as written.

In the end, as with any significant transaction, know your rights and have an understanding of your bargaining power before you agree to terms.

SALES AND WARRANTY AUDITS

There are always discrepancies in every audit, and your job is to audit the auditor. Make sure your manufacturer is playing by the rules. State law strictly controls the period that can be audited by your manufacturer. If a manufacturer wants to go beyond the last year or so, it must invariably demonstrate some sort of fraud to justify expanding the scope of the inquiry.

Check the facts. A great example is audits of sales incentive programs in which the manufacturer will promise retroactive payments for hitting certain sales figures. Months after the numbers are achieved (and well after you priced vehicles using the incentives) the manufacturer will threaten chargebacks based on faulty audit results.

Here is a more detailed hypothetical: the sales policies of many manufacturers dictate that the "actual sale date" used for purposes of calculating vehicles sold during a promotion/incentive period is controlled by the date a vehicle is actually delivered. Theoretically, it is the enforcement of this policy that causes "audit adjustments" that prevent a dealer from qualifying for significant objectives and retroactive payments. However, the vehicles that are "incorrectly" reported were often done so because a manufacturer representative is pushing for sales to be reported before they are finalized with the customer to meet his numbers for any given month. To combat this epidemic, dealers should review the beginning of the incentive period.

More often than not, the same manufacturer representative was pushing the dealer to report vehicles in the past. Rules controlling incentive payments cannot be inequitably and arbitrarily enforced. Accordingly, when the manufacturer's rules are applied uniformly to all sales, the dealer may exceed the applicable objectives despite the objectives of the audit.

INTERNET ADVERTISING: BE AGGRESSIVE WITH YOUR PRICING, NOT YOUR TACTICS

Consumers are increasingly using the Internet to research purchases, especially of motor vehicles. Dealers have responded with various attempts to direct customers to their personalized web sites as part of a more targeted

form of advertising. For these advertising programs to be effective, the key is being one of the highlighted "results" at the top of any search on Yahoo, Google or other search engines as a sponsored advertisement. While this goal is seemingly easy to achieve, there are significant concerns raised when trying to be creative to beat the competition.

A recurring practice involves a dealer embedding a competitor's trademark as a hidden metatag on its web site or within the search engines to which it subscribes. The result is that the dealer's web site will appear in the results of Internet searches for the competitor and, thus, the dealer is unlawfully and purposefully diverting Internet users and/or potential customers to its own web site, thereby piggybacking on his or her competitor's trade names. The fact that both dealers are competitors in the same industry creates a likelihood of confusion among consumers, and courts around the country have repeatedly found that reference to a competitor's trademark in metatags such as this constitutes a violation of trademark law. Thus, what may seem to be "creative" advertising is actually a violation of trademark law and could cost you money rather than generating customer traffic and positive revenue.

PROTECT YOURSELF: ALWAYS PAPER THE RECORD

With tough times in the auto industry, manufacturers are getting quicker to pull the trigger on termination notices. The recent financial woes of some manufacturers are indicative of their need to meet financial obligations, and at the same time, causes manufacturers to exert pressure on dealers to perform and move product despite strained market conditions. While channeling strategies and facility upgrades are often part of the plan, terminations are frequently the most economical way for manufacturers to control and manipulate a given market in their efforts to increase overall performance.

Accordingly, as a dealer, you need to be aware of the "signals" that the manufacturer may be sending which can be precursors to termination actions. For example, manufacturers are more readily sending out warnings of potential breaches about seemingly ancillary issues. Despite the innocuous nature of these warnings, they simply cannot be ignored. If a

manufacturer puts pen to paper to communicate an issue, you can be sure it has done so for a reason, legitimate or otherwise. At the very least, it is creating a "record" of alleged problems or issues to which it can point down the road to support its termination efforts. A manufacturer's demands are not always reasonable; however, ignoring the warnings, notices and bulletins that detail the unreasonable demands and expectations will undoubtedly be used against you in the future.

A more specific example relates to a manufacturer's sales goals. It should be no surprise when you receive notice of completely unreasonable sales goals. Under the law, manufacturers must always provide reasonable notices to cure sales deficiencies, and they know this. Most of the time, the manufacturer will not use these goals against you. However, when the incentive is termination, the manufacturer will quickly point to the fact that you failed to meet its expectation of increasing sales by 20% each year.

The end result is that the dealer is left with the manufacturer pointing to numbers and deficiencies which the dealer has either ignored or been unable to cure. The best plan of attack is to be proactive rather then find yourself with the deck stacked against you. Therefore, when you receive monthly, quarterly or yearly projection numbers, tell the manufacturer their numbers are unrealistic (and why), then emphasize how you are committed, invested, enthusiastic and eager to sell as many vehicles as possible.

Similarly, when the manufacturer claims you are committing some breach, even a minor infraction, be it legitimate or not, respond by stating your position and elaborating on your strengths as a dealer. Do not let these "signals" go unanswered.

Finally, while your relationships with manufacturers may not be stereotypical partnerships, you cannot do it without them. If they are not holding up their end of the bargain, you need to call them on it. Keep the correspondence cordial, but in the process create a written record that will protect your interests down the road.