

# 2016's Top Twenty Legal Trends for Automobile Dealers

By Eric L. Chase<sup>©</sup>

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*NOTE: 2015 Rankings are in parentheses; NR (Not Rated in 2015).  
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**DealersEdge**

# 2016's Top Twenty Legal Trends for Automobile Dealers

By Eric L. Chase©

An entirely new trend leaps into the No. 1 slot for 2016: Brand integrity, or lack thereof. This phenomenon arises out of the extraordinary spate of auto franchisor dishonesty, recently illustrated most notably by high level misconduct at Volkswagen, which connived for years to install software in VW, Audi and Porsche diesel (and some regular gas) models to cover up non-compliant engine emissions. The fallout from this disclosure is only beginning. Litigation could take years.

VW is hardly alone in its dishonest acts. For GM, a faulty ignition switch problem became a multi-year criminal scheme, characterized by secrecy and cover-up, causing over 100 deaths, innumerable injuries and a devastated reputation.

Add the phenomenon of Toyota's acceleration problem and Takata's defective airbags (implicating many auto brands), in addition to a bevy of assorted violations by other makes, and we have a simple-yet-profound question: What the heck is going on in the auto industry? Over a period of at least six years, VW's misconduct consisted of systematic fraudulent software placement in millions of units worldwide, with the purpose of

understating engine emissions to falsely show compliance with standards that were actually exceeded many times over. The stunning market reaction to the VW revelation was a nearly immediate drop of over 30% in share value, followed by tanking retail sales. Serious reporting failures to the National Highway Traffic Safety Administration by Fiat Chrysler and American Honda received less press attention than VW and GM, but, taken together, such transgressions demonstrate a breadth of serious dishonesty across many makes.

Why do such examples, albeit large ones, of misconduct or even criminality among several world-class automakers and suppliers translate into 2016's No.1 legal trend for dealers? Dealerships carrying the specific brands in question foreseeably suffer losses in retail sales and service, difficulties in hiring and retention of qualified personnel, loss of customer loyalty and diminution of goodwill. The owners of such stores may attract fewer prospective acquirers of their businesses, lower brand multiples and, thus, lower business valuations.

At the same time, there is a foreseeable negative consumer perception across all brands, because such high-level, calculated misconduct



spurs consumer distrust, or understandable cynicism. Government inquiries and enforcements always follow. Dealers continue to suffer from a largely undeserved narrative among retail car buyers that dealers are not to be trusted – that they are business predators. With the combined woes of VW, GM, Takata and others broadcast incessantly, there is predictable pain to be endured by dealers across all makes.

The No. 2 trend is captured by the phrase, “elections matter.” President Barack Obama sometimes repeated these words during his presidency, especially during his first term. Mr. Obama’s statement is a truism – that is, a proposition that is undeniably and obviously accurate. But it follows that the importance of elections in America truly matters when victorious candidates take office.

The consequences of the 2016 election cycle will profoundly impact the lives and livelihoods of America’s automobile dealers going forward. What dealers sell, how they sell, what they say in advertising, how much and in what areas their regulatory burdens will grow, how much they pay their workforces and the scope of benefits for employees, and how they interact with their workforces, are all in play for 2016 federal, state and local elections.

There is even the prospect of politically driven legal assaults on businesses, with shaky or absurd “evidence” to justify fines and restitution.

The “disparate impact” phenomenon is a prominent example of this sort of ideology-based punishment of businesses that lend to consumers, or participate in the loan process under a grossly concocted “analysis” of “discrimination.” Currently, the Congress is trying to push through legislation to curtail the CFPB’s overreach against dealers.

In third place for 2016 is last year’s No. 1: The Regulatory Trend. Unfortunately, there is no foreseeable end to over-regulation in America, and the resulting cost and waste of time and money.

As always, the Top 20 Trends will impact dealers differently, depending on their circumstances. My goal in this annual analysis is to help dealers foresee and cope with the major issues that affect them, their employees, and their businesses.

*The ranking of the top twenty legal issues/trends is based on three factors: 1) the likely number of dealers affected; 2) the probability of change from the current situation; and 3) the seriousness of a trend/issue impact on the lives of dealers.*

**1. Automaker (and Supplier) Misconduct and Brand Integrity: How Bad Actors at Factories Injure People, Hurt Dealers and Enrage the Public. What Dealers Can and Should Do (NR)**

In Article 1 of its dealer agreements’ standard provisions, VW vows, in a binding contractual commitment to its franchised dealers

to “[a]void all discourteous, deceptive, misleading, unprofessional or unethical practices.” The admitted transgressions of (1) manufacturing non-compliant diesel engines, and (2) installing software engineered to falsely measure and record emissions as compliant were breathtaking violations of VW’s promises to dealers. Subsequent revelations of similar “adjustments in gas models,” and the growing list of Porsche and Audi violations triggered constant bad news for VW on financial pages.

The same dealer agreement article pledges to “safeguard and promote the reputation of Authorized Products and the manufacturer [and] to refrain from all conduct which might be harmful to the reputation or marketing of Authorized Products or inconsistent with the public interest.” Dealers, of course, purchased defective units in the tens of thousands, and retailed them to unsuspecting consumers.

Now, allegations in numerous class action lawsuits suggest that the harm may go beyond the “technical” transgressions of higher-than-allowed emissions of nitrogen oxide. Claimants contend that their purchased vehicles are worth less than what they paid. And rightly or wrongly, some consumers even contend that the pollutants have caused serious illnesses or conditions. The massive collection of consumer lawsuits is being swept into multi-district litigation in the Northern District of California.

(Interesting side note: Judge Charles Breyer, assigned to the case, is the brother of U.S. Supreme Court Justice Stephen Breyer.)

Although the VW phenomenon probably tops the charts for its breathtaking illegality and scope, VW is hardly alone in eroding public confidence in the integrity of automakers. Integrity issues have recently plagued GM, Toyota, and many others, and these incidents have been happening in an era of record recalls. The combination of dishonest acts and factory defects, intentional or not, makes it difficult for the dealer who occupies the front line with consumers who want answers and need reassurance that they will not pay a price in safety, comfort or value.

Nor is it just the auto franchisors who are under scrutiny. The most prominent example of a supplier gone haywire is Takata Corporation. Among other things, Takata is a huge airbag manufacturer whose products have been shown to be dangerously defective. Takata’s airbags have been used by a dozen or more automakers. The business and legal fallout for Takata and its customers is devastating.

What can a dealer do when manufacturers or suppliers go off the deep end? When products become unavailable for sale, even on a temporary basis, the dealer may face a crisis. A “no-sell” order on cars in a dealer’s inventory can slow or stymie retail efforts and sales. In such



circumstances, dealers, singly, together and/or through associations, need immediate and effective cures and assistance from their franchisors. Manufacturers do step in to help dealers, and sometimes dealers receive at least temporary windfalls in doing the curative work.

But problems for dealers can be pervasive. VW dealers have seen a precipitous drop in retail sales. "U.S. [VW] sales tumble[d] 25 percent in November." Ryan Breane, "Frustration flares for VW dealers as sales nosedive," Automotive News, Dec. 7, 2015, p.1. The coming year will be a painful and expensive ordeal for VW and its dealers in America. The broader lessons of "integrity matters" will test the industry for years to come.

*Bottom line: For dealers, the obvious injustice of widespread automaker wrongdoing, whether by design or not, is that they are likely to directly suffer the dissatisfaction of consumers who own/lease vehicles of the offending brand. In the early stages of the VW fiasco, retail sales dipped dramatically for VW dealers. Every dealer facing a brand crisis needs to quickly and decisively make sure that all dealership employees know how to respond to customer inquiries. We will see more of this phenomenon in 2016, especially as VW tries to remedy most of the problems created by its scandal.*

*We've seen this movie before. Whatever the brand, dealers need to take immediate and correct steps when the brand is under fire for product failures, and dishonest acts. "Best practices" include honesty with customers, as well as civility and advocacy by the dealer for customers to the franchisor. Most damage control is the application of common sense.*

## 2. How and Why the 2016 Election Cycle Critically Impacts Dealers' Legal Rights and Duties (NR)

For businesses generally, and for automotive dealers in particular, the 2016 electoral cycle will impact them legally more than ever. Observers (and office-seekers) do make this kind of claim every four years, but in today's political turbulence in the midst of vigorous partisanship, there is little doubt that the legal consequences of the elections of 2016 will impact highly regulated industries and businesses, and car dealers are wise to take note.

In past years, I heard occasional criticism about any political discussion being blended with legal/business analyses for dealers. But such criticism has nearly disappeared, because the reality of the connection is now too pervasive to ignore. Any 2016 discussion on the topic of auto dealers and the law in this election year must include a political dimension, or else the discussion ignores the proverbial elephant in the room. For 2016, without the slightest doubt, the election cycle will determine the legal outcomes of issues critical to the lives and businesses of dealers and their workforces. For many dealers, it's the most important topic for 2016.

Writ large, the debates are over big government versus small government and left versus right on a host of policies, regulations and agencies. Republicans urge the electorate to erase many actions taken during President Obama's two

terms. See Phil Gromm and Michael Salon, "Cheer Up, Obama's Legacy Can Be Erased," *Wall Street Journal*, Dec. 21, 2015. On the other side, Democrats warn that all the progress of the last eight years needs to be continued and confirmed.

*Bottom line: Make no mistake about this year's election cycle: It's big government versus smaller government. It's more regulation versus less (sort of) regulation. It's consumerism versus fairness for small businesses, including auto dealers. Take your pick, but don't be surprised at outcomes. We get what we vote for.*

### **3. The Regulatory Tide Swamps All Boats (1)**

The American regulatory phenomenon continues to be a seemingly never-ending train wreck that always worsens year-over-year, regardless of which party occupies the White House or sits in any state's governor's mansion. Some have compared this tendency to behavioral or chemical addiction. That is, everyone knows the problem and laments it, but those in power nevertheless annually increase the volume and coverage of the very regulations they criticize.

Among many such examples, Senator Richard Shelby (R. Alabama), Chairman of the Senate Committee on Banking, Housing and Urban Affairs, has sought to reform what he sees as the excess of the Dodd-Frank Law. According to Shelby, that 2,300 page enactment is a business and job killer. He has introduced a bill to provide broad regulatory relief.

Studies – including a 2014 NADA sponsored study – confirm a profound and costly problem for small businesses, resulting from the federal/state/local regulatory monster. The growing paperwork obligation frequently includes redundant or unnecessary busy work – but required for compliance. Every dealer spends thousands of dollars in employee time and work effort to accomplish tasks that lack purpose.

*Bottom line: For more details and discussion about the bad news for the regulatory trend, see the lengthy analysis in 2015's Top Trends. 2016 will probably not be much worse for those who must comply with detailed regulations, including America's dealers, but, to a certainty, there will be no improvement either. It remains to be seen what promises will be made in the election cycle about reforming the regulatory monster, but, regardless of promises, the best bet is that reform to lessen a dealer's regulatory compliance load won't happen anytime soon.*

### **4. Increased Retail Sales and Higher Dealership Values Affect Dealer-Franchisor Relationships; The Phenomenon of "Unreasonable" Factory Demands, Standards and Practices (2)**

The retail automotive marketplace has been booming for over two years, and retail sales forecasts for 2016 remain generally optimistic. Soaring new car sales, however, nearly always motivate automotive franchisors to push their dealers to "invest" in facilities, programs and inventory. Further, they try to coerce dealers to commit to high levels of retail sales, even



exhorting all dealers to perform at above average – a statistical impossibility for a dealer network.

2016 will be no different in this regard.

Although methodologies can vary somewhat, the basics for factory measurement of sales performance by dealers are standard. With registration data, they establish a dealer's "opportunity" or "opportunity within the assigned area" (known as Area of Primary Responsibility or other comparable term). Then, manufacturers credit the dealer for retail sales made to consumers residing anywhere (not just in the assigned territory). Then, with the total sales in a numerator, and the opportunity in the denominator, the resulting fraction is compared to a benchmark covering other same line dealers in a given area, such as district, region, state or national.

Among automotive franchisors these days, the common standard for dealer minimum sales performance is average. That is, at any given time, about half the dealers for any given brand perform inadequately, according to brand executives and managers. In fact, dealers are frequently asked to sign agreements, conceding that below-average sales penetration performance is a breach of the dealer agreement. This unreasonable – even farcical – standard has been challenged by dealers for years. In recent times, the absurd conceit that all dealers should maintain top 50% sales performance has been

refuted by some courts that have sided with dealers (and state franchise laws).

***Bottom line:** When an auto franchisor asks its dealers to agree (in writing) to minimum performance levels in sales and CSI, watch out. As a general rule, seasoned dealer counsel will urge their dealer clients not to sign commitments to performance standards that are clearly unreasonable, when it is obvious that such "standards" can only be achieved by about half the dealer body. For sure, dealers should not be signing agreements that confess breaches. In 2016, dealers need to watch for such overreaching franchisor initiatives.*

## **5. State Franchise Laws: The Continuing Need to Level the Playing Field; The Tesla Story Continues (6)**

In a deposition, the general counsel for the Alliance of Automobile Manufacturers told me that the time had come for ending or at least diminishing the era of protective automotive franchise legislation. After all, he contended, many dealer conglomerates had amassed such size, power and wealth that there was no longer a need – if there ever was one – to legislate protections that, as he saw it, trumped sacrosanct rights of freedom in contracting. The reality, though, is that franchisor bargaining power dwarfs that of dealers, most of whom operate with only one, two or three franchises. Without the continuing protections of state franchise laws, dealer risks would soar.

*Bottom line:* Attacks on franchise laws continue. Expect some heated controversies in 2016. Even the CFPB suggests that direct factory sales should be allowed. The NADA and state dealer associations will remain the vanguard in educating lawmakers about the consumer values served in franchise laws.

## 6. Workforce Issues and Unionization (18)

This trend has soared in importance, in large part because the Obama administration and the NLRB have moved aggressively to favor a unionization and workforce agenda that could come at the expense of businesses, including auto franchisees. Car dealerships are especially vulnerable. See Ronald Meisburg, "The Shop Steward in the Oval Office" *Wall Street Journal*, Sept. 4, 2015.

*Bottom line:* My informal survey of experts in labor and employment law revealed unanimity in their conviction that pro-union government initiatives and enforcement actions will continue, and perhaps accelerate in the final months of the Obama administration.

## 7. Buy-Sell Activity in a Bull Retail Market for Dealerships. Will There be a Downturn? Rights of First Refusal (8)

The wild ride of dealership acquisitions continues. Multiples, especially for luxury brand stores, are soaring and the good times are rolling enough to push transactions everywhere. Some economists predict a 2016 U.S. downturn – maybe even a recession in 2016-2017. They point to negative economic news from Japan, Russia, and China, and argue that we're due. Most economists,

however, are optimistic about the 2016 outlook, and my own view is optimistic.

Dealers in the acquisition mode should be aware that franchisors have recently been aggressive in the exercise of a right of first refusal, even "cherry picking" their brand when multiple brands are included in a buy-sell.

*Bottom line:* Many signs indicate that dealership values will continue to drive higher transaction sales prices for dealerships of most brands, and most especially, high line brands such as Lexus, BMW and Mercedes. But in such an upward market, "lesser" brands should also see activity, too. Expect a few more exercises of factory rights of first refusal, some of which will be deployed to add minority representation, some to close points.

Be wary about the buy-sell market in 2016. It's been seven years since the "Great Recession." Economic pessimists might be right that the next recession is in sight for 2016 or 2017.

## 8. Consumerism (3)

Protection of consumers has become a talisman for politicians that often masks unfair assaults on auto-related businesses. The Consumer Financial Protection Bureau ("CFPB") has assumed (or presumed) a role of super-protector. In so doing, it has gone to great lengths to impose jurisdiction over dealers, even where the Congress has forbidden it.

We face an ever-present reality: the consumer is the darling of politicians, regulators and the press. Dealers are underdogs in disputes with customers. That reality won't change.



***Bottom line:** The consumerism trend will continue at a fever pitch level in 2016. Even as more and more dealers emphasize the integrity factor, the public perception of greedy opportunistic dealers, fueled by politicians and bureaucrats, will continue to pose challenges to dealers. The excesses of the CFPB can't be curtailed much before the election.*

## **9. Involuntary Termination (5)**

For the dealer, involuntary franchise termination is the business death penalty. All states now have laws prohibiting the involuntary termination (and non-renewal) of an auto franchise unless there is good cause (or other comparable benchmark) and proper advance written notice is given so that the dealer can contest the franchisor's decision. When a serious prospect of termination arises, it's time to see a lawyer well versed in franchise termination cases.

***Bottom line:** All signs are that sales performance termination notices across several brands are on the rise. Dealers need to be especially vigilant when they receive written performance admonitions or cure letters, especially for low sales penetration. Do not sign agreements that admit breaches. Do respond responsibly, civilly and accurately to factory threats of default or termination.*

## **10. Warranty Reimbursement (12)**

Since the 1990s, most of the legal action in the warranty reimbursement arena has been in franchisors' resistance to paying dealers' retail prices for parts used in warranty work. Now there is a growing interest by dealers in seeking a true calculation for warranty labor.

***Bottom line:** Look for some emphasis to shift to dealers' demands for true retail reimbursement for warranty labor. On the retail parts reimbursement legal question, dealers are on a winning streak.*

## **11. Privacy and Identity Theft (13)**

There are two connected core reasons why the safeguarding/protection/storage of customer (and employee) records gets more difficult each year. First, while technology advances constantly change the means and methods of acquiring, storing, sending and safeguarding data, they also potentially open new doors for hackers and thieves. Second, new laws and regulations are in constant flux, with lawmakers trying to keep pace with new vulnerabilities and risks.

***Bottom line:** Every dealer needs a designated employee to stay current in this fast moving area, and to vigorously deploy and enforce internal compliance methodology. The legal and financial consequences of breaches in this area, including identity theft, should motivate dealers to take all appropriate prevention measures.*

## **12. Recalls: Reaping the Whirlwind of the last 2 years (10)**

Is the unprecedented spike in recalls over or is this a lasting trend? Or maybe a little of both? With all the publicity and attendant liability issues, auto franchisors are more and more apt to make voluntary recalls more quickly and readily than in the past.

***Bottom line:** Highly publicized recalls in the recent past (along with integrity issues reviewed in Trend No. 1) will motivate automakers to err on the side of more and earlier voluntary recalls. The*

*potential for harsh government action and class action lawsuits now outweigh the downside of a recall, especially where safety or dishonesty may be in play.*

*Dealers are often caught in the middle, especially when safety issues are in play, or, worse, when a "no-sell" mandate is issued. When the stress of a recall hits, dealers and their associations need to aggressively insist that manufacturers take care of their dealers and consumers. Don't take "no" or "later" for an answer.*

### **13. The "Joint Employer" Issue Grows (17)**

In *Browning-Ferris Industries of California, Inc., et al. v. Sanitary Truck Drivers and Helpers Local 350, et al.*, the National Labor Relations Board set forth an "indirect control" standard for assessing whether there may be "joint employment" arising out of vertical relationships. That could spell problems for auto dealers and their franchisors. In a lengthy opinion, the majority of three changed the standard from a discerning assessment of direct involvement to one of a more lenient and more subjective measurement of a company's potential to assert control over wages and working conditions.

*Bottom line: This is a stealth issue that has the potential for great mischief in the factory-dealer relationship. Fortunately, however, the arguments against this ill-advised expansion of a narrowly applicable doctrine should prevail. See John T. Bender, "Barking Up the Wrong Tree: The NLRB's Joint Employer Standard and the Case for Preserving the Formalities of Business Format Franchising," 35 Franchise L.J. 207 (2015).*

### **14. Alternate Dispute Resolution (9)**

Mandatory pre-dispute arbitration agreements in auto retail sales agreements continue to be primary targets of state and federal agencies. Such provisions that prohibit class or mass actions are particularly disfavored by the CFPB, state agencies and consumer advocates.

*Bottom line: 2016 could mark, at least for the time being, an end to dealers' preference for arbitration provisions in retail contracts. Dealers' principal motivation in customer arbitration provisions is the avoidance of class and mass actions. If government agencies succeed in invalidating such exclusions, meaningful arbitration clauses will be a thing of the past.*

### **15. Environmental Issues (14)**

According to the Obama administration, climate change is a definitively proven reversible phenomenon that requires urgent world-wide (and certainly American) human remediation. The Global Climate Conference in Paris echoed the claims of a coming catastrophe. Others, however, resist what proponents call "settled science," arguing that whatever the perceived gains of "action" may be, the economic and societal costs are too much.

*Bottom line: Human intervention to combat what is believed by many to be "the world's biggest challenge" – climate change – could have a vast impact on the auto industry. New rules could influence every aspect of car making and selling.*



## 16. The Factory-Dealer Question on a Fiduciary Relationship (4)

Does the auto franchisor owe fiduciary obligations to its dealers? So far, the answer is no. Yet, in many respects, the multi-faceted controls of the factory over its franchised dealers would suggest a fiduciary relationship. Why would it matter? Simply put, if auto franchisors were to owe fiduciary obligations to dealers, they would need to realign their priorities to act in the best interests of their dealers.

*Bottom line:* The issue of whether auto franchisors should be deemed fiduciaries vis-à-vis their dealers is a legitimate question, even though a number of courts have said that generally, a franchise relationship does not equate to one that is fiduciary. With auto dealers, however, the factory control, articulated in detail in dealer agreements, would support a conclusion that they are fiduciary relationships. Therefore, in appropriate cases, dealers should consider whether a fiduciary claim should be included.

## 17. Terrorism, Unrest and National Disasters (17)

Any prudent dealer needs to have a basic plan to cope with a catastrophe, however unlikely such an event may be. In national politics, national security has become a top electoral issue, mainly because of the growth of international and internationally inspired domestic terrorism.

*Bottom line:* Every dealer needs a basic emergency plan, and it should be updated at least once a year.

## 18. Factory Audits. And also: State Sales and Use Tax Audit (16)

This year, I've combined the ubiquitous factory audits (with the prospect of chargebacks for warranty fraud violations) with state tax audits. Of course they are different in important respects, but both threaten the dealer with unexpected expense – sometimes big expense – based on an audit. One huge difference is that with tax matters of consequence, the dealer almost certainly should retain an experienced, professional familiar with the applicable state's taxing authority. With factory audits, in many cases, the dealer can try to work with the factory without outside advice or assistance.

*Bottom line:* In nearly all situations, the dealer has no lawful option other than to properly submit to audits, whether they be on behalf of the automotive franchisor or under government authority. Nevertheless, there are rare occasions of audit abuse, and when a dealer reasonably suspects any kind of misconduct or overreach, it is time to contact counsel.

## 19. Encroachment (Protest Laws) (19)

With retail sales soaring, it has been an inevitable bi-product to see more add-point and relocation cases brought under state laws allowing protests by nearby same-line dealers. The stakes in these battles can be enormous.

*Bottom line:* Dealers embroiled in protests have much at stake. For the existing dealer faced with new same brand competition, a profitable business might lose its viability in extreme cases. For the moving or establishing dealer, the ability to either confirm or start a dealership business is a

*monumental undertaking. These cases are the rare dealer-vs.-dealer disputes, and they rise and fall on data analyses by industry/economic experts.*

## 20. Taxes (11)

In this election year, lots of tax proposals are on the table, sort of.

*Bottom line: Whether 2016 will lead to meaningful tax reforms depends largely on election outcomes.*

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