

# 2011's Top Twenty Legal Trends for Automobile Dealers

By Eric L. Chase

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  - (4) **If Challenged by Dealer, Audit Chargebacks Not Allowed Until/Unless Factory Satisfies Burden of Proof in Evidentiary Hearing; and**
  - (5) **Mandatory Reimbursement at Retail for Warranty Labor and Parts.**

NOTE: 2010 rankings are in parentheses; NR (Not Rated in 2010).

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The one-sided results of the mid-term election of November 2010 drive some of the key legal issues for dealers in 2011. As of January 2011, Republicans control the House with a 242-193 majority, and the Senate reflects a narrowing Democratic majority: 51(D)-47(R)-2(I). State legislatures and governorships also saw dramatic shifts to Republicans. From tax policy to fiscal and monetary strategies, to discretionary spending, to environmental initiatives, to regulatory “reform,” politicians tell us (again) that “things will be different” in 2011. Hopefully, there will be targeted and realistic efforts to tame the persistently high level of unemployment, reduce the deficit, and articulate some sense in federal tax rates. (In December 2010, the belated action to continue the Bush era tax rates was a positive step—even before the new Congress arrived.) And, perhaps, there will be law: regulatory and policy shifts that could spell some relief – and improved profitability – for auto dealers.

To be sure, this year's evaluation of the industry is a mixed review. There are both positive and negative signs. Thus, dealers should be wary and careful, but should not despair. We and you will come back. We always do.

For good or for bad, the first two years of the Obama administration were “historical,” especially in record federal spending and plans for higher expenditures in the “out years.” For context, consider the American economy of World War II which still stands as a convenient benchmark. During those bleak years on the domestic front, the federal government implemented and enforced extraordinary controls over the U.S. economy, from high taxes to labor laws to price controls to rationing (e.g., food, gas, cars and you-name-it). During the war years, 1941-1945, over sixteen million mostly-drafted Americans served in the armed forces at a time when the population was less than half of what it is now (132 million vs. 308 million). The excep-

tional government domination of American life was meant to be aberrational – calculated to cope with the unique threats of a global war and the potential for the demise of the western democracies.

Fast forward to 2011. In some respects the tentacles of government have multiplied and now have a deeper reach into the American economy and everyday life than they had even during the Second World War. Many top economists have expressed grave concerns about the increased annual deficit (about \$1.3 trillion in 2010), which merges into the exploding national debt (now at \$14 trillion, and on a trajectory toward \$20 trillion!), and counseled against a continuation of this trend.

*In my opinion*, from an economic perspective, some of the initiatives undertaken by the President (Obama *and* Bush) that Congress both deepened and lengthened, or even embedded the harm to the U.S. economy, made a bad recession worse, and stifled recovery. At the state and local levels, some say that the situation is even more dire with, for example, out-year obligations to public workforces that can never be satisfied. “*Unsustainable*” has become the watchword, but specific cures to stem the tide are difficult to implement. For many auto dealers, their families and employees, the consequences of a teetering economy in 2008-2010 have already been tragic.

For just a few examples, consider the new federal health care law, government ownership interest in the New GM and the New Chrysler, \$800 billion in “stimulus,” the “green” emphasis on what Americans buy and consume, the unprecedented increase in the deficit, growth (actual and anticipated) of the national debt, persistently high unemployment, hundreds of thousands of foreclosures, massive foreclosure forgiveness and the extended 99-week eligibility for unemployment benefits. Government measures, including serial unprecedented monetary steps by the Federal Reserve, did not make a dent in the high unemploy-

ment rate, nor did they spur GDP growth. The emergence from the recession is hardly noticeable to many. And the national debt continues to soar, with gargantuan annual deficits projected for years. Many states, especially California, Illinois and New York, face unprecedented fiscal crises of their own.

As the new Congress convenes in January 2011, it *should* signal several mighty shifts in both policies and priorities. Since the huge financial implosion of 2008, the U.S. economy has ranged from awful to fragile. It will remain fragile in 2011. And nowhere – nowhere – has the impact been more profound than in the auto industry. Just ask former Saturn and Pontiac dealers.

An annual barometer of the American economy is the measurement of new motor vehicle retail sales. The seventeen million units threshold of past years is not likely to be seen again for a long time – certainly not in 2011, and probably not in 2012 or 2013 either, even though we have seen some rebounding on the positive side. *Automotive News* has reported that we might see as many as fourteen million units sold in 2011, but that is really optimistic. Macroeconomic trends will drive the fates of many automotive dealers for 2011 and beyond. The surviving franchised dealers of the 2009 bankrupts, GM and Chrysler, will remain sensitive to cyclical trends, and they will be especially vulnerable to periodic downward or upward spikes. Any number of potential as yet unknown crises, such as a major terror event, further European (or other) financial meltdowns, another war, a large natural disaster, hyper-inflation or a price spike in oil could trigger another recession.

The Chrysler Group, and especially its Chrysler and Dodge brands, would almost certainly suffer disproportionately if there is another big economic hit so soon after the 2008-2009 devastation. At GM, the turnaround – at least financially – shows some signs of success. The November 2010 GM IPO and repayment of a chunk of taxpayer money were welcome milestones, and the Volt has enjoyed some good press. Nevertheless, the return to full GM health is, at best, still years away. Some of the problems, including those with the UAW, have not been cured, and some industry observers see GM's fast turnaround as illusory. Buick and GMC still lack strength in the U.S. market, but Buick may have deeper resilience because of its international reach and its

two durable brands in the U.S. market (Chevrolet and Cadillac). That resilience will not necessarily be helpful, though, to Buick or GMC dealers in the U.S. At Ford, the Mercury line fell victim in 2010, and Ford's optimism about Lincoln's prospects is high on rhetoric, but still lacking in substance.

Economic woes and government growth impact many of the other Top 20 legal trends in major ways. Political Independents generally, and Tea Party activists specifically, represented a growing segment of America in opposing what they perceive as the outrageous intrusion of government into, well, everything. Bailouts; record deficits and debt; high taxes; universal and mandatory health care; regulatory minutiae; and so on. To a certainty, these phenomena affect the livelihoods of America's auto dealers. The continuation of the so-called "Bush tax cuts" was a necessary compromise, despite the bevy of criticisms from every direction. For 2011, the optimists see signs of a turnaround, but positive evidence is fragile.

Once again, although dealers have many legal trends to cope with in 2011, the elephant in the room is indisputably the economy at large – and fallout from economic and related legal, tax, and regulatory issues. Thus, this year's discussion of the Top 20 trends is frontloaded with my views on those issues.

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. Economic Turmoil and the Post-Bankruptcy Shakeout: The Future of GM and Chrysler Dealers; How the Events of 2008-2010 Affect Other Brands in 2011 and Beyond

### ■ The Legacy of the GM and Chrysler Bankruptcies and Bailouts; Dealer Reinstatements; Mercury's Demise; The Fallout from the Economic Downturn. After Mercury, Are More Brands on the Edge? (1)

In 2009, following a year of exceptionally broad and deep economic downturn, the impossible

happened: both GM and Chrysler – two of the three stalwarts of the American domestic auto industry – went into bankruptcy. Then, with unprecedented taxpayer funding and government equity, new entities emerged at warp speed from Chapter 11. The “new” Chrysler and the “new” GM have reduced their dealer networks, and GM brands Saturn, Hummer and Pontiac were shut down.

Recall that GM and Chrysler fought the reality of impending bankruptcy until the very end, predicting a national calamity if it happened. U.S. help came at a price. The pre-packaged, federally financed “cures” included the destruction of hundreds of dealerships, with the phony argument that the elimination of dealers would “save” billions of factory dollars. The “greening” of cars, too, was – and remains – a controversial government objective. In 2010, many rejected GM dealers (only in the continuing brands, of course) and a few rejected Chrysler dealers were reinstated, thanks to unprecedented federal legislation that allowed dealers, rejected in bankruptcy, to challenge their terminations in arbitration.

Although dealers frequently respond to their franchisors – and their government, for that matter – with a healthy dose of both skepticism and cooperation, the reversals of 2008-2010 have torn asunder the sort of trust that carmakers once took for granted with their dealers. Dealers are more skeptical about franchisor (and government) promises than ever before. GM and Chrysler, understandably, face a high level of distrust from their dealers. But other auto franchisors, too, are reaping the whirlwind of the bad times of 2008-2010. Even the vaunted Toyota brand took an unforeseen hit with perceived or real product problems (mainly (supposedly) a sticking accelerator), but, in contrast to GM and Chrysler, Toyota dealers remained (generally) supportive of their supplier. Now, although it brilliantly avoided bankruptcy, Ford is testing its credibility with dealers, as a result of its ham-handed treatment of the Lincoln and Mercury brands.

The bad news isn't over yet.

All dealers are in a quandary, some brands more than others. In more stable economic and financial times, American businesses had considerable control over their fate. That is, they could rely on their business savvy, planning, and strategies

to influence their own success. American engines of creativity, know-how, and unlimited resources always powered us out of past downturns. Government regulations and tax policies had at least a semblance of predictability. Today, however, the most severe problems in the marketplace are not only outside the control of individual businesses, but the return to any kind of “normalcy” also remains largely unpredictable for at least 2011 and perhaps much longer. Some argue (as I do) that the current federal administration's agenda is, in some specific respects, fiercely antagonistic to American prosperity generally and business specifically, and this attitude negatively impacts dealers. Hopefully, the November 2010 election results and a new Congress can force at least some favorable policy reversals.

GM's 2010 IPO was at least temporary good news for the auto industry, including dealers. Chevrolet and Cadillac are in excellent shape, while Buick and GMC remain on the “B” team. Chrysler's brands are seeing some good signs, too, but it will be years before we can declare success.

Even as many of the rejected GM branded dealers were reinstated (along with relatively few of the rejected Chrysler dealers), in June 2010, Ford announced the withdrawal of the Mercury brand. In contrast with Chrysler and GM, domestic giant Ford had escaped bankruptcy, and it received considerable praise from industry observers for its foresight and fiscal strategy. With the termination of Mercury, however, accompanied by “offers” to pay the terminating dealers, Ford, too, was now under the gun from dealers who believed they were being “had.” After all, significant numbers of Mercury dealers operated “Lincoln/Mercury” duals, without a Ford Division franchise. Without Mercury, they would be Lincoln exclusives. At the same time, without Mercury, there was hardly a sense of clear sailing for Lincoln, and reports in *Automotive News* and doomsday speakers at dealer meetings only served to fan the fires of dealers who questioned what Ford was telling them.

The hard and unanswered Ford question, from 2011 into the future, is whether there is a long life ahead for Lincoln. Even as Ford was overseeing the final days of Mercury, its sometimes contradictory messages to Lincoln dealers were dire. There will be fewer Lincoln franchisees, and the changes should come quickly, according to Ford.

At the same time, it cajoled dealers to invest in big ways to make Lincoln stores truly exclusive and to image them per Ford's specifications. Ford's "promises" about product were blurry at best, and depressing at worst. "Where are the new models?" asked many dealers. "When are we going to see something really new and different in the Lincoln brand?" "Will there be enough inventory?" It seems that Ford is energetic in demanding of its Lincoln network that investments be made now, with the hope and a prayer that popular product will be supplied in the years ahead. Under these circumstances, Lincoln dealers are wary, and they should not throw their good dollars at a Lincoln vision until and unless they can make a business case.

Dealers of other brands – *i.e.*, other than those of GM, Chrysler and Ford – may justifiably sigh with relief. Some brands are doing fairly well in difficult circumstances, including Hyundai, Honda and others. But the tragic tumble of 2008-2010 may be seen as a lesson for those who would become complacent.

Okay. What now? In fielding literally hundreds of calls and speaking to dozens of dealer groups in 2010, I see the concerns as both genuine and unprecedented. As reinforced in the discussion of other trends (below), dealers should carefully and thoughtfully resist taking steps that are not buttressed by a well-reasoned business case. At some point, it is likely and perhaps a certainty that the economy will rebound into either the "old normal" or a "new normal." In the meantime, risky behavior by dealers in, for example, investing heavily into facilities now without the business case, is too risky.

#### **OUTLOOK:**

*The economy will not burst out of the doldrums in 2011, nor will the auto industry. Let's be thankful that politicians in Washington finally extended the Bush tax cuts. If they had not done so, 2011 would have become another disaster. Even so, the growth back to good times will take years, and recovery cannot happen in earnest until the government ceases its large-scale interference with America's engines of prosperity: private businesses such as car dealerships. Some brands will continue to thrive, even in a slow turnaround. These will include Hyundai, Honda, and a few other imports. Chrysler will struggle, as will GMC and Lincoln.*

## **2. Consumerism and Government Action Generally: Targeting**

### **Dealers for Consumer Litigation, Especially Class Actions, and State/Local Regulatory Enforcement; New Federal Laws, Regulations, Agencies and Powers; Preventive Medicine; Adopting Best Practices. (14)**

"Consumerism" is a broad term, generally describing a paternalistic pro-consumer advocacy and philosophy, deployed to benefit and promote consumers, usually directed at perceived exploiters of innocent consumers. Car dealers have traditionally been targets of consumerism. Often, government agencies such as state consumer affairs offices or the FTC tackle issues they promote as pro-consumer. Or they civilly "prosecute" businesses, including auto dealers. Certain private lawyers have made an industry of pursuing dealers for even the most technical of alleged violations, often class actions. While the concept of consumerism may be worthy, in practice, it has frequently become the purveyor of anti-business strategies.

"Elections mean something," President Obama told us in 2009, shortly after his inauguration, and he meant it with respect to consumerism. Pro-consumer initiatives to tame mean and nasty businesses abounded. Arguably, dealers were among the many American businesses that seemed paralyzed in 2009-2010, mainly because tax and regulatory policies were in limbo, credit availability nosedived, consumers had less disposable income, and because the Obama administration was perceived as hostile to small businesses. The "Auto Team's" emphasis on unnecessarily destroying hundreds of GM and Chrysler dealers in the 2009 bankruptcies reflected this attitude. In late 2010, The Wall Street Journal's Holman W. Jenkins, Jr. described the Obama White House as "[t]he most auto-unfriendly administration in a generation, committed to expanding union power, and committed to forcing Detroit to invest tens of billions in green cars that the public won't pay for." *Wall Street Journal*, November 20, 2010 at A17.

During 2006-2010, a major rallying cry of the controlling majority Democrats in both houses of Congress was supposedly on behalf of a beleaguered middle class – against businesses sullied as greedy adversaries. According to the Pelosi-led House and the Reid-driven Senate, the middle class – and more generally, consumers – were

constant victims of a classic “screwing” by the wealthy. This theme reached a crescendo when Senator Barack Obama ascended to the Presidency, and Democrats were in full control of both elected federal branches of government. What followed was a spate of federal laws and regulations that espoused consumerism and benefits to, and protection of, the middle class. But, arguably, the initiatives have perversely and profoundly injured America economically for at least the short term, and, many argue, for the long term because of the skyrocketing national debt.

One telltale example was the establishment of the complex Consumer Financial Protection Bureau. Despite a supposed carve-out for dealers, the expectation is that dealers will be adversely impacted.

Like other small businesses in America, most auto dealers struggle to cope with an onslaught of laws, regulations and trends that have poured from federal, state and local governments.

#### **OUTLOOK:**

*Businesses like auto dealerships continue – perversely – to be targets of consumerism, and this will still be the case in 2011. Dealers have to be wary and vigilant to avoid becoming a target of consumerism.*

### **3. Credit Chaos: Floorplans and Other Credit Stress Points for Dealers: GM, Chrysler; SBA Floorplanning. Where Are the Non-Captive Lenders? (2)**

Despite lots of flowery rhetoric about government boosts to small businesses, 2010 was a bad year for dealers hoping for a looser credit market and more reasonable requirements from lenders. New credit relationships for dealers were hard to come by, and, when available, terms were frequently onerous. This phenomenon affected floorplan availability, operational funds, and mortgages. Of course, consumer credit – the life blood of retailing cars – became a serious obstacle.

#### **OUTLOOK:**

*Dealer feedback still informs us that banks view franchised car dealers as the equivalent of third-world borrowers. That is, in too many instances, dealers need not apply for credit at banks. To put it mildly, the continuing credit crunch places many dealers in extreme financial difficulty. For 2011, if you have a solid credit relationship with a lender, stay with it. It may not be until 2012 or beyond*

*that we really see a comeback for credit relationships with car dealers, beyond the carmaker captives.*

*We will not see in 2011 a return to normalcy in credit markets. Lessons of the financial meltdown of 2008 will linger, and dealers will need to be patient and proactive in courting creditors. Dealers with solid credit relationships will be prudent to nurture them.*

### **4. Franchisor Strategies and Pressures on Dealers: Imaging; Renovation; Dedualling; Pre-Signed Termination Agreements; “Average-or-Above Minimums”; Relocation; Site Control; Sales; CSI. Can They Do That? (3)**

#### **■ Responding to Automakers’ Assaults on Dealer Rights and Autonomy: Dealers and Their State Associations Need to Strengthen State Laws; Federal Meddling. (5)**

They’re baaaack! The automakers are pushing hard to right-size and right-position and right-architecture their dealer networks.

Automaker initiatives are now truly off the charts. Imaged and exclusive facilities are now the Order of the Day, and the pressures from brand representatives range from sophisticated to crude. Elimination of dealer points (think Lincoln) are the regular subjects of press releases and pressure. Sales goals and objectives are frequently cited in connection with termination threats, and letters to dealers frequently purport to “require” that dealers – at a *minimum* – be at least equal to or above regional averages in sales penetration and CSI.

In the single year 2010, at least 24 states amended their automotive franchise laws, and many more amendments are in the works for 2011. This ability to move state legislation quickly is one saving grace for dealers. Most state association professionals know that they face constantly moving targets. I frequently consult with state associations, and their persistence and enthusiasm in seeking a level playing field for dealers are admirable. Auto franchisor legal departments are ever exploring new ways to circumvent old and recent laws enacted to protect dealers, and the associations need to stay vigilant and proactive.

For example, franchisors push dealers to properly “image” their facilities and render them “exclusive,” if they are not already single-line operations. They have rolled out pre-signed termination agreements, to hold over the heads of dealers as they struggle to perform in compliance with aggressive performance standards. “Minimum requirements” that hold dealers to performances that must be average or above are totally outrageous and overreaching, but proliferating nonetheless.

Some franchisors, especially Chrysler, are more insistent than ever that site control be part of the franchise relationship.

In this environment, by themselves, dealers are hard-pressed to resist the onslaught of factory demands. Let’s be thankful for the yeoman work of state dealer associations.

#### **OUTLOOK:**

*Franchisor strategies to shape and control their dealer networks are likely to accelerate throughout 2011. Total new unit sales for the industry will remain down from what they were a few years ago, but way up from the last two years. In December 2010, Morgan Stanley forecast U.S. sales of 14 million new units for 2011. Every auto franchisor will be aggressively seeking to maximize its share of the movement back to higher overall numbers. Look for more and more “take-it-or-leave-it” “choices” imposed on dealers. Dealers will feel pressure like never before to comply with factory demands. Associations will have their hands full in coping with new developments through their efforts to support new legislation.*

### **5. Involuntary Franchise Terminations, Termination “Threats,” Brand “Withdrawals,” “Pressured” Buyouts, Financially Driven Resignations, Consolidations, and Rights of First Refusal (4)**

In the recent past, an unprecedented number of auto franchisees were involuntarily shut down. Of course, the GM and Chrysler bankruptcies accounted for huge numbers of business death sentences, even when the large numbers of GM “reinstatements” are factored in. GM’s Pontiac and Saturn line makes are history, as is Ford’s Mercury brand.

For 2011, termination considerations will abound. With the Lincoln brand, for example,

Ford has already made it clear that it wants to clear out large numbers of Lincoln retailers, even as it promotes the brand’s future. Within a few years, we should be better able to gauge whether Lincoln will thrive and survive, or follow Mercury’s demise.

As for individual instances of termination threats, franchisors are becoming ever more adept at creating and implementing pressures against disfavored dealers. For example, it has become common for many brands to extort from dealers an “agreement” with an admission that the dealer is not satisfying so-called sales obligations, and a commitment to perform at *a minimum of average or above* in the future. Thus, a low-performing dealer commits to rise to the top half of all dealers in performance and stay there, or be subject to termination for the “breach.” These are outrageous tactics being deployed by franchisors, but they are nevertheless abundant and occurring in greater number than in past years.

Other franchise-related factory initiatives abound. Automakers are aggressively seeking ways to “right-size” and “right-locate” their dealers. There will be more consolidations and more exercises of rights of first refusal in 2011.

When faced with these kinds of situations, a dealer should *not* sign agreements that admit breaches (that are truly not breaches in any event), and they certainly should not agree to perform at a level that has to be above average to be compliant with the dealer agreement.

#### **OUTLOOK:**

*Some brands are certain to push the termination envelope, because they feel they need to “re-shape” or “consolidate” their dealer networks. Of course, there will be some of the usual performance and misconduct termination notices that reflect genuine factory reasoning, but those will be the exception. More abundant will be the “pretext” notices that have an underlying strategy to make right-size and right-locate the networks. Any dealer in the cross-hairs needs to employ a strategy of responsibility and timely responding to every threat.*

### **6. Workforce Issues: Employee Rights and Benefits, the Prospect of Unionization (Card Check and Mandatory Arbitration), and Health Care Legislation (6)**

Perennial issues like sexual harassment, discrimination (mainly race and age), wage and

hour compliance, etc. will be challenges everywhere. As experience has shown, dealerships with lots of turnover are particularly vulnerable to these kinds of potential problems, and it is crucially indispensable that managers are proactive in training and staying current with federal and state laws and regulations.

The good news for dealers and other small businesses is that targeted federal legislation to abet unionization will not happen, now that there is a Republican majority in the House and a smaller Democratic majority in the Senate. Forget about Card Check and the kind of mandatory final arbitration that was under consideration.

#### **OUTLOOK:**

*Expect some turbulence on the legislative side of workforce issues. At the federal level, any new controversial laws will be difficult to pass, now that the Republicans rule the House and the Democrats have a narrower Senate majority. However, watch for developments from federal agencies (like the NLRB) where the Obama Administration has successfully planted appointees who are perceived as hostile to business interests.*

### **7. Buying and Selling Dealerships: Factory "Stealth" Conditions (7)**

Transactions to buy and sell dealerships have been down, and the goodwill numbers are still way down from pre-recession days. There are fewer total dealerships and more consolidations of franchises within mega-dealer and public ownership. Nevertheless, toward the end of 2010, anecdotal evidence suggests that buy-sells are on the upswing, and the elite franchises (i.e., Honda, BMW, Lexus, etc.) are fetching decent goodwill numbers. At the same time, there are more stories than ever about factories weighing in with buy-sell conditions that are likely unlawful under most state laws. For example, there have been notorious attempts to coerce buyers into entering into facility and performance commitments that did not exist with the seller's dealer agreement. Watch for more of this in 2011.

#### **OUTLOOK:**

*You should expect plenty of dealership buying opportunities in 2011. The problem is that lower selling prices truly reflect lower values, high risk and scarce credit. The Hyundai franchise, however, is beating the odds and is going to continue to be hot for the foreseeable future. Some old standbys like Honda will be in pretty good shape as well.*

### **8. Taxes (10)**

Had the "Bush tax cuts" expired as scheduled at the end of 2010, the overall U.S. economy would have been further devastated. At long last, in December, the Congress acted, and at least for now, higher federal income taxes in 2011 will not be the instrument of a double-dip recession.

At the same time, there are no shortages of critics regarding how tax policies are manipulated, at both the federal and state levels. The continuation of past federal income tax levels should spur an upward spike in 2011. Even so, we're only a year away from what will likely be a contentious 2012 election cycle, and it is certain that the federal tax rates will be front-and-center as an issue not only for the presidential contest, but also the House and Senate.

#### **OUTLOOK:**

*Dealers may breathe a sigh of relief for 2011, because the federal tax situation has not worsened as was once expected. There is some reasonable expectation that the continuation of the Bush tax cuts will stimulate more dealer business in 2011, not just in new car sales but also in all the profit centers.*

### **9. The Storms of Legal Issues and Concerns: The Evolving Legal Landscape Brings Abundant Challenges to Dealers; How to Cope Using Best Practices and the Legal Audit Checklist (8)**

Since I first started distributing my annually updated Legal Audit Checklist, I have heard from many dealers that it was serving a valuable function for them. Of course, it is not crucial that dealers use *my* checklist, but rather, that they regularly (perhaps once or twice a year) confirm their compliance with the seemingly countless responsibilities assigned to dealers by law, regulation, or practice.

Every dealer informally "audits" a financial status of the business at least once a month, if not more often. They do this with reference to their monthly statements to the factory, in combination with other resources that reflect upon how the business is doing. These days, unfortunately, it can be equally important to ensure legal/regulatory compliance at every level and in every section of the dealership. For example, in-



attention to sexual harassment policies, wage and pay requirements, advertising and sales practices, environmental rules, and a host of other topics can wind up costing the dealer thousands, sometimes even millions, of dollars. The avoidance of class action vulnerability is usually in the dealer's control, yet too many dealers have had to learn their lessons with unfortunate experiences.

It is strongly recommended that dealers quickly go through a checklist to assure compliance at least once or twice a year.

**OUTLOOK:**

*Unfortunately, dealers in 2011 will continue to face frequently unexpected legal challenges. Every dealer should follow the recommendation of a periodic legal self-audit, using a comprehensive checklist such as the one that I provide (at no cost).*

## 10. Privacy Concerns and Identity Theft (9)

This trend has spawned an entire industry. Excellent publications and regular seminars are available for dealers to keep track of this ever-moving area of the law. Every dealership should have a well-trained person who supervises and trains other personnel so that costly and embarrassing breaches do not happen. The financial consequences of errors can be catastrophic.

**OUTLOOK:**

*Every dealer (every business for that matter) faces the ticking time bomb of bad people who seek to steal and exploit private information of customers or employees. In 2011, the law's coverage will continue to be tested in serious cases of identity theft. It is incumbent upon every dealer to train personnel in the necessary vigilance and security measures to avoid financial and privacy calamities.*

## 11. Audits of Incentive or Warranty Claims: Dealer Beware (11)

Audits and resulting chargebacks can be a dealer's nightmare. Although, automakers undoubtedly catch dealers who mistakenly or willfully claim monies they have not earned, the problem is frequently one of interpretation of ambiguous rules or a failure to follow procedures.

**OUTLOOK:**

*Audits – especially of franchisor incentives – are on the uptick, as are the resulting chargebacks. In 2011, dealers must expect a continuation of this aggressive factory strategy. Thus, dealers are encouraged to assure internal measures to make sure of full*

*compliance with often detailed and sometimes ambiguous incentive rules.*

## 12. Customer Satisfaction: CSI vs. Reality (12)

CSI continues its two-decade run as a “gold standard” for automotive franchisors in purporting (or pretending) to measure the satisfaction of dealerships' retail customers in both sales and service experiences. The reality, however, continues to be that these indexes are neither scientific nor reliable. Rather, they rely upon unscientific and untested surveys and standards that do not provably have any connection with “real-world” measurements of satisfaction.

At the same time, there is no denying that dealer behavior can influence the results of surveys, and in turn, influence CSI scores. This recognition puts dealers in a bind, because they often have to take steps that are not particularly consistent with good business, but, instead, will drive scores up. In 2005, I dealt at great length with the many problems and inaccuracies of CSI in the automotive industry. See *2005's Top Legal Trends for Automobile Dealers*.

**OUTLOOK:**

*Franchisor emphasis on CSI is here to stay. Thus, dealers must balance their good business practices against striving for high scores. In all circumstances, dealers must avoid any temptation to “rig” results or otherwise take inappropriate steps to get higher scores.*

## 13. Alternate Dispute Resolution (ADR) (13)

For about twenty-five years now, Alternate Dispute Resolution (ADR) has enjoyed real growth, and general acceptance. Basically, ADR consists of various means of resolving legal disputes outside the courtroom. There are generally three broad categories of ADR: (1) direct good faith negotiations between the disputing parties; (2) mediation which calls for a third-party “mediator,” usually an experienced professional, who tries to assist the parties in reaching their own agreed-to resolution of a dispute; and (3) binding arbitration which calls for an arbitrator who sits as a substitute judge, and can impose enforceable decisions upon the parties.

Many dealer agreements incorporate ADR into the relationship, that is, they have provisions that require or permit specified methods for re-

solving disputes, prior to formal litigation. Remember, though, that federal law now prohibits auto franchisors from requiring that disputes must be arbitrated. See 15 U.S.C. § 1226.

The ADR concept also includes hybrid mechanisms such as Ford's Dealer Policy Board which has three board members – all career Ford employees – who, in certain defined instances, can preside over complaints by dealers against Ford. (Important: If you receive a notice of termination from Ford, you must first go to the FDPB as a condition precedent to seeking relief elsewhere.) If the FDPB decides in favor of the dealer, it's over; but if the dealer does not prevail before the Board, he still has all of his rights to pursue remedies elsewhere, including court. Until recently, I viewed the FDPB as the gold standard of the industry. In recent times, especially with reference to the Mercury brand termination, wherein the Board decided that it had no jurisdiction to provide remedies to dealers, I am concerned about the direction of the Board today.

Nevertheless, in most instances, dealers are well advised to use their franchisors' dispute resolution mechanisms. In the majority of cases, disputes can be resolved without the stress and cost of going to court.

#### **OUTLOOK:**

*ADR is now a permanent part of the legal landscape, and dealers will no doubt continue to participate in large numbers in various aspects of trying to resolve differences by means other than formal litigation in a court or before a government administrative body. Although there have been some setbacks regarding the use of mandatory arbitration with consumers, dealers should still consider the use of arbitration with consumers as long as the practice adheres to existing state law and judicial precedent.*

### **14. Living with the Threat of Terror...and Natural Disasters, Too: Doing Business in an Era of Constant Vigilance (15)**

This trend ebbs and flows, but it will not go away. It is unquestionably a sad commentary on the state of the world in 2011, but we know that federal and state agencies devote substantial resources to every aspect of the terror threat, both internally and abroad. Inevitably, there are laws, regulations, and a host of inconveniences that citizens and businesses are wise to recognize and confront. In addition to the terror threat, we

have seen the consequences of natural disasters play out in various parts of the United States. Hurricane Katrina may be the most memorable such event in recent years, but there are also natural disasters of lesser magnitude – hurricanes, floods, tornados and the like – that make it imperative that dealers prepare for a response to this kind of emergency.

#### **OUTLOOK:**

*"Expect the unexpected." We will endure acts of terrorism and natural disasters from time to time. Contingency plans for such events are a must. Every dealership should have a plan for emergencies that is current and known to the employees.*

### **15. Retail Reimbursement for Warranty Work and Parts (16)**

The retail warranty reimbursement saga continues. The battleground is mainly in the parts area, because, in most instances, auto franchisors now at least purport to reimburse for warranty labor at the dealers' retail rate. But in the area of reimbursement for parts used in warranty, some franchisors – most notably Ford – continue to flout the law in an effort to deprive dealers of their statutory entitlements.

#### **OUTLOOK:**

*For at least the short term, maybe another two or three years, the fight will continue. This is certainly an area in which nationwide treatment should be the same. Dealers should be reimbursed at retail for both their labor and parts in doing warranty work on the factory's behalf.*

### **16. Encroachment (Protest Laws) (17)**

A smaller population of U.S. dealerships should mean that there will be fewer protests. At the same time, the protests that *do* get filed will have more at stake.

#### **OUTLOOK:**

*Look for a continuation of fewer protests in 2011. But many of those that are filed will be hotly contested, because with fewer dealerships in play, the ability to control a larger territory is more important to dealership sales, service and profitability.*

### **17. Minority and Female Representation (18)**

Reports in *Automotive News* and other media, indicate that the economic downturn and reduction in auto retailers had a disproportionately severe impact on minorities.

**OUTLOOK:**

*In 2011 auto franchisors will be trying to place more minority dealers—to affect the losses of 2008-2010.*

## 18. Environmental Pressures: Is “Green” Really Green? (19)

Federal, state and local governments continue to push for “greener”— i.e., more environmentally-friendly . . . trucks and automobiles.

**OUTLOOK:**

*In 2011 the Chevrolet Volt and some other “environmentally friendly” models should fare well, but in small numbers. On the other hand, American preferences are not likely to yield to the pressures of environmental activism. Not yet.*

## 19. Internet Marketing, the Technology Revolution, and the Remarkable Changes to “Business as Usual” (20)

It is getting harder to recall the days before the internet and dealer websites. Each year, more and more business is conducted through cyberspace. Mr. and Mrs. American can buy their cars without ever getting out of their bathrobes.

Facebook’s Mark Zuckerberg is *Time’s* Person of the Year. “Social media” are the new darlings of business networking and retailing.

**OUTLOOK:**

*In this area, dramatic changes happen every year. 2011 will follow that trend. Dealer internet marketing and the use of social media will continue to skyrocket.*

## 20. Author Editorial: Five Legal Standards That I Would Establish on Nationwide Standards:

### (1) Mandatory Fair Market Buyouts for Dealers “Terminated” by Brand Withdrawals

A number of states now mandate that automotive franchisees of brands that are withdrawn/terminated by the automaker be compensated at fair value or fair market value. The nature of such an action by a franchisor is such that there is no principled reason to have differing standards from state-to-state. In each such case, because of a unilateral business decision by the franchisor, the dealer abruptly loses all its good will unless

the law – by statute or common law – provides for a remedy. Under these circumstances, where the carmaker ends the life of a brand, but continues to operate with other brands, the compensation to the terminated franchisee should be no less than the fair market value lost as of the moment the factory makes public its decision to terminate a line make. Some states, like Colorado and New Jersey, have such laws, and basic equitable principles and fundamental fairness support nationwide applicability.

### (2) Nationwide Good Cause Standard for Involuntary Termination

Similarly, there is no rational justification for having multiple “good cause” or “just cause” standards for involuntary automotive franchise termination. The evidence, the proofs, and the overall standards should be set forth in a uniform and comprehensive way. There should also be a uniform requirement that the continued operation of the franchised auto business is guaranteed for the length of any dispute resolution, except that the factory would have the opportunity to show cause why an earlier termination must occur in a particular case.

### (3) Burden of Proof Always on Factory in Termination Cases

While many jurisdictions do place the burden of proof in termination cases upon the franchisor, that requirement is not uniform. It should be.

### (4) If Challenged by Dealer, Audit Chargebacks Not Allowed Until/ Unless Factory Satisfies Burden of Proof in Evidentiary Hearing

At present, it frequently happens that a dealer is charged back after an incentive or warranty audit, even though there has been no final legal adjudication of the dealer’s challenge to the chargeback. This is a particularly harsh and arbitrary action, because, for the dealer, the immediate deprivation of cash can gravely injure a dealership’s operations, or even put it out of business. Thus, the preservation of the status quo – i.e., the chargeback is not allowed until and unless the factory prevails – makes sense.

### (5) Mandatory Reimbursement at Retail for Warranty Labor and Parts

Franchisor reimbursement policies for warranty labor and parts vary considerably from brand to brand. Most of the retail laws in many states are either ignored or abused. *The unvarnished truth is this: when dealers are reimbursed at less than retail rates for labor and/or less than retail mark-ups for parts, the dealer is, in effect, subsidizing the factory's warranty.* This inequity should end everywhere. At present, many franchisors apparently rely upon the less-than-retail reimbursement rate to keep down the cost of the factory warranty that is embedded in the dealer invoice and ultimately in

the MSRP, as well as the final negotiated retail price of a vehicle. If all brands had to pay dealers for the retail value of warranty work and parts, there would be no competitive advantages to any brands, because they would all need to account for the true warranty cost from the outset.

**OUTLOOK:**

*Unfortunately, there is no ongoing campaign or effort for uniformity of these concepts on a nationwide basis. It is high time to do so.*

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