

2018'S Top Twenty Legal Trends For Automobile Dealers

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dealers will always be deemed “under-performing.” Third, any system devised to assure the “failure” of dealers with lower numbers is unfair. Fourth, auto makers use these results, based on unreliable and unfair metrics, to arbitrarily identify “winners” and “losers” from among their franchisee network.

For many years, manufacturers have evaluated, identified and enforced dealer sales objectives and requirements under a misguided pretense of scientific validation and reliability. The truth is, these metrics are an unfair and inaccurate gauge of whether a dealer may be in material breach of the dealer agreement.

U.S. auto franchisors (*almost universally*) measure dealer sales efficiency by computing an “average” sales penetration benchmark for all the same-brand dealers in the applicable region or state. Then they compare each dealer’s sales penetration in its area of responsibility measured against “opportunity” or “expected” or “average” sales. Dealers whose sales penetration falls below “average” of all same-brand dealers in the comparative geography are deemed “underperforming.” That means, at any given time, about half the dealer network of an auto franchisor is unsatisfactory, and in material breach of the dealer agreement!

Keep in mind, sales performance evaluations often impact a dealers’ eligibility for certain bonuses, which can determine a dealer’s profitability or competitiveness. Also, if a dealer is looking to acquire another dealership, below average sales of existing stores can be an automatic disqualifier.

If manufacturers want to use metric-based statistics in determining dealer sales performance efficiency, they must be required to first demonstrate the validity and accuracy of both the metrics themselves AND their statistically demonstrable relationship to the sales performance of individual dealers.

2018 might be a year of extraordinary good fortune for dealers, not only in sales, profits and store values, but also in legal and regulatory reform. At the same time, counter-developments in political and investigatory arenas could profoundly undermine some of the upbeat initiatives and developments. Every dealer needs to take a hard look at which of the following trends could impact their business, and plan accordingly.

1. Franchisor Sales Performance Standards and Pressures on Dealers

Franchisor governance of dealer sales performance is inherently problematic. First, their “accuracy” in determining dealer sales efficiency and “expectation” numbers, as well as establishing fair minimum sales benchmarks, is flawed and scientifically unsound. Second, the methodologies used make certain a significant percentage of

There are too many variables that arriving at any kind of meaningful “average” sales evaluation is probably a lost cause. Not to mention, using an “average” penetration threshold as a minimum passing grade is both absurd and unreasonable. No manufacturer should construct a network plan that assures the automatic failure of about half its franchisees at a given time. With an “average” benchmark for all dealers, the failure rate never improves, because the “average” will move up or down along with a brand’s sales trends. Even if a brand’s sales double, the number of “below average” dealers will stay constant. Manufacturers should use systems that increase the likelihood and assure the possibility that every franchisee can comply with reasonable standards at the same time.

So, in revamping their current methodologies, what should auto franchisors do instead? First, instead of “one-size-fits-all” metrics that depend on convoluted and artificially devised comparisons, they should establish discerning standards so that each store is assessed on its own compliance with those standards (*i.e. adequate facilities, well-trained professional sales and service staffs, customer friendly policies and practices, reasonable capitalization, regular suitable advertising in local media, appropriate and adequate inventories of vehicles and parts, etc.*)

Second, if manufacturers insist on relying upon vehicle sales metrics, they must develop methodologies that are fully explained to dealers and proven to be statistically valid to scientifically determine how many vehicles a given dealer should sell or should have sold.

2. Autonomous Cars: A Threat to Dealer Survival, or a Major Growth Opportunity?

Auto retailers are just starting to figure out what role they will play in the autonomous vehicle wave coming down the road. Some predict human-driven vehicles will be legislated off the highways in 15-20 years, which will spell the demise of automotive retailing. Most industry experts see autonomous vehicles serving as an “addition” not a “substitution” to existing automotive sales because they will enable many people who cannot or should not operate a vehicle (*i.e. those with disabilities or under the influence*). There is no indication that most current drivers will want to completely cede operational control of their vehicle.

So will today’s franchised distribution network will be diminished or displaced? In my opinion, even if vast numbers of self-driving vehicles enter the marketplace in the next 10-20 years, today’s dealers should continue as the principal retailers and fleet marketers of the new units in a modernized and reconfigured distribution system.

3. Impact on Dealers from the Changes in Government and the Push-Back Against Regulatory Growth

For legislation and regulations affecting dealers, 2018 will be a year of both uncertainty and some gains. The maelstrom that seems to perpetually surround the Administration of President Trump shows no sign of abating in 2018.

The development of various congressional oversight and special counsel investigations remains a wild card that could stymie much of President Trump’s regulatory agenda. If the 2018 mid-term election cycle goes poorly for Republicans, 2019 legislative initiatives could drop or change precipitously. A serious impeachment initiative with a new Congress in 2019 could derail the overall economy and cause the retail auto market to tumble. Even without intervening problematic political events, some economists warn that a major market correction is long overdue.

A thorough federal regulatory overhaul requires direct congressional action, with the passage of new laws and the repeal of old ones. Congressional cooperation, however, is an oxymoron as political partisanship continues. Regulatory cutbacks are happening administratively and by executive order in many areas without new laws enacted by Congress.

4. Retailing by Non-Dealers

New car retailing could be changing and it could be changing sooner than many realize. Amazon, Wal-Mart, Costco, and other non-dealer entities are chomping at the bit to be direct vehicle retailers. Tesla and many others continue to push the envelope with electric vehicles (EVs).

I believe that “department store” and online sales by nationwide or regional vendors are likely at some point in the future, but so is the expansion of products and needed services, tailor-made for the brick-and-mortar dealership.

5. After Manufacturer Scandals, Are Brand Integrity and Brand Reputation Recovering?

The Volkswagen emissions scandal, GM ignition defect revelation and Takata airbag mess, affected public confidence in many brands. Egregious factory misconduct and cover-ups have occurred (*or have been exposed*) with troubling frequency in the recent past. Hopefully, even if manufacturers are not motivated by doing the right thing for their own sake, they will see the wisdom of avoiding spectacular business losses, along with reputational harm.

6. Taxes and the Positive Impact on Dealers of a Federal Tax Overhaul

On December 20, 2017, Congress passed the first major overhaul of the Internal Revenue Code since 1986. When all factors are taken into account, the newly revised Code lowers net income tax payments for individuals at all income levels, and cuts the corporate rate from 35 percent to 21 percent.

This is good news for dealers, as increases in personal and corporate disposable income will likely motivate more new car sales in 2018 than there would be otherwise. Dealers, however, have every reason for optimism about sales and profits, stimulated by this new tax law.

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LEGAL TRENDS | continued from page 23**7. Franchisor Programs: Incentives, 2-Tiered Pricing, Stair-Steps and More**

Although the particulars of Cadillac's "Project Pinnacle" are more complicated than most incentive programs, they illustrate the kind and quality of control that franchisors seek. Automakers routinely put together "programs" they hope will boost sales of their vehicles. The aim is to "encourage" dealers to sell more units by paying them additional money as "incentives" or "bonuses." In certain programs, the per-unit payment to the dealer goes up at specified benchmarks in retail sales ("*stair-step*" programs).

But these programs result in high-volume dealers having more money per vehicle than their lower-volume peers. That complaint is the essence of "two-tiered pricing." Not only is it unfair to the lower-volume dealers, it also that discriminatory result unfair, say critics, but it turns off customers.

For years, a few dealers have challenged "two-tiered pricing on the basis of anti-discrimination and antitrust laws. But dealers also contend that such programs may be counter-productive, as a practical matter, when the resulting retail price differences destroy consumer confidence.

8. State Franchise Laws

For over a decade, material revisions to franchise laws have been enacted in about 20 states per year. State associations and the ATAE are both vigilant and proactive in confronting what they perceive as factory overreaches. 2018 should continue this trend, hopefully, with some emphasis in seeking to address the auto franchisors' flawed methodology in the evaluation of dealer sales. Elimination or reduction of auto franchisors' power to exercise their contractual right of first refusals should be a priority for amendments to state laws.

9. Privacy and Identity Theft; Cyber Security

Just when we think the threats of hacking and identity theft may be abating somewhat, or that protective software is prevailing, along comes the Equifax disaster, exposing over half of American adults (143,000,000 people) to thievery by sophisticated hackers. Then comes an announcement in October 2017 that 3 BILLION Yahoo accounts had been compromised. These recent, large-scale cyber nightmares should signal to small businesses that vulnerability to criminal actors is a problem for everyone who relies on computers, and that the problem will not get better anytime soon.

Dealers are finding that many customers, in response to the Equifax exposure, have frozen businesses' access to credit reports from Equifax and others. Thus, dealers cannot readily obtain customers' credit reports if frozen. In such circumstances, the customer must unfreeze the credit report so that the dealership can access the report. Unfortunately, this kind of delay and inconvenience, along with some added expense, will need to be endured for the foreseeable future.

As an overall proposition, Auto dealers must remain especially vigilant as they obtain, safeguard, and store large volumes of sensitive

customer information, both in hard copy form and in electronic storage. Constant updating of cyber security is important, because computer invaders become more sophisticated all the time. 2018 is bound to see more examples of brazen hacking, cyber-attacks and identity thievery. Every dealer is well-advised to have a well-versed IT employee to oversee continuing and updated safeguards.

10. Recalls

Recall numbers will continue their historical upward trend, yet the public will take such news in stride. Recalls are so commonplace now, they rarely get lasting headlines, unless there is also an issue of deliberate misconduct.

It's not that larger numbers of cars now have more defects, or more serious defects, than in earlier years. Quite the opposite is true. So why all the recalls? In large measure, the recall trend is so proactive because both automakers and state and federal government agencies want to avoid the negative impact of highly publicized failures, especially if they threaten lives.

Thus, a very small percentage of defective cars within a model group is apt to spur a model-wide recall. For example, if only ten cars out of 100,000 manufactured vehicles are shown to have a serious safety defect, you nevertheless could see 100,000 recall notices. This is prudent, even when the odds of a serious defect in a particular vehicle are very low.

For dealers, recalls do generate service and parts income, at no cost to the customer. But downsides can include factory delays, which generate stress for both dealers and their customers. What is a dealer to do with new inventory in the face of recall notices? What about used inventory under recalls? What about the irate customer who receives a recall notice, but the factory is short on parts? What about consumers who ignore recalls altogether, choosing instead to drive with defective vehicles?

Dealers need to know the recall status of their inventory, and due diligence in keeping up on a continuous basis is a good practice. To be doubly certain, a dealership employee should regularly match vehicles in stock to the available public information about recalls. The National Highway Traffic Safety Administration (NHTSA) is an indispensable tool for recall information. See www.nhtsa.gov to search for relevant recall information by make, model and year.

11. Alternate Dispute Resolution

The Consumer Financial Protection Bureau (CFPB) has continued to assert itself in this area. On July 10, 2017, under former Director Richard Cordray, the CFPB published a rule that purportedly protected consumers' ability to bring class action lawsuits. However, that rule has been effectively overturned, and the CFPB is definitively moving in a different direction under the Trump Administration.

The big ADR question for dealers continues to be the viability of mandatory arbitration clauses in contracts with consumers, especially where a customer signs away any right to initiate a

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class or mass action. From the dealer's viewpoint (*and, I believe, the customer's as well*), the availability of such provisions is a good thing. Hopefully 2018 will see more clarity and consistency on this important issue.

For now, the previous CFPB mission to thwart consumer arbitrations is in tatters. Therefore, dealers who want arbitration clauses with consumers should monitor developments in state and federal law, including relevant court decisions to assure legal compliance. State associations have done an excellent job staying current, and are reliable resources for dealers looking for guidance on arbitration provisions.

12. Workforce Issues and Unionization

The Obama era of one-sided, pro-labor, anti-business initiatives is receding, but hardly vanquished. Businesses (*and dealers in particular*) should be cautious about becoming overconfident in dealing with unionization issues.

Caution: A number of states now prohibit asking job candidates for hire about pay history. Hiring practices are under more and more scrutiny today than in the past. In addition, incidents of sexual harassment in the workplace will be met with fierce legal repercussions. A "zero-tolerance" policy for such misconduct is a must.

Look for a year of gradual transition to more fairness for employers on basic economic issues, and a more "enlightened" National Labor Relations Board ("NLRB"). State laws vary considerably in employment requirements. Stay current on your jurisdiction's workplace laws and regulations!

13. Environmental Issues

Industrial waste and hazardous material are always subjects for dealers' attention and vigilance. The overarching environmental philosophy of EPA Chief Scott Pruitt and the Trump administration appears to be to ease those restrictions on industries and businesses that arguably provide nothing meaningful to protect or conserve the environment. A more laissez-faire regulatory policy is likely to make administrative burdens down at the dealership level considerably less onerous. This easing

regulatory approach will not cause harm to the environment or foul water or air.

Dealers may draw some comfort from the probability that 2018 will see an easing of bureaucratic tasks associated with environmental matters. Nevertheless, dealers must be sticklers in complying with existing requirements, and assure that employees heed best environmental practices.

14. Involuntary Termination

Auto franchisors continue to threaten "death penalty" sanctions against their dealers in large numbers, but the delivery of an actual termination notice to a targeted dealer is still a relative rarity. In all instances of franchisor termination threats, a dealer needs to respond in writing – promptly, civilly, accurately and firmly. The response should be factual and professional. It should contest the basis of the threat, and invite the franchisor to discuss all issues further. It is never a sound strategy to ignore such a serious matter. Of course, if you receive a notice of termination, call your experienced franchise attorney immediately.

15. Rights of First Refusal ("ROFRs") and Buy-Sell Activity

For 30 years, I've contended that ROFRs limit buy-sell opportunities and tend to drive selling prices down. That is because prospective buyers are wary of wasting time and effort, only to be thwarted by a factory exercising its contractual ROFR. Five states now prohibit ROFRs, and there may be a minor state law trend to follow suit. ROFRs, or even their threat, have become serious impediments to buy-sell activity, especially when franchisors try to "cherry pick" their brand out of multi-brand deals.

16. Consumerism

"The consumer is king" is still an applicable maxim, and dealers are well advised to walk the extra mile in directly resolving customer gripes at the earliest possible time. In dealer vs. consumer disputes, the deck remains heavily stacked in favor of the consumer,

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and dealers should stay mindful of this reality. Many states (*including New Jersey*) have consumer fraud statutes that call for treble damages against businesses found liable for prohibited practices, PLUS attorneys' fees.

Of course, there are situations where the dealer should take a stand. In those cases, dealers should fully document all the facts, make sure that (a) it's worth the cost of a legal contest, and (2) all the facts line up favorably.

At the federal level, for several years now, the Consumer Financial Protection Bureau (CFPB), was the 500-pound gorilla of consumerism. Now, the bloom is off the rose. Again and again, under former Director Richard Cordray, the CFPB repeatedly tried to cast businesses and banks as villains out to cheat or discriminate against various classes of consumers.

The CFPB has been defanged under the Trump Administration, but that's not a disservice to consumers. Rather, it suggests there will be fairness and reasonableness in how the federal government approaches consumer-based issues. The CFPB had unlawfully tried to grab legally-prohibited jurisdiction over dealers through the "back-door" when dealers make loan applications available to consumers.

On a number of fronts, dealers in 2018 will see some relaxation of the unfair onslaught by consumer groups and state and federal regulators.

17. Encroachment and Franchise Modification

There may be fewer encroachment and modification cases in 2018, but they will be important nonetheless. The establishment or relocation of a competing same-line store near an existing location may potentially cause grievous harm to the original store's ability to remain profitable, retain their staff, and even their growth viability. With "modifications" of franchise agreements, a bevy of state laws now allow dealers to protest unilateral changes.

Auto franchisors usually visit protest-eligible dealers to try to coax them not to protest the establishment or relocation of a nearby competitive store. Now, they do the same if a modification law is in place. A factory representative will tell the existing dealer that the proposal is either good for, or indifferent to, their livelihood, but those representations are, generally, not true. If you receive a notice from the factory stating the intention to put a competing dealer near you, or to change your dealer agreement in an important way, call your lawyer to explore your options. And do so right away, because statutory time limits for filing a protest are usually very short.

18. Natural Disasters, Terrorism and Unrest

Hurricanes Harvey, Irma and Maria and major California wildfires stand as recent horrific reminders to America's auto dealers that calamities far beyond their control can have a profound impact on them, their businesses, their employees, as well as their communities, friends and neighbors.

Of course, human beings cannot control natural disasters. But they can, and should, take precautions to try to lessen the repercussions on themselves, their employees and customers, and to recover in the aftermath.

Every employee manual should contain a section devoted to what steps should be taken in the event of a serious emergency, including natural disasters. Also, dealers are prudent to consider business interruption insurance, and other applicable types of coverage.

19. Warranty Reimbursement

About 30 states now prohibit auto franchisors from surcharging dealers to recoup high warranty parts expense. A small number of states have amended their laws to stop the carmakers' practice of charging dealers for "add-on" warranty work and parts. This issue won't go away for a while, despite a series of dealer victories in court.

20. Factory Audits

Dealer fears of (*and suspicions about*) factory audits are often overblown. In nearly all instances, such audits are legitimate, and, in any event, auto franchisors have the right to audit dealers for compliance with basic contractual requirements. Most audits relate to oversight of work done and/or sales made and dealer claims for factory money including bonuses, incentive payments, warranty work, etc. To be sure, they must abide by state law and dealer agreement timing, but, unless there is a truly objectionable overreach, dealers must simply cooperate with auditors. Of course, the results of an audit, including chargebacks, are often reasonably disputable. In those instances, dealers can and should challenge questionable chargebacks. **nj car**

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