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DEALERS FOCUSED ON FRANCHISE LAW PROTECTIONS

By Peter K. Bauer

In early November, the McNees Automotive Dealership Law group hosted its dealership law seminars in Philadelphia and Pittsburgh at the headquarters of the Automobile Dealers Association of Greater Philadelphia and the Greater Pittsburgh Automobile Dealers Association. We greatly appreciated the hospitality of both associations in accommodating our seminars.

The dealership seminar topics ranged from employment law issues to environmental law, regulatory enforcement concerns, estate planning, buy-sell transaction considerations, as well as a franchise law activities update. For those that were not able to attend this well received event, we would like to highlight the discussion points surrounding the dealer franchise law, the Board of Vehicles Act, and the impact this law has on important franchise business decisions to be made and day-to-day activities when working with a manufacturer.

The “Franchise Law & Franchise Litigation Update” presentation focused on these topics and what rights a dealer has under the franchise law:

- Increased sales incentive and warranty audits by manufacturers;
- Product availability and allocation issues;
- Increased pressure by manufacturers on dealers to achieve sales performance objectives;
- Continued and accelerated demands for new or upgraded stand-alone facilities;
- Manufacturers altering the marketplace

through relocation and establishment of dealer points; and

- Update on recent amendments to Pennsylvania’s Board of Vehicles Act.

Sales Incentive and Warranty Audits

The materials on this topic noted the following issues:

- Increased frequency and intensity of audits;
- Manufacturer insistence on technical compliance;
- Not uncommon for mid-sized dealer to see proposed chargebacks of \$300,000 to \$700,000;
- Audits being viewed by dealers as draconian attempts to recoup monies;
- There is a need to take audits seriously, and to be vigilant;
- Research and present materials to refute chargeback transactions; and
- Falsified records are rare, but be prepared to mitigate possible consequences.

This discussion focused on reminding dealers that in an audit situation, dealers need to make manufacturer auditors and managers aware that Pennsylvania has Board decisions pertaining to both warranty (which is court affirmed) and sales incentive audits (not appealed to a higher court) that limit the type of chargebacks a manufacturer can make in an audit. If protested by the dealer before the Board, the Board standard of review of what can be charged back is generally not as stringent as what a manufacturer has

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charged back. The Board standard is if the claim is not false, or it is substantiated with reasonable documentation that the work was performed or the sale was made, the manufacturer is not permitted to chargeback the money paid the dealer.

Allocation

The materials on this topic highlighted the following issues:

- Allocation issues used to be only for dealers selling hot brands or models;
- Now it is a concern for both domestic and import dealers;
- Manufacturers are exercising greater discipline in production (for the moment);
- Greater competition exists between dealers for product;
- Some dealers favored with greater allocations, while other dealers get minimal product;
- Poor allocation significantly impairs some dealers' ability to operate profitably;
- Franchise law requires manufacturers to operate a reasonable and fair allocation system;
- Manufacturer cannot arbitrarily determine allocations; and
- Continued "lean" production into future could impair dealer profitability or performance.

The item to note from this discussion was that the franchise law does require manufacturers to allocate vehicles in a fair and reasonable fashion. If a dealer believes they are not allocating appropriately, the franchise law can be pointed to (or a protest could be filed) as a means to try to force the manufacturer to revise its allocation calculations or process.

Sales Performance

The materials on this topic noted the following issues:

- Sales performance is an issue for manufacturers which ebbs and flows;
- Most manufacturers are criticizing dealers performing in the bottom 10% to 20% of their peer group;
- Unlike the past, a dealer cannot ignore poor sales performance notices until a manufacturer threatens termination;
- As noted above, insufficient product allocation may significantly impair a dealer's ability to operate profitably and also to meet sales goals;
- Poor sales performance could result from:

- o Peer group dealer measured against,
- o Size and configuration of area of responsibility, and
- o Buyer purchasing preferences;
- Immediately address matter with manufacturer; and
- Document all contacts and activities to address sales performance issues.

Here, dealers were cautioned to react immediately and with great detail regarding any oral or written indication from the manufacturer that sales performance is lacking. Currently, manufacturers are using poor sales performance as their best leverage to try to set up a paper trail that a dealer is not performing up to standard and a termination is warranted. The dealership should use its best efforts to explain in writing why it believes sales are lacking, what its plan is to increase sales and to request manufacturer assistance to address the problem.

Facilities

The materials on this topic highlighted the following issues:

- Pressure to upgrade, renovate or build new stand-alone facilities is not a new phenomenon;
- Now several factors making facility upgrades more difficult:
 - o Borrowing for real estate improvements can be difficult;
 - o After recent economic events, most lenders view dealerships as "special purpose" facilities not easily renovated for other commercial uses; and
 - o Many manufacturers' image programs are more expensive in terms of demands increasing costs of renovations;
- Be careful when agreeing to renovate or improve facilities; manufacturers seek to enforce agreements made; and
- Incentives tied to facility upgrades and renovations: non-compliant dealers run the risk of not being competitive with peers.

It was noted it is no secret that the pressure is on from just about every manufacturer for its dealers to upgrade, renovate or construct facilities. The franchise law does offer protection from demands that are too extreme. Dealers can point to the franchise law protections requiring that any facility revisions must be reasonable based on economic conditions, must be justified by business considerations,

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and cannot be required if the local market and economic conditions do not justify the facility revision.

Relocation and Establishment

The materials on this topic noted the following issues:

- Manufacturers of all sizes and levels of market share are looking to fill out dealer representation maps;
- Domestic manufacturers are back-filling open areas cleansed through bankruptcy;
- Import manufacturers are expanding dealer count or requiring dealers to relocate to new facilities as market share expands;
- Includes relocation of franchise points to higher traffic areas, or areas where population migrated;
- Manufacturers are establishing franchises where lacking representation, or sufficient population exists to warrant another dealer franchise being established;
- Either relocation or establishment can impact existing dealers, as well as dealers trying to relocate or establish a new franchise;
- Regardless of which side of relocation or establishment a dealer is on, the franchise law has protections and rights for dealers on both sides that could be helpful;
- Know the franchise law.

It was noted the franchise law offers protections to prevent a dealer from being established or relocated too closely to another existing dealer. The law generally allows a protest to be filed to the establishment of an additional dealer within 10 miles of an existing dealer, or to the relocation of an existing dealer within 5 miles of another dealer.

Statutory Update

The materials on this topic highlighted the latest two revisions to the franchise law:

- Act 65 of 2011 (SB 419) expanded dealer protections in the dealer franchise law to:
 - o stay chargebacks by manufacturers following warranty/sales incentive audits; and
 - o create an appeal process for dealers to dispute an alteration of an area of responsibility.
- These recent amendments became effective on September 5, 2011.

Stay of Chargeback

- Previously, when a manufacturer determined a chargeback would occur, and the dealer did not file a protest prior to deduction of chargeback, the

chargeback amount was deducted from the dealer account;

- Even if the dealer subsequently filed a protest with the Board, the Board did not require the manufacturer to return the chargeback pending its decision, thus little incentive existed for a manufacturer to settle the chargebacks;
- The amendment prohibits a manufacturer for 30 days after its final audit determination from assessing the chargeback;
- The 30 day period allows the dealer time to file a protest of the pending chargeback with the Board;
- If a protest is filed, the chargeback is stayed until a final determination is made by the Board; and
- This allows the dealer to retain the disputed chargeback amount in its dealer account pending resolution of dispute.

This 30-day stay period helps ensure that the dealer has the opportunity to file a protest with the Board in order to stay the manufacturer from debiting the dealer's account for the chargeback amount. This also helps give leverage in the audit process to the dealer, as the dealer retains the money it was paid the manufacturer. With the dealer retaining the money, this gives the manufacturer an incentive to work with the dealer to reach a resolution before the Board decides the matter for the parties.

Area of Responsibility

- This amendment adds to the "unlawful acts by manufacturers" section of the Board of Vehicles Act;
- It establishes a new prohibition against a manufacturer unreasonably altering a dealer's area of responsibility;
- Previously, no specific provision addressed a manufacturer's alteration of an area of responsibility;
- The provision requires the manufacturer provide 60 days notice before revising a dealer's area of responsibility and requires the manufacturer to disclose the basis for revision;
- During 60-day time period, the dealer may file a protest of an alteration to an area of responsibility with the Board;
- No revision to an area of responsibility becomes effective until a final determination is issued by the Board;
- If protested, the manufacturer must prove the area of responsibility revision is reasonable and justifiable in light of market conditions; and

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McNees Automotive Dealership Law group

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Since our formation in 1989, we have assembled an outstanding group of lawyers who understand the unique legal problems which affect dealers and who also understand and are interested in the businesses of our dealer-clients.

We are available to assist dealers with any of the broad range of legal problems encountered in today's highly regulated business environment. From buy/sells to franchise terminations; from environmental to employee relations; from consumer complaints to problems with PennDOT; from formation of a new dealership to successor planning; from taxes to tags—we can help.

We will work with your regular local attorney, whenever it is efficient to do so. We will be pleased to provide an estimate of legal fees for a project before you engage our firm.

- If an area of responsibility is amended, the manufacturer must provide the dealer 18 months to become sales-effective in the newly assigned area before the manufacturer can take action against the dealer for failure to adequately penetrate the area of responsibility.

It was noted there was recent activity where both domestic and import dealers were informed of changes to their area of responsibility. This new franchise protection provision allows a dealer an opportunity to object and to file a protest where the manufacturer attempts to alter an area of responsibility which the dealer believes negatively impacts it. Now dealers will have an opportunity to challenge these changes going into the future, as some revisions of responsibility can make a dealer's performance appear substandard where nothing else has changed except the area being measured.

Overall, the emphasis with this franchise law presentation was to remind dealers that there are numerous protections granted dealers under the franchise law. Dealers should be prepared to cite these protections (and file a protest, if necessary) where a manufacturer is seeking to force a dealer to do something that doesn't make business sense, or is not appropriate given the circumstances and the protections provided under the Board of Vehicles Act. ■



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