Automobile Dealerships - Creating a Workout Plan

By: John Pico, BA, JD

The Ground Rules

The basic ground rules for any workout plan are "good faith and fair dealing." These rules apply to both the lender and the dealer. This concept of good faith and fair dealing has its origins in the common law of many states, has been reiterated in the Uniform Commercial Code, the Restatement (Second) of Contracts and case law.

Uniform Commercial Code, Section 1-203:"Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." *Restatement (Second) of Contracts, Section 205, Comment d.*

"A complete catalogue of the types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of power to specific terms, and interference with or failure to cooperate in the other party's performance."

It appears, however, that parties who enter into a contract in Texas should search for a theory other than good faith when seeking remedial help from a court. In *English v. Fischer*, 660 S.W. 521 (Tex. 1983), at 552, the court, when reviewing the concept of implied covenants of good faith and fair dealing, held:

". . . (It) is contrary to our well reasoned and long-established adversary system which has served us ably in Texas for almost 150 years.... The novel concept advocated by the courts below would abolish our system of government according to settled rules of law and let each case be decided upon what might seem `fair and in good faith,' by each finder of fact. This we are unwilling to do."

In our opinion, the best definition of how the parties involved in a workout situation should govern their conduct was handed down in a California appellate court decision, *Rich & Whillock, Inc. v. Ashton Development, Inc.*, 157 Cal. App. 3d 1154 (1984), which involved a debtor taking advantage of a financially strapped creditor. In that case, the debtor, well aware of the creditor's financial problems and need for cash, gave the creditor the option to accept less money than it was legitimately owned and to sign a release for the balance, or to get nothing. The creditor accepted the money, signed the release and sued the debtor. In setting aside the release and allowing the creditor's suit, the court held, at page 1159:

"The underlying concern of the economic duress doctrine is the enforcement in the market place of certain minimal standards of business ethics. Hard bargaining, `efficient' breaches and reasonable settlements of good faith disputes are all acceptable, even desirable, in our economic system. That system can be viewed as a game in which everybody wins, to one degree or another, so long as everyone plays by the common rules. Those rules are not limited to precepts of rationality and self interest. They include equitable notions of fairness and propriety that preclude the wrongful exploitation of business exigencies to obtain disproportionate exchanges of value. Such exchanges make a mockery of freedom of contract and undermine the proper functioning of our economic system. The economic duress doctrine serves as a last resort to correct these aberrations when conventional alternatives and remedies are unavailing."

The Negotiations

If the workout team appears before the loan becomes "classified? or "written-off", the first objective is to keep the interest payments current thereby preserving an asset on the lender books. From a timing standpoint, the lender has not taken a loss at this point and negotiations for "walk-aways" or settlements would be premature. Prior to writing-off the loan, the question is: How much of the lender's money can be preserved? After the loan is written-off, the lender has already taken the loss and the question, from an accounting standpoint becomes: How much of a profit can be made, from recovery?

The collateral protection and set-aside agreement discussed above is equivalent to immediate first-aid. Now the patient is at the hospital and a diagnosis of the damage and cause must be made and a prognosis rendered, before a sensible solution can be rendered.

Is the dealership worth saving? Can it ever be profitable again? Can the problems that caused its financial problems be rectified? If so, can the present dealer rectify them? What is the risk-reward-probability ratio? In other words, what do the parties expect to make, or lose, if a particular course of action is followed and what are the probabilities of that action succeeding. Both the lender and the dealer must weigh those factors, discuss them and decide upon a course of action. If the dealership's management is good, or can become good by changing personnel, and the circumstances which caused the financial problem can be corrected, benefits to the lender in helping to devise a workout plan which would give the dealership the opportunity to recover, would be immense. In addition to being repaid the outstanding debt, not only would the lender would continue to have a large, profitable customer, but money could not buy the recognition the lender would receive, in the industry, regarding how it participated in a successful workout.

Consequently, the first decision to be made is whether the dealership is worth saving, or whether the parties should proceed with a plan for selling or liquidating the store.

Saving the Dealership

First, a reasonable plan has to be established with respect to the existing principal deficiencies, which is to say: the sold and unpaid units and any past due principal. Assuming the lender has placed a competent keeper in the store, the amount of the sold and unpaid units should not increase. If it does increase, either the keeper is not competent, or the dealer is one with whom the bank does not want to do business. In the former case, the keeper should be replaced; in the latter case, an immediate plan for selling, or liquidating the dealership should be implemented.

Depending upon the degree of confidence the lender has in the dealer, it may be mutually beneficial to set-aside the delinquent amount and make no effort to reduce it, pending completion of the workout. Such an action would enable the dealer to better operate the dealership by using gross profits to, at least minimally, meet operating expenses. The lender, of course, would receive proceeds from any infusion of new capital, or the sale of the dealership, or the sale of a portion of the dealer's interest in the dealership.

There is only so much a dealer and a lender can expect from a plan, even if they are sincerely committed to making it work. Too many times lenders and dealers enter into a workout situation, with the naive notion that everything will be back to normal in a short period of time. The workout plan is, in essence, a business plan for the dealership, which plan, if it works, will also benefit the lender. Each party must, therefore, step into the shoes of the other party, if a workable solution is to be reached. Chrysler Corporation's workout plan took five years. Storage Technology took over three years. If the lender is not willing to make a commitment of at least a year, then the parties should proceed with a plan to sell the dealership. A simple infusion of capital to bring a debt current will not solve the problem and the parties who believe it will usually find themselves, at some later date, returning to the bargaining table with a bigger problem than they had the first time.

Each dealership and each lender is different and the combination of types of dealerships that may be matched with types of lenders is even more infinite. In arriving at a workable plan, consideration must be given to the size of the lender, the size of the dealership, the size of the investment and the staying power of both parties. If the lender, for because of its own size, or for other reasons of its own, cannot participate in a workout plan for the requisite time necessary to successfully accomplish that plan, it makes no sense for the lender to agree to the workout proposal in the first place.

An obvious alternative, which has been omitted from this section because it is discussed at length in another article, is the choice of instituting a plan, which would allow the dealership to obtain alternate financing at another institution. There is much case law regarding a lender's duties with respect to permitting its customer this election and the duties of the parties when pursuing this opportunity; because of the liability aspect, the topic is discussed under the lender liability section.

As always, you should always work closely with a qualified attorney when dealing with out of trust situations.

Starting in 1972, Pico entered the automobile business by representing dealership groups such as Tasha Corporation (once the 17th largest dealer group in the country before it sold to AutoNation), and handling sales such as Lucy DiGulio's sale of her deceased husband's share of Prospect Motors (currently the largest General Motors dealership in the nation) to Skip Halverson.

Before retiring from the active practice of law in 1980 Mr. Pico and his law firm represented numerous automotive dealers in the reorganizations, purchases, and sales of dealerships. He both tried cases as the attorney for the dealerships and arbitrated and mediated dealer related cases.

Mr. Pico built upon his experiences and became a student of the industry by receiving training and attending seminars with respect to the various departments in new car dealerships, participating in National Automobile Dealer Association (NADA) Management Education Program, having "hands-on "experience" operating a store by filling in as General Manager on an "interim" bases. In 1986, after five years of research and two years of writing, Mr. Pico authored and National Legal Publishing Company published the nation's first book on Buying and Selling Automobile Dealerships.

Mr. Pico is recognized as an expert in the field of buying, selling and investing in automobile dealerships. In addition, both State and Federal Courts have also recognized Mr. Pico's expertise and in various legal proceedings he has been:

- Approved by the U.S. Bankruptcy Court, 10th Circuit, District of Colorado, pursuant to Rule 202 of the Bankruptcy Code, as "Consultant to Debtor" in sale of a new car automobile dealership;
- Approved by the U.S. Bankruptcy Court, 9th Circuit, Northern District of California, pursuant to Rule 202 of the Bankruptcy Code, as "Consultant to Debtor" in sale of a new car automobile dealership;
- Approved by the U.S. District Court, 8th Circuit, Wisconsin, as Arbitrator/ Appraiser in new car Dealership litigation;
- Approved by the District Court of Colorado as expert in dealership valuation litigation;
- Approved by the Superior Court of California as:

(a) “Consultant to Court Appointed Receiver" in check-kiting case
(b) "Expert Witness", with respect to dealership valuations, and
(c) Superior Court Mediator in dealership/lender litigation.

The one place to go for advice when investing in an automobile dealership is Advising Automobile Dealers LLC

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