Automobile Dealerships - Out of Trust – Keepers

By: John Pico, BA, JD

The Necessity of a Keeper

When a lender feels its security is in jeopardy, it frequently places a keeper in the dealership. This action is usually precipitated by the lender losing its "comfort level" with the dealer.

While many dealers interpret the placing of a keeper in their dealership as a hostile action on the part of the lender, their reaction is based more upon emotion than logic. The lending officer works for a corporation and the corporation is owned by shareholders. The officer has a duty to the company and to the shareholders to protect their security.

"The act of (a lender) in placing its representatives at the plant of its debtor reflected only the natural instincts, interest and solicitude of any other creditor then in its position, and (the lender) is not on that account alone to be penalized by being declared the principal." **Commercial Credit Co. v. L.A. Benson Co., Inc.** 184 A. 236, at 240 (Md. 1936).

See too: **Cosoff v. Rodman** (**In re W.T. Grant Co**.), 699 F.2d 599 (2d Cir.) cert. denied, at: 104 S.Ct. 89 (1983) where the court said the banks would have been derelict in their duty to their creditors and stockholders if they did not keep a careful watch on the debtor.

The lending officer did not wake up one morning and decide it would be a good idea to put a keeper in the dealership. In the typical case, the dealership had either been experiencing financial difficulties for a period of time, or a series of floor checks revealed the dealer had "sold and unpaid" vehicles of such an unusually high proportion to monthly sales, that the lender classified the vehicles as being sold out of trust. In either situation, a prudent lender must view the dealer from a different perspective.

No one can predict what a person will do under the continued pressure of serious financial difficulties. By the time a lender puts a keeper in a dealership, the burdens the dealer is shouldering have been growing for some time. The dealer usually does not fully comprehend the extent of the strain under which he or she has been functioning; but, when one faces numerous negotiations with creditors, endless days of chasing cash to

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make payroll and pay bills and does not have enough cash to purchase and keep a good trade, one's judgment becomes clouded. An experienced lender knows that a normally rational person can do most anything when placed under a sufficient amount pressure, for a sufficient amount of time.

When the keeper appears, the dealer rather than being vengeful or hurt should realize the dealership needs professional help and seek it. There are many ways to continue operating a dealership with a keeper and to resolve the situation, re-capitalize the store, or sell the dealership at a fair price, vis-à-vis a fire sale.

In most instances, a keeper is placed in a dealership upon the mutual consent of the dealer and the finance company. At the meeting preceding such an action, it is wise for the parties to identify, agree to and understand the specific duties and corresponding actions, of the keeper.

The Keeper's Affirmative Duties

Although the primary concern of the keeper lies in the care and custody of the floored vehicles, in most instances the lender also holds a security interest in all or part of the dealership's assets. Consequently, the keeper will want to be and should be aware of the dealer's attitude towards assets other than the floored vehicles and should report to the credit company any indication on the part of the dealer to dispose of any such assets.

The keeper, usually more than one person, will be at the dealership every business day from the time the first employee arrives, until the last employee leaves. The keeper should be responsible for:

(1) The condition, location and security of the pledged assets;

(2) Keeping the vehicles':

  a. Ignition Keys
  b. Dealer License Plates
  c. MSOs and / or Invoices and other documentation required to transfer title.

(3) Being present when the mail is opened;

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(4) Taking custody of the cash and checks;

(5) Taking custody of the unused check stock;

(6) Supervising preparation of the bank deposit and agreeing upon whom will make the deposit;

(7) The disposition of proceeds on contracts of sold vehicles, to be sure the money gets to the proper parties;

(8) Arranging for third party finance companies, which purchase the dealer's contracts, to include the lender's name on proceeds checks, or, in the alternative, to refuse to permit the dealer to contract a sale to other finance companies;

(9) Being responsible for protecting the vehicles after the dealership closes; if the vehicles cannot be blocked from exiting the facility, via a fence and "blockers", a security guard should be hired;

(10) Establishing a means of maintaining a running, daily, or semi-daily, inventory control of unsold vehicles. Only one vehicle at a time, for which the lender has not received payment, should leave the dealership, whether of not that vehicle is floored;

(11) Being aware of the activities in the Parts Department and its employees.

Courts have approved of lenders controlling the release of the bank's collateral, depositing all accounts receivable in a special banking account and requiring the counter-signature of the bank's agent for all payments from the special account [**Ford v. C.E. Wilson & Co. Inc**., 120 F.2d 614 (2d Cir. 1942)], receiving regular reports on the accounts payable activity, receiving estimated weekly expense budgets [**Edwards v. Northeastern Bank**, 39 N.C. App. 261, 250 S.E. 2d 651 (1979)], proffering advice to the dealer, even coupled with a decision to withhold credit [**In re Beverages International, Ltd**., 50 Bankr 273 (D. Mass 1985), requiring the debtor to hire a consultant acceptable to the bank in the management and sale of the company, requiring the debtor to implement a lockbox with respect to its receivables and requiring certain individuals to pledge their stock in the

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debtor, to the bank [**In re. Technology for Energy Corp**, 56 Bankr. 307 (E.D. Tenn. 1985).

Acts a Keeper Should Not Perform

If the work-out plan ever deteriorates and/or the relationship becomes hostile between the lender and the dealer, or creditors or employees of the dealer, the keeper's will come under the scrutiny of a court. In such a case, those actions could be the beginning of a basis of liability or exoneration for the lender. In order to best protect the lender, the keeper should be aware of the following:

(1) The lender has an affirmative duty not to unnecessarily, maliciously or promiscuously disclose the financial condition of its debtor and any unauthorized disclosure could be a basis for both compensatory and punitive damages. Rubenstein v. South Denver Nat'l Bank, Case No 86CA0840 (Colo. 1988);

(2) Participating in board meetings and exercising decision making authority with respect to the day to day operations of the business could make the lender liable for all of the debts of the debtor. Lurgen, **Liability of a Creditor in a Control Relationship With Its Debtor**, 67 Marq. Law Review 523 (1984); See too: **Restatement (Second) Agency**, Section 14-0, Comment "a";

(3) Evidence of personality conflicts with the borrower could support a bad faith claim by the debtor. **K.M.C. v. Irving Trust Co**., 757 F.2d 752 (6th Cir. 1985)

(4) Making threats which the lender is not prepared to carry-out, may support a fraud action against the lender. **State Nat'l Bank of El Paso v. Farah Manufacturing Co**. 678 S.W.2d 661 (Tex. App. El Paso 1984).

(5) Misleading a lender who intends to refinance the debtor, as to the debtor's financial condition may result in liability to the third party lender. **General Motors Acceptance Corporation v Central National Bank of Mattoon**, 773 F.2d 771 (7th Cir. 1985).

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Note too: while a factory does not seem to owe a duty to protect a lender's floor plan status, to inform the lender of the fact that the dealer is going to sell, there is a triable issue of fact as to whether or not the factory has a duty to disclose the foreseeability of the dealer going out of trust. **Beneficial Commercial Corp. v. Murray Glick Datsun**, Inc. 601 F.Supp. 770 S.D.N.Y. 1985).

Procedures for Handling Insurance and Service Contract Monies

Some lenders have experienced staffs, which understand the above issues and problems. In any case, the dealer should be aware of them and should open new trust accounts. The accounts should be opened at a separate bank, in order to avoid any misunderstandings. If the lender wishes to audit these new accounts, that is fair. If a lending officer threatens to penalize the dealer for protecting the customer's money, he or she is being unreasonable and the dealer should ascend the chain of command until reason prevails. If reason does not prevail, the dealer has hard evidence of the lender creating an untenable position, which evidence may prove useful at a later date.

The handling of the premiums for life, accident and health insurance, and for service contracts, does not create a problem, if a routine is established. Always, with respect to insurance premiums, and usually with service contracts, the sale is covered under a security agreement. The lender and dealer should agree that all "time sales" will be restricted to the lender, unless a third party financing company agrees to put the lender's name on the proceeds check, which usually does not happen.

When a time-sale is being arranged, advance approval of the lender is should be required. Subsequently, when the contract is offered to the lender for purchase, the lender should deduct the amount necessary to release the flooring. If the proceeds of sale are insufficient to clear the flooring, the keeper should have already deposited the cash down payment, and/or have taken possession of the title to the trade-in.

The proceeds of sale, in excess of the flooring, are given to the keeper, who supervises the deposit of the service contract and insurance monies to the trust account and the mailing of the premiums to the appropriate

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insurance companies. If possible, the pay-off for the traded vehicle is also made from the general account of the dealership.

The above process, while time consuming, is necessary. The parties should appreciate the understanding, patience and cooperation needed from each other in order to make the operation run smoothly. If either the keeper, or the dealer, has a problem working with the other, the problem should be discussed with the keeper's superior and resolved, or a new keeper assigned.

Procedures for Handling Payroll Monies

With respect to payroll monies, the dealership should continue with separate payroll account and the lender should agree to permit a payroll large enough for sufficient personnel to run the dealership in order to complete whatever stage of the work-out plan the parties have reached. If the dealership is winding-down sufficient payroll should be allowed for a "skeleton crew" to prepare the dealership for sale, or closing. Equipment will have to be guarded and maintained. Secretarial and accounting work will have to be completed. With respect to sales people, although they do fall within the minimum wage laws, they only get paid a commission if they make a sale and, if they do, they probably will have sold the asset for more money than the lender would get at an auction. The source of funds to cover the dealership operations is discussed in the next section.

Commissioned Salespeople

As mentioned, the commissioned salesperson gets paid a commission if and only if a contract for the sale of a vehicle cashes. They represent the best means of obtaining full value for the lender's security. Consequently, the lender, regardless of its security interest, would probably be wise to subordinate its interest to the extent necessary for the sales people to earn a reasonable commission.

Closing a dealership is covered in another article. At this point, it is enough to mention that a lender, liquidating foreclosed vehicles, would have to deduct transportation, insurance, storage and auction fees from the forced liquidation sales prices of any vehicles it sold, before receiving any monies itself. Therefore, the amount of a salesperson's commission for selling

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vehicles, net of the foreclosure costs, would appear to be a good investment, on the part of the lender.

An interesting question arises as to whether or not the lender has an implied duty, knowing the sales people are liquidating the inventory for the benefit of the lender, to inform the sales people that it, the lender, intends to keep all of the gross profit from the sale; and, further, if the lender, knowing it does not intend to allow the sales people to be reimbursed for their efforts, says nothing, do the sales people have an action against the lender?

In any event, the payment of employees (salaried or commissioned) should be made by the dealer from a separate payroll account. The account should be funded under the supervision of the keeper, but the lender's employees should not participate in distributing the funds. Note: Participation in distributing the company payroll could make the lender liable for taxes. 26 USC 3505 and 6672.

Division of the Discretionary Income

Vehicle Income

If a lender maintains a security interest in the dealer's vehicle inventory and if the dealership has collected and spent money for vehicles which have been sold, without reimbursing the lender for those vehicles, then the dealership's gross profits from all future vehicle sales should be applied to reduce the number of sold and unpaid units. The cash profits from such sales should be applied immediately to the lender's debt, such as vehicle gross profit, finance and insurance commissions and service contract profits. Factory rebate money and incentive monies should be assigned to the lender and applied to the borrower's debt only upon receipt of the actual cash.

Service Department Income

Unless the dealership is averaging a 100% service absorption rate of its fixed overhead expense, which is unlikely, trying to operate a dealership on the service department's income will be difficult, if not impossible. If the lender is unable or unwilling to allow these monies to be applied to the

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general operating fund of the dealership, it means the lender has decided to close the dealership, whether it believes so or not.

The service department monies include gross profits from parts, service, labor and the body shop, if the dealership has one. The percentage of all fixed overhead expenses covered by this profit reflects the dealership's absorption rate.

If the dealership is being sold or closed, these monies should be used to complete the payrolls necessary to accomplish an orderly transition or liquidation.

As always, consult with a qualified attorney whenever 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.

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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.

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