Automobile Dealerships - Out of Trust - Tips for Lenders

By: John Pico, BA, JD

Out of trust positions do not cure themselves and regardless of past cordiality's, any situation involving a bad loan could always result in litigation. Accordingly, a lender should immediately begin to position itself in a light most favorable for litigation by always conducting itself in a business-like manner. The phrase "business like" means in a straight forward, professional manner.

The lender should decide upon a tentative course of action and then have a meeting with the dealer to discuss the problem and possible solutions. The dealer should be immediately made aware that the lender recognizes the problem, although perhaps not the cause, and that while the parties have a mutual interest in solving the problem their interests will probably conflict at times because each party has a duty to protect its own shareholders; therefore, the dealer should rely upon his or her own advisors (attorneys, accountants, consultants) for advice.

While workout personnel must be as blunt as possible, care must be taken to avoid their actions being construed as "management" or "control" of the dealership's business. Once the "control" line is passed, the financial institution exposes itself to a variety of legal actions. For its own protection, the lender should have written internal policies that state:

> (1) None of the lender's employees have either permission or authority to make oral promises to the dealer; ***Kruse v. Bank of America***, 202 Cal. App. 3d 38 (1988).
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> (2) None of the lender's employees should ever speak disparagingly about the dealer or the dealer's advisors; ***K.M.C. v. Irving Trust Co.***, 757 F.2d 752 (6th Cir. 1985).
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> (3) None of the lender's employees should ever make threats upon which the lender is not prepared to act; ***State Nat'l Bank of El Paso v. Farah Manufacturing Co.*** 678 S.W.2d 661 (Tex. App. El Paso 1984).
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> (4) None of the lender's employees should divulge to nonmaterial third parties any information concerning the

dealer's financial status, without the prior written consent of the dealer; ***Rubenstein v. South Denver Nat'l Bank***, Case No 86CA0840 (Colo. 1988).

(5) None of the lender's employees have the authority to make management decisions regarding the day to day operations of the dealer's business; Lurgen, Liability of a Creditor in a Control Relationship With Its Debtor, 67 **Marq. Law Review** 523 (1984); Also see: Restatement (Second) Agency, Section 14-0, Comment "a".

(6) All of the lender's employees are required to make memos to the file regarding conversations with the dealer and they should be conscious of that fact whenever speaking with the dealer or the dealer's advisors; the employee should not engage in the kind of conversations or perform the kind of actions that would cause embarrassment to the lender if the information regarding those conversations and actions were to be contained in a written memo to be read by a judge or jury.

(7) The lender must work closely with its own attorney during the entire workout process.

These rules should help ensure a business like atmosphere and a business like approach to resolving the problems at hand and thus increase the probabilities of accomplishing a successful workout.

The lender should make the dealer aware that while the lender has no intention of operating or controlling the dealer's business, certain basic procedures will be required to protect the lender's interests amongst which will be reducing agreements to writing.

Having met with the dealer, the lender should permit the dealer an opportunity to seek outside advice. The circumstances of each case will dictate the definition of a reasonable amount of time. Sometimes an hour could be too long, other times a day too short. After deciding upon a time to reconvene, the lender should be prepared at this second meeting to enter into a "COLLATERAL PROTECTION AND SET-ASIDE AGREEMENT" that

includes, in addition to the standard contract language regarding default, jurisdiction and term, the following:

(1) Recite the outstanding obligations of the dealer to the lender;

(2) Enumerate the notices given by the lender to the dealer, informing the dealer of the problem and enumerating the dealer's responses to the notices;

(3) Make demand upon the dealer for full payment of all indebtedness owed the lender, by the dealer and the dealership;

(4) Have the dealer acknowledge, individually and as president of the corporation, both the dealer's and the dealership's inability to pay;

(5) Recite any workout arrangements agreed upon between the lender and the dealer, such as additional capital loans and how the proceeds from said loans will be spent, method of pay-back, use of demonstrators, the method agreed upon for handling the out of trust monies, the method to be used with respect to the funds received from continued operations, additional security, if any, by the dealer, or the dealership, the method of handling any future floor-plan advances;

(6) Provide for the lender's use of a "keeper" at the dealership premises, listing the keeper's duties and obtaining the dealer's written consent thereto;

(7) Provide a contingency clause for the lender to take further actions, without notice, in the event the lender's collateral continues to deteriorate, or in the event the dealer breaches the agreement;

(8) Provide for affirmative covenants of the dealer, with respect to further documentation, method and time of payments to the lender, security of the lender's collateral, delivery of receipts

and collateral and payment of the lender's expenses, with respect to protection of its collateral.

THE ABOVE COLLATERAL PROTECTION AND SET ASIDE AGREEMENT IS ONLY AN INTERIM TOOL, TO PROVIDE THE LENDER AN INCENTIVE TO PROCEED WITH A WORKOUT PLAN. IT IS NOT THE PLAN ITSELF.

With the above acts accomplished, the lender should make every legitimate effort to have its dealer succeed. A successful workout plan provides good relations not only with the lender's debtor, but it also establishes a standard in the industry with which other business people wish to become associated. It shows the world the lender knows what it is doing.

As soon as the protection and set aside agreement is signed, the parties should immediately discuss a realistic plan for permitting the dealership to work out of its problems. The resulting plan could be anything from recapitalization to liquidation. The process for developing a plan is covered in another article.

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.

www.AdvisingDealers.com