

Buying and Selling Automobile Dealerships - Limitations When Negotiating the Contract

By John Pico J.D.

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Duties of and to Shareholders

The sale of control of a corporation at a premium is not in and of itself a breach of duty. A "premium" is that amount an investor is willing to pay to gain control of a corporation.

But, a sale of control under the following circumstances may be actionable:

1. The sale of control is in effect a disposition of control over a business asset which the corporation may not use to the corporation's advantage. Example: if a majority shareholder sells his shares to a party that is paying a premium for control over certain transactions, but who otherwise would not pay a premium for the corporation itself.
2. The majority shareholder failed to disclose receipt of a premium when a purchaser attempted to acquire the minority's share;
3. The majority shareholder failed to disclose favorable employment contracts, profit sharing agreements and the like.
4. If the offer is to purchase all shares at the same price, but the majority first buys-out the minority at a lower price, without disclosing the higher offer the minority shareholder.

Although the law is still developing it appears the minority may be eliminated at a lower price, if there is a legitimate business purpose.

State case and statutory law is diverse on the question of minority shareholder rights. Given two identical fact situations, a sale by majority shareholder could, for example, give rise to a cause of action in California, while conforming to Delaware law. In sales involving several shareholders, the attorneys for each shareholder should research the question of "premiums", with respect to both t h e state of incorporation **and** the state wherein the company's principal place of business is located.

Duties to Other Purchasers

Probably the biggest case in this area was a Houston jury's award of \$7.53 billion in actual damages and \$3 billion in punitive damages to Penzoil Co. In 1984, Penzoil was negotiating a takeover deal with Getty Oil Co., which Texaco eventually purchased for \$10.2 billion. Penzoil then sued Texaco for \$14 billion, charging that Texaco coaxed Getty into jilting Penzoil takeover deal.

Intentional interference with contractual relations, intentional interference with prospective business advantages and related torts are "hot ticket items" and general and punitive damages are almost unlimited. **This exposure provides another reason both buyer and seller should involve their attorneys to a greater extent than just having them review the Buy-Sell Agreement.**

Opinions as to Performance

Sellers inevitably opine how well a dealership will do with additional capital or a new owner and the courts have generally supported the adage "No one can predict the future" and refused to recognize a cause of action based upon one party's predictions, to the other regarding future events, performance, opinions, or intentions.

Statements such as "there are no bad franchises -- only bad operators"; the store was "a gold mine"; or that the buyer would make more money than before have been held "purely opinion, puffing, or conjecture as to future events" and as a matter of law not actionable.

Automobile dealerships are anomalies in the field of buying and selling businesses because by the very nature of the business both parties must be amongst the most knowledgeable people in the field, as the seller has already been qualified by both the factory and a financial institution as having that special knowledge and extra skill necessary to be approved as a dealer; and the buyer by virtue of the fact that the buyer intends to purchase the dealership has represented that he possesses the knowledge and skill necessary to obtain factory and finance approval, or that someone on his team possesses the necessary qualifications.

In ***Denison State Bank v. Madeira*** the defendant purchased an automobile dealership and in addition to refusing to pay his loan, he cross-complained against the bank alleging the bank misrepresented and omitted material facts about the dealership when he purchased it. In reversing a jury verdict against the bank the appellate court stated the defendant was a knowledgeable car man and although he testified he trusted and relied upon the Bank to furnish him complete, honest information, he could not abandon all caution and responsibility for his own protection and unilaterally impose a fiduciary relationship on the bank without a conscious assumption of such duties by the bank. See too: *Kruse v. Bank of America* where the court stated the plaintiffs could not have reasonably expected what they said they expected from the bank's promises and assurances.

But Beware: In ***Martens Chevrolet, Inc.*** the owner of the dealership was negotiating with the plaintiffs to sell his dealership and in response to plaintiff's inquires as to the profitability of the dealership the owner indicated that it was "mildly profitable" and offered produced a handwritten trend sheet prepared by his accountants supporting the statement and stating that the audited statements of the dealership's operations were not complete or available.

After the purchase, the buyer learned that the dealership was operated at a loss as reflected in audited statements prepared prior to the negotiations and sale sued alleging breach of contract, deceit and

negligent misrepresentation against the former owner. The Court assumed a duty existed between the former owner and the buyer and reaffirmed the tort of negligent misrepresentation against the dealer.

Special Rules for Accountants

There are three different tests employed by other courts to determine what, if any, duty an accountant has to a third party, in preparing a financial statement for his own client. These tests were:

1) The Traditional (Ultramares) Approach holds that before a plaintiff could sue an accountant he had to have privity, or a relationship equivalent to privity. The Plaintiff must establish:

(a) the accountants must have been aware that the financial reports were to be used for a particular purpose or purposes;

(b) in the furtherance of which a know party or parties was intended to rely; and

(c) there must have been some conduct on the part of the accountants linking to that party or parties, which evidences the accountants' understanding of that party or parties' reliance. See: ***Ultramares v. Touche and Credit Alliance Corp v. Arthur Anderson and Co.***

2) The Foreseeability Approach holds that an accountant is liable to a third party whose reliance on the accountant's services was reasonably foreseeable to the accountant. Accordingly, an accountant who prepares an audit report is liable to a third party for negligent misrepresentation if it is reasonably foreseeable that such third party might obtain, and rely on, the audit report. This is an expansive view of accountant liability and even a number of the small group of states that adopted it, have retreated from it. New Jersey, for example, passed a more restrictive statute: *N.J. Stat. Section 2A: 53A-25 (L. 1995, 2000)*.

3) The Restatement Approach adopted over half the states that holds an accountant is liable to third party if he supplies information to a third parties that is actually foreseen as a user of the information for a

particular purpose. In other words, for liability to attach the plaintiff must be a member of a limited class to whom the accountant intends to supply the information, or to whom the accountant knows the recipient intends to supply it, and who suffers a loss through reliance on the information for substantially the same purposes as the bona fide client. For example, the accountant may be held liable to a third party lender if the accountant is informed by the client that the audit report would be used to obtain a loan, even if the specific lender remains unidentified or the client names one lender and then borrows from another.

Libel and Slander

Every jurisdiction has statutory definitions for libel and slander, the elements of which include a false and unprivileged publication by writing or orally, which has a tendency to injury a person with respect to his office, trade, or business. Included are statements impugning the competency of a dealer to manage the affairs of a dealership.

During the course of negotiations, a buyer sometimes become frustrated with a seller's actions and expresses those frustrations by impugning the seller's ability to operate a dealership. Such statements, while generally harmless, assume a magnified significance, when the purchaser is negotiating to acquire a financially troubled dealership. At best, under such circumstances, lenders are apprehensive; at worst, they are neurotic. Invariably, at some point during the negotiations, a purchaser will meet the seller's lender and at that point in time -- more than any other -- the prospective purchaser must realize that he has the ability to damage the seller and must be disciplined enough to be discreet when commenting upon the seller's status, or abilities, regardless of how determined a lender's inquires may appear.

Interference with a Contract or Prospective Contract

Whether or not a prospective buyer becomes the ultimate purchaser, the prospect has a duty not to intentionally or negligently interfere with a contract, or, in many states, a prospective business advantage, of the seller. Again, during the course of negotiations, there are occasions

when a purchaser is tempted to say or do something in order to frighten a competitive bidder and preserve an exclusive business opportunity. Such actions are proscribed and when called upon to determine the legitimacy of the purchaser's actions the courts will generally consider the following factors:

- (a) the conduct
- (b) the motive;
- (c)) the interests of the other with which the actor's conduct interferes;
- (d) the interests sought to be advanced by the actor:
- (e) the social interest in protecting the freedom of action of the actor and the contractual interests of the other;
- (f) the proximity or remoteness of the actor's conduct to the interference, and
- (g) the relationship between the parties.

See *Second Restatement of Torts* and ***Buckaloo v. Johnson***.

Summation

The increased dollar value, of dealerships, combined with the higher level of sophistication of today's automobile dealer, versus the automobile dealer of twenty years ago, has led to more dealers being willing to litigate, when they have been damaged. Recently, that litigation has expanded from dealers suing manufacturers, to dealers suing dealers. If one had to predict the area in which litigation will expand, in the next ten years, one would have to include in that prediction the area surrounding buy-sell negotiations.

The courts have held, time and again, that hard bargaining is part of the American system [***Sheehan v. Atlantic International Insurance Co.***, but they have also noted, that the notions of fair play and a sense of propriety are also a part of that system. [***Rich Whillock, Inc. v. Ashton Development, Inc.***] And, while many scholars agree that the most successful negotiations result in solutions where both parties, to one degree or another, win, the courts recognize that each party not only has

a duty to protect their own interests and that of their shareholders [*Cosoff v. Rodman (In re W.T. Grant Co.)*], but that people who do not affirmatively perform that duty [due diligence], have no cause of action against their opponents, because the opponents did not perform the duty for them. [See: *Dennison State Bank v. Madeira, 230 Kan. and Macon County Livestock Market, Inc. v. Kentucky State Bank, Inc.*].

In summation, the negotiation table is a business table, at which, both parties are expected to be at their best with respect to preparation, presentation and determination. If one party is lacking in one of the categories, it is not the responsibility of the other party to supplement the deficiency. To the contrary, the participants have a duty to themselves, their families and to their shareholders to obtain the best possible terms, without unjustly fettering the opposing party's ability to respond.

John Pico is the founder and managing partner of Advising Automobile Dealers LLC, has represented and advised dealers since 1972 and has been recognized by both state and federal courts as an expert.

He also served as court appointed "Consultant to Debtor" in bankruptcy cases, "Court Appointed Mediator" in automotive disputes, "Court Appointed Arbitrator / Appraiser" in partnership disputes, "Court Approved Consultant to Receiver" in a check-kiting case, as a "Superior Court Mediator" in dealership/lender litigation.

He has consulted on upside-down positions and out of trust positions in the millions of dollars and has completed over 1,000 automobile dealership transactions, whose combined values exceed One Billion Dollars. He also authored, and National Legal Publishing Company published, the first book in the Library of Congress on Buying, Selling and Representing Automobile Dealerships.

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