

Site Control For Automobile Dealerships in the 21st Century

By: John J. Pico, JD

This article is the first in a trilogy of articles regarding site control.

An understanding of site control sometimes referred to as “point protection,” is important with respect to the dealer’s intended use for the property and becomes extremely important if a dealership proves not to be successful. [A “point” is a location where a manufacturer or distributor (hereinafter referred to jointly as “manufacturer” or “factory”) either has or wants a dealership.]

As explained below, there are many forms of site control. There is a distinction, however, between site control as it applies to non-dealership real property and site control regarding new car dealerships. Because of the many forms and because of the distinction with respect to car dealerships, it would be wrong to generalize that site control per se is either good or bad. Each case must be assessed individually.

A right of first refusal almost always chills a land owner’s ability to sell the real estate. The theory being that a prospective third party purchaser would not be as easily inclined to spend the time, money and energy required to compose an offer for real estate, knowing the tenant has the right to accept the offer and obtain the benefit of the third party’s research and bargaining when the optionee exercises his option.

In the case of a sale of an automobile dealership, that statement is rarely true.

BACKGROUND

While site control had been around for decades, the surge in real estate prices, in the 1970s and 1980s saw many metropolitan dealers selling their facilities for what seemed then to be astronomical sums. Properties that dealers purchased, or constructed for a few hundred thousand dollars in the 1940s, 50s and 60s were, by the late 1970s, selling for millions.

As real estate prices escalated, so did the cost of replacing the facilities and manufacturers were finding it difficult to obtain dealers to invest in many of those areas.

Consequently, by the mid 1980s site control began to appear for the first time in Sales and Service Agreements of the factories.

For a short time back in the 1980s, there was a conflict between dealers and Chrysler Realty Corporation (Realty) when Chrysler sold Realty to an independent, non-automotive company, ABKO.

The situation in the 1980s was an anomaly and since Chrysler repurchased Realty from ABKO, all of the factory realty companies have been owned by the factories, whose goal is to support their dealers.

In the mid 1980s, when a few factories began to include rights of first refusal in their service and sales agreements, most people thought the restrictions would affect the sales price of dealerships and their facilities by chilling prospects and diminishing offers.

By the 1990s, every manufacturer's sales and service agreement contained a right of first refusal and, by the turn of the century, no one thought anything about it.

By the year 2000, dealers discovered that the manufacturer's right of first refusal had absolutely no effect on the sales price of dealerships or their facilities.

Over the course of the past 20-years, we have never seen or heard of a case where a dealership sold and the dealer received less blue sky because of site control, or the purchase price of the facility was discounted because of site control.

Even in the few instances that the factories have exercised their options, we never heard of an instance where there was a "discounted price" because of the right of first refusal.

Generally, the factory exercises its right and just hands the existing contract to a dealer of its choice and the new dealer pays a full commercial retail for the business and real estate.

Below is an example of the wording in Mercedes-Benz USA's Sales and Service Agreement:

IX. TRANSFERS

B. RIGHT OF FIRST REFUSAL OR OPTION TO PURCHASE

1. **Rights Granted** If a proposal to sell Dealer's principal assets or transfer the majority ownership interest in Dealer is submitted by Dealer to MBUSA, or in the event of the death of the majority Owner of Dealer, MBUSA has a right of first refusal or option to purchase such assets or ownership interest, **including any leasehold interest or realty**. MBUSA's exercise of its right or option under this Section IX.B supersedes Dealer's right to transfer its interest in, or ownership of, the dealership. MBUSA's right or option may be assigned by it to any third party and MBUSA hereby guarantees the full payment to Dealer of the purchase price by such assignee.... [Emphasis added.]
....

4. **Option to Purchase** In the event of the death of the majority Owner or if Dealer submits a proposal which MBUSA determines is not bona fide or in good faith, MBUSA has the option to purchase the principal assets of Dealer utilized in Dealership Operations, **including real estate and leasehold interest**, and to cancel this Agreement and the rights granted Dealer hereunder. The purchase price of the dealership assets will be determined by good faith negotiations between the parties. [Emphasis added.]

Below is an example of the wording in General Motors' Sales and Service Agreement:

12.3 Right of First Refusal to Purchase

12.3.1 Creation and Coverage

If Dealer submits a proposal for a change of ownership under Article 12.2, General Motors will have a right of first refusal to purchase the dealership assets or stock and such other rights proposed to be transferred regardless of whether the proposed buyer is qualified to be a dealer.

12.3.2 Purchase Price and Other Terms of Sale

(a) Bona Fide Agreement

If Dealer has entered into a bona fide written buy/sell agreement, the purchase price and other terms of sale will be those set forth in such agreement and any related documents, unless Dealer and General Motors agree to other terms.....

12.3.3 Consummation

Dealer agrees to transfer the property by Warranty Deed, where possible, conveying marketable title free and clear of liens and encumbrances. The Warranty Deed will be in proper form for recording and Dealer will deliver complete possession of the property when the Deed is delivered. Dealer will also furnish copies of any easements, licenses or other documents affecting the property and assign any permits or licenses necessary for the conduct of Dealership Operations.

A number of factories even provide in their Sales and Service Agreements for reimbursement to the perspective purchaser if the factory exercised its option. The following examples are from the Mercedes and Ford Sales and Service Agreements:

Mercedes-Benz USA's Sales and Service Agreement

IX. B. 3. Right of First Refusal.

If, as a result of MBUSA's exercise of its right of first refusal, Dealer is contractually obligated to reimburse the initial buyer for reasonable attorney's fees, broker's fees, title searches, property inspections, and other similar costs and fees that the buyer incurred in connection with the buy/sell agreement, MBUSA shall reimburse Dealer for such costs and fees in an amount up to but not exceeding Fifty Thousand Dollars (\$50,000.00). Dealer shall provide MBUSA with all documents substantiating such costs and fees as MBUSA may reasonably request.

Ford Motor Company's Sales and Service Agreement

24. (b) Company Right of First Refusal to Purchase.

(6) The Company agrees to pay the reasonable expenses, including attorney's fees which do not exceed the usual, customary, and reasonable fees charged for similar work done for other clients, incurred by the

proposed new owners and transferee prior to the Company's exercise of its Right of First Refusal in negotiating and implementing the contract for the proposed sale or transfer of the Dealer or Dealer's assets.

DEFINITION OF AUTOMOTIVE SITE CONTROL

Site control is when a dealer grants to a manufacturer, its real estate company, or its finance company the right to decide the use of a dealership's real property.

In general, site control means that for the duration of the agreement, a dealer's interest in the dealership facilities and real property may never be sold, leased, assigned, or encumbered in any manner, without the written consent of the factory, or its representative, which consent must be obtained in order before the real estate may be used for any purpose, other than as a new car dealership, for the particular manufacturer which has the control.

Usually the site control is not only for a specified period of time, but it may also for a specified rent, or brand vehicle, or any combination of those items.

There are both advantages and disadvantages to a facility being encumbered by site control.

Site control may affect the value of the dealership real property in several ways:

1. **Loan Value.** One could find it more difficult to get a 2nd mortgage if a property appreciates in value and the rent is fixed at a certain rate for a number of years.
2. The difficulty, if any, would depend upon a number of factors. For example, the strength of the business being operated on the property would play a large roll, as would the willingness of the entity possessing the site control to agree to a change in the rent.

Conversely, site control could be a plus when financing a property. A dealer may be able to qualify for a loan that would otherwise be impossible to obtain without site control. See: ***Beaudry Motor Company v ABKO; Chrysler Corporation and Chrysler Realty Corporation***, 780 F.2d 751, 4

Fed.R.Serv.3d 142 (1986), where a dealer could not qualify for a loan without the benefit of site control.

3. **Lease value.** If the dealer terminates or is terminated, usually the factory has a right to lease the facility for a specified term and at a specified rent. In the 1980s there were a couple of instances where insolvent dealers received offers from competing factories to purchase the dealership facility. Had either dealer given the factory site control, the offers could not have been entertained as the facilities were in desirable locations and General Motors would probably not have consented to having their facilities become dealerships for a competing brand. The mere fact such offers could be entertained, raised the value of the real property because it brought in competitive bids, from strong buyers.
4. On the other hand, if a dealer fails in his business, the factory can (a) continue to lease the property from him, thus building equity for the former dealer; (b) return the site control to the dealer for him to do what he wants with the property; or (c) purchase the property from the dealer. In many instances, in a cold real estate market (such as the early 1980s, the mid-1990s and the era after 2008), the factory is the only legitimate buyer for such a special use property. Through 2008, 2009 and 2010 there have been a glut of vacant dealerships throughout the United States.
2. **Resale value.** Again, back in the 1980s, there were instances where dealers had purchase offers for the dealership real property from non-automotive buyers, but they were precluded from accepting them because the factory had recorded point protection.

Today, however, many of the use limitations imposed by both public and private entities limit the use of dealership facilities to new car dealerships.

Use Limitations

Obviously, a single point dealer intending to deal with another manufacturer, would require the prior written consent of the manufacturer possessing the right to site control. Additionally, a chain dealer (owner of several brand dealerships) would require the manufacturer's consent before rearranging nameplates and facilities.

Two things that have substantially changed the effects of site control in the 21st Century, however, are:

- (a) **City government and Auto Mall Association attitudes.** In 2010, if a property is being used for a new car dealership, it will probably stay a new car dealership. Many dealerships have moved to “auto malls” where both city zoning ordinances, auto mall association by-laws and CC&Rs (Covenants, Conditions and Restrictions) prohibit the properties from being used as anything other than a car dealership, even if the factory does not have site control.

See, for example, the ***Elk Grove City Council Staff Report*** of August 26, 2009, prepared by Heather Ross, Senior Management Analyst, reporting that both the city and the auto mall association restrict the use of dealership property.

Locally, the Automall lots are zoned AC (Auto Commercial) and can only be used for “motor vehicle sales, leasing, repairing and servicing”. Other prospective uses would require a zone change.... The current restriction of uses is also specified in the Elk Grove Automall Design Guidelines, so a text amendment of that document would also be required. There may also be restrictive covenants governing the uses of the automobile properties that the property owners would have to address.

In some states, such as Texas and Colorado, sales tax from car sales goes mostly to the city in which the BUYER resides. In others, like California, however, the sales taxes go mostly to the city in which the car DEALERSHIP resides.

On June 6, 1978 California citizens passed “Proposition 13” which limited the amount of property tax cities could charge its citizens. The proposition was held constitutional by the United States Supreme Court in the case of ***Nordlinger v Hahn***, 505 U.S. 1 (1992) and since the mid 1990s California cities began feeling the economic pinch from Prop 13’s limitations on property taxes.

As a consequence, cities have been striving to restrict current dealership properties for dealership use only because the monies collected from dealership sales taxes usually make car dealers the largest source of income for the city.

The ***Oakland Tribune*** reported how the “steady flow of income” from new car dealerships “provides 50 percent... of the city’s sales tax revenue every year, but city officials are worried about its future. The article goes on to quote the Burlingame City Manager as stating “My concern is how to keep these (auto dealerships) viable long term...” More importantly, it relays the intention of cities to limit dealership property to dealership use. “**Auto dealerships on California Drive sit on prime real estate** from Peninsula to Howard avenues. Auto dealerships were the city’s savior when hotels faltered after Sept. 11, 2001, said Councilwoman Rosalie O’Mahony.” [Emphasis added.] “We certainly need the auto dealers more than any business in the entire city,” she said. May 6, 2006.

See too: ***The Sacramento Business Journal***, March 14, 2008, where auto mall members were against using property within the auto mall to sell used vehicles unless the business was part of a new car dealership.

“It’s (a used car lot) just not something we’d like to see,” said Maggie Tadlock, president of the Elk Grove Auto Mall Association.... Sales of used cars only is “totally different from our expectations for the mall” and “defrays from what we’re trying to do” at the auto mall.

Throughout the first decade of the 21st century, a plethora of articles were written concerning “taxes, cities and dealerships.” See, for example: *San Francisco Business Times*, November 23, 2003; *The Palo Alto Weekly*, June 2, 2004; *Palo Alto Weekly*, September 21, 2005; *The Contra Costa Times*, January 12, 2006; *Los Gatos Weekly Times*, March 29, 2006; *Sacramento Bee*, March 10, 2007; *The Oakland Tribune*, January 2, 2008; and *Ward’s Dealer Business*, April 1, 2009.

All of the above articles have the same themes: (a) the amount of monies automobile dealerships bring to cities; and (b) cities prohibiting dealership properties from being used for anything except automobile dealerships.

(b) **State laws.** On March 22, 2010 Donna Harris reported that there are currently forty states in which franchise legislation has been proposed in 2009 and 2010. ***Automotive News***.

(c)

Even with the restrictions many state laws impose upon site control, it is important to remember that it is more difficult to challenge site-control if the

dealer has been compensated for it by the factory – and factories will generally state that all dealers are compensated. One universal claim of a quid pro quo is the granting of the Sales and Service Agreement to sell the factory's brand of vehicles.

(c) Federal Law. The Federal “Dealer’s Day-in-Court Act” (U.S. Code, tit. 15, § 1221)

About the Author

John J. Pico, JD is the founder of Advising Automobile Dealers, LLC. Since 1972, he has advised automobile dealers throughout the United States on dealership operations, profitability, acquisitions, strategic planning and emerging industry trends.