

CURRENT POSTRESS RESIGNING YOUR FRANCHISE

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IN THE PAST TWELVE TO TWENTY FOUR MONTHS

In the past twelve to twenty-four months, a record number of Ford dealers have voluntarily surrendered their franchises or have had their franchises terminated or not renewed by Ford. Prior to the second half of 2008 when the bankruptcy or insolvency of one of the Big Three was seen as a non-event, this article would have only addressed the rights of surrendering or terminated dealers under the Ford Dealer Sales and Service Agreement (the “Agreement”) and applicable state law. In light of recent developments with General Motors and Chrysler, however, it is critical to also examine the impact on the dealer body of the filing of a Chapter 11 petition in bankruptcy by the automobile manufacturer, specifically with respect to surrendering or terminated dealers.

SURRENDER OF MOTOR VEHICLE FRANCHISE

The Agreement and applicable state law governs the surrender by a dealer owner-operator of a motor vehicle franchise. Generally, to the extent that the applicable state law is inconsistent with the relevant provisions of the Ford Dealer Sales and Service Agreement, applicable state law will govern. We have used the New Jersey Franchise Practices Act (the “Act”) as an example of a state statute that contains significantly greater protections than the Agreement. A dealer contemplating any action covered by this article must consult his or her applicable state statute and his or her own local counsel! The following are certain of the critical provisions of the Agreement and the Act covering the surrender by a Ford dealer of a motor vehicle franchise.

PRIOR WRITTEN NOTICE

Under the Agreement, a dealer may terminate or not renew the agreement at any time by providing Ford with at least thirty (30) days prior written notice. The Act is silent as to any requirement for prior written notice by a dealer desiring to surrender a franchise. Accordingly, a dealer who seeks to surrender his or her franchise to Ford must provide thirty (30) days prior written notice, as required by the Agreement.

To the extent that Ford seeks to terminate (or not renew) a dealer as a result of the occurrence of an event controlled by the dealer (e.g. misrepresentation by the dealer of warranty adjustments, conviction of the dealer principal of a crime in a Court of competent jurisdiction, transfer by the dealer of assets or equity interests not in the ordinary course without the consent of Ford), the Agreement generally requires Ford to provide at least fifteen (15) days prior written notice. In situations where Ford desires to terminate a dealer that is a non-performing dealer, Ford is required to provide at least ninety (90) days prior written notice. The Act, however, mandates that Ford provide at least sixty (60) days prior written notice of termination or non-renewal unless (i) the dealer voluntarily abandoned the franchise in which case fifteen (15) days prior written notice is sufficient, or (ii) the dealer was convicted on an indictable offense directly related to the business, in which case, any prior written notice from Ford is sufficient.

Finally, the Agreement permits Ford to terminate a dealer for any reason upon the provision of one hundred twenty (120) days prior written notice. However, the Act prohibits Ford from terminating or failing to renew a dealer without “good cause”, defined as the failure of a dealer to substantially comply with reasonable requirements imposed upon the dealer by Ford.

REPURCHASE OF ITEMS

Both the Agreement and the Act require Ford to repurchase certain items owned by the dealer upon termination. However, the Agreement mandates the repurchase of such items only if the franchise is terminated by Ford and does not provide for the repurchase of such items if the franchise is surrendered or terminated by the dealer. On the other hand, the Act requires that Ford repurchase such items regardless of whether the dealership is terminated by Ford, surrendered by the dealer or cancelled by mutual consent of Ford and the dealer.

The following tables list the items that Ford would be required to purchase from a dealer surrendering a franchise pursuant to the Act within ninety (90) days of the termination date:

| Item | Unused, undamaged and unsold vehicles |
|------------------|---|
| Agreement | Must be in dealer's stock on the termination date, in first class salable condition, must be of a current model, and not altered outside Ford's factory. Purchase Price: Dealer Price before deduction of any cash or discounts plus Ford's charges for distribution, delivery and taxes minus allowances paid or offered by Ford. |
| Act | The Act does not specify that the inventory for repurchase must be for a current model year. Purchase Price: Dealer net acquisition cost plus dealer cost of handling, packing and loading the inventory. |
| Comments | <ol style="list-style-type: none"> 1. Under a strict interpretation of the Act, unused and unsold vehicles need not necessarily be 2009 model year vehicles; such vehicles could potentially be 2008 and even 2007 model year vehicles. 2. Under the Act, demonstrator vehicles are deemed to be unused and unsold inventory and subject to repurchase by Ford. |

| Item | Unused, undamaged and unsold parts and accessories |
|------------------|--|
| Agreement | Ford's obligations to repurchase parts and accessories are limited to those that were either (i) purchased within the twelve-month period prior to the termination date, or (ii) sold to the dealer by Ford for use in a current model year vehicle. Purchase Price: Dealer Price before deduction of any cash or discounts less allowances paid or allowed by Ford. |
| Act | There is no limitation in the Act that the parts and accessories must have been purchased within the twelve-month period prior to the termination date. Purchase Price: net acquisition cost plus dealer cost of handling, packing and loading the parts and accessories. |
| Comments | <ol style="list-style-type: none"> 1. The parts must be listed in Ford's current price catalog and acquired from the manufacturer or a source approved by Ford. 2. Parts and accessories held by the dealer for display or demonstration are deemed to be unused and unsold parts and accessories and subject to repurchase by Ford. 3. Under the Agreement, the Dealer is responsible to pay for the packaging and boxing of the parts but Ford will pay the dealer an additional five percent (5%) of the Dealer Price of the items packaged and boxed. |

| Item | Special tools |
|------------------|--|
| Agreement | Purchase Price: the fair market value as agreed to by Ford and the dealer and, if they cannot agree, the fair market value as determined by a qualified independent appraiser mutually selected by Ford and the dealer. |
| Act | Purchase Price: Sliding Scale based upon the date on which the special tools were acquired. |
| Comments | <ol style="list-style-type: none"> 1. Under the Agreement, the tools must specifically be designated as "special" in the applicable Customer Service Bulletin, in usable and good condition, reasonable wear and tear excepted, and which were purchased in the three (3) year period prior to the termination date. There are no such limitations in the Act. 2. Under the Act, dealer should be reimbursed by Ford for the dealer's cost of handling, packing, loading and transporting the special tools. |

| Item | Dealer-owned signs |
|------------------|---|
| Agreement | Purchase Price: the fair market value as agreed to by Ford and the dealer and, if they cannot agree, the fair market value as determined by a qualified independent appraiser mutually selected by Ford and the dealer. |
| Act | Purchase Price: Sliding Scale based upon the date on which the dealer owned signs were acquired. |
| Comments | Under the Act, the dealer should be reimbursed by Ford for the dealer's cost of handling, packing, loading and transporting the dealer owned signs. |

| Item | Late payments |
|------------------|--|
| Agreement | If Ford does not pay the dealer for the above items within two (2) months after the dealer fulfills all of its termination obligations, then Ford will advance 75 percent of the estimated amount due with the balance to be paid by Ford as soon as practical thereafter. |
| Act | If Ford does not pay the dealer for the above items within ninety (90) days of the termination date, interest at a rate of twelve percent (12%) per annum shall accrue on the outstanding balance due and payable. |
| Comments | |

LEASE OF PREMISES

Under most (but not all) circumstances, in the situation where a dealership is terminated or not renewed by Ford and the premises are owned or leased by the dealer as a dealership, the Agreement requires Ford to either enter into a lease or a sublease for a period of one (1) year commencing on the ninetieth (90th) day following the termination date at the then fair rental value. This provision does not apply in the Agreement to dealers who surrender their motor vehicle franchise to Ford. If the parties cannot agree on such value, fair rental value will be determined by an appraisal process. If notwithstanding the termination of the franchise, the dealer is able to lease the property to a third party at less than fair rental value, Ford is only required to pay the differential between the fair rental value and the amount of rent that the dealer actually received from the third party.

It is important to note that Ford is not required to provide the assistance set forth in the previous paragraph if (1) the dealer fails to request the above assistance from Ford within thirty (30) days of the date that Ford provides the dealer with a list of benefits available to the dealer upon termination, (2) the dealer does not retire from the sale and service of motor vehicles within the dealer's locality, (3) the dealer does not use good faith efforts to obtain a third party to lease or purchase the premises, (4) the dealer rejects an offer by Ford made with respect to the premises, (5) the dealer or a third party occupies the premises for an alternate purpose, or (6) Ford arranges a cancellation of the lease (if any) with the landlord and the dealer.

It should be noted that the Act does not contain such a provision; however, other state statutes may contain a provision governing Ford's requirement to either enter into a lease or a sublease for a period of one (1) year commencing on the ninetieth (90th) day following the termination date. Consequently, the dealer must consult with his or her applicable state statute and local counsel to determine if the applicable state provides the terminated dealer with greater benefits than those set forth in the Agreement.

RELEASE | _____

The Agreement provides that the payments that the dealer receives upon termination of the franchise will only be provided to the dealer if he or she signs a release with Ford pursuant to which the dealer releases Ford from any and all liabilities (except for Ford's responsibility to pay for the items set forth above). The Act, however, does not condition payment of the items that Ford is required to purchase upon the dealer's execution and delivery of such a release. As a practical matter, however, Ford will require the dealer to sign a release notwithstanding the Act prior to processing the post-termination payments specified above.

DEALER BANKRUPTCY | _____

The simple surrender of a dealer's franchise may not be the panacea to all of the dealer's trials and tribulations. If the dealer has insufficient funds to deal with his or her accounts payable, the dealer may need to take the additional step of filing a Chapter 7 petition in bankruptcy. Under a Chapter 7, a trustee will marshal all of the dealer's assets and pay his or her general unsecured creditors on a pro-rata basis. Of course, the process is complicated by the fact that almost all dealers have secured credit with respect to floor plan financing and capital loans. The dealers have also usually executed personal guarantees with respect to same. At a minimum, a Chapter 7 petition in bankruptcy will present some orderly means of dealing with the usual imbalance between accounts receivable and accounts payable. There are risks that the trustee, armed with enormous power, can claw back monies that have been paid in satisfaction of antecedent debts or to insiders. This is not a step to be taken lightly. Competent local bankruptcy counsel should always be engaged. If a dealer is proceeding in this direction he or she must make certain that the dealership has sufficient funds to pay the required up-front retainer.

You have often heard of a Chapter 11 petition in bankruptcy that involves a reorganization. A dealer who has not set aside sufficient funds in order to pay bankruptcy counsel and to pay an up-front retainer, and who does not have sufficient funds or available credit to operate within a Chapter 11 while seeking reorganization, really has no shot at a successful reorganization. Assuming that a dealer can pass the thresholds set forth above, a Chapter 11 may be the Nirvana for the appropriate situation. What is the appropriate situation? If a dealer has a shingle and/or real estate for which there is a market, meaning that there is one or, better yet, two or more potential purchasers, the Bankruptcy Court will hold off creditors while the dealership, in an orderly fashion, sells the assets to the highest bidder.

Please note that the Chapter 11 bankruptcy petition freezes all litigation. It also stays all rights of the factory to terminate the dealership. This is particularly the case where the filing of the Chapter 11 petition in bankruptcy precedes the notice of termination.

CHANGE OF CONTROL OR WITHDRAWAL FROM THE MARKETPLACE BY THE FACTORY | _____

Under the Act, if Ford were to undergo a change of control or change in ownership of its business operations (i.e. an asset sale, a stock sale, merger, consolidation, reorganization, restructuring, etc.), it may not, directly or indirectly, terminate or fail to renew a dealership. Moreover, under the Act, if Ford were to terminate or cease to operate all or part of its business operations (for example, if Ford were to terminate the Mercury line), Ford must comply with the following four requirements:

- 1 Within ninety (90) days of the effective date of the termination, cancellation or non-renewal, Ford must compensate the dealer in an amount at least equal to the greater of (i) the fair market value of the franchise on the date that Ford announces that it is terminating the applicable portion of its business operations, and (ii) the date on which the notice of termination corresponding to the cessation of the applicable business operations is announced by Ford.
- 2 Ford must authorize the dealer to continue servicing and supplying parts, and service pursuant to Ford issued warranty for a period of not less than five (5) years from the date of termination and must continue to reimburse the dealer for parts and service in an amount no less than what Ford reimbursed to the dealer prior to termination.
- 3 Ford is required to supply the dealer with replacement parts for any goods and services marketed by the dealer for a period of not less than five (5) years from the effective date of termination, cancellation or non-renewal at the price no less favorable than what was in effect prior to termination or at the same price offered to all dealers.
- 4 If the dealer continues to sell and service vehicles following the termination date (as provided for in (2) and (3) above), then the compensation that Ford is required to pay to the dealer can be adjusted.

It should be noted that a termination is deemed to have occurred (triggering the above) if Ford terminates any distinct series, line, brand or class of new motor vehicle; however, a manufacturer is permitted to modify, add or delete models and model names of vehicles (without triggering the above) so long as the particular line, brand, series or class of vehicle is not discontinued.

Again, it is important to note that other jurisdictions may contain provisions that differ from those contained in the Act with respect to termination, cancellation or non-renewal of a franchise by the manufacturer. Accordingly, the dealer must consult with his or her applicable state statute and local counsel to determine the impact of the termination, cancellation or non-renewal of the franchise on the dealer.

THE BANKRUPTCY OF AN AUTOMOBILE MANUFACTURER AND ITS IMPACT ON THE DEALER AND THE DEALER'S RIGHTS

The filing of a Chapter 11 petition by an automobile manufacturer overrules and eliminates substantially all of the protections provided in the Act as well as in the Agreement. The federal jurisdiction of the Bankruptcy Court preempts the application of state law and statutorily provides for the rejection by the Debtor of executory contracts. (11 U.S.C. §365) The Agreement is an executory contract. The Debtor can reject some Agreements and assume others; thus, dealers may be treated differently in a Chapter 11. It is apparent that the automobile manufacturer will use the Chapter 11 process to reduce the number of dealers and force consolidations.

Rejection of an Agreement will give rise to a claim by the dealer against the manufacturer/debtor for damages arising from the breach of the Agreement by the manufacturer/debtor; however, the damage claim is a pre-petition claim. As such, the claim is treated as an unsecured claim and will entitle the dealer to receive only a percentage of the claim as ultimately allowed depending upon the dividend approved in the Chapter 11 Plan for unsecured creditors.

As part of the manufacturer's right to breach the Agreement with the dealer, the manufacturer

also may have the right to escape from the payment of warranty claims, repurchase obligations and all other benefits to which the dealer might otherwise be entitled as part of the Franchise Agreement. Effectively, a rejection of the Franchise Agreement by the Manufacturer will leave the dealer without a franchise, and with a claim for damages upon which it may only receive pennies on the dollar.

Upon the filing of a Chapter 11 by the automobile manufacturer, all creditors, including the dealers, will be stayed and enjoined from pursuing claims which were prior to the filing date against the manufacturer. The exception to the stay will be so called "critical vendors," that is, those vendors, mostly suppliers and parts manufacturers, whose continued business is essential to the ongoing business of the debtor and the reorganization effort. All other creditors will be stayed from receiving any monies due to them from the manufacturer until the confirmation of a Plan and payment of a dividend.

The manufacturer will continue to operate while the negotiation of the reorganization continues among the major stakeholders, consisting of labor interests, bondholders, suppliers and secured creditors. While the dealers will have a voice, it will not be substantial.

If the Plan is one that has been heavily negotiated prior to the filing of a bankruptcy (Prepackaged Plan), the various stakeholders will try to expedite the process and persuade any non-consenting parties to consent to the Plan. All parties will make concessions.

The manufacturer will emerge from bankruptcy a different company. The company will be smaller; its ownership will be different and it will no longer retain all of its franchises for some will have been sold or liquidated during the process.

For the individual dealers, the bankruptcy may mean either the loss of his or her franchise or the renegotiation of his or her other franchise.

CONCLUSION

Although the surrender or termination of a franchise will provide the surrendering or terminated dealer with certain benefits under the Agreement and the Act, these benefits may be abrogated in the event that Ford files a Chapter 11 petition. As stated previously, the rejection of the Agreement by Ford would leave a terminated or surrendering dealer with a claim for damages upon which it may only receive pennies on the dollar, at best.

Ford has recently announced that it has no present intention of filing a Chapter 11 petition in bankruptcy. Accordingly, a Ford dealer who is strongly contemplating the surrender of a franchise or who is negotiating a voluntary termination with Ford (pursuant to which, Ford will agree to pay consideration to the dealer beyond the consideration specified in the Act) should consider proceeding expediently with the surrender/voluntary termination before Ford decides to modify its stated position or is forced to file for bankruptcy protection.

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