NADC
National Association of Dealer Counsel

DEFENDER

The National Association of Dealer Counsel Newsletter MAY 2016

In this Issue:

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Avoiding Successor Liability

By Erin K. Tenner, Esq.

Avoiding successor liability is the single most important objective (aside from getting the deal done) when buying the assets of any business. Typically a buyer will buy assets instead of buying capital stock in order to avoid unnecessary liabilities. Allegations of successor liability after closing can undermine this objective.

Successor liability means a buyer is treated as if it stepped into the shoes, and into all the liabilities, of the seller. This includes everything from income, sales and employment tax liability to environmental liability and liability for lawsuits. Such lawsuits can include liability for failure to comply with wage and hour laws, discrimination laws, sexual harassment laws, and even claims for failure to comply and the cost of defending allegations whether or not true.

A buyer usually pays less for stock because the buyer is buying, or assuming by virtue of buying the stock, all the liabilities that the seller has. When the buyer steps into the shoes of the seller the buyer is said to have assumed "successor liability."

If a lawyer does not understand what creates successor liability and how to avoid it, even a buyer who buys assets with the intent to avoid successor liability can step right into it. Unlike a stock purchase, a buyer should never have successor liability when buying assets. However, missteps along the way often expose buyers unnecessarily to successor liability.

This article will discuss the means by which a buyer can inadvertently assume successor liability and give some specific examples of how it can happen and some tips on how to avoid it.

Unsecured Creditor Claims. Bulk Sales laws are designed to protect a buyer from a seller's unsecured creditor claims. If a buyer complies with the state's bulk sales laws in which the business being transferred is located, the buyer is immune from liability to the seller's unsecured creditors for any claims they have against the seller. Failure to comply, on the other hand, results in the buyer having liability for the seller's unsecured creditor claims–a situation that can be easily avoided. Bulk Sales laws vary somewhat from state to state. Most states have adopted the Uniform Commercial Code provisions. The first step is finding the state's Bulk Sales law's requirements. Often, nothing needs to be done in order to comply with the Bulk Sales laws. The states that do require action typically require either publication of a notice of the pending sale or mailed delivery of notice to creditors.

A common misstep that can create liability where it could have been easily avoided is waiving compliance with the Bulk Sales laws. Often buyers either fail to comply, or could have complied by doing nothing, but instead agree in writing to waive compliance, because nothing needs to be done. This is a mistake. By waiving compliance, the buyer waives the very

protection that was granted by virtue of having done nothing.

After closing of an asset purchase, I sometimes will get a call from my client because one of the seller's creditors is claiming that the buyer has liability for one of the seller's obligations. It usually takes one phone call to get rid of these claims. I can only do this if the parties have agreed in the written terms of the purchase agreement that they will comply with the Bulk Sales laws. I can show this provision to the attorney for the seller's creditor, and invariably the creditor claim goes away. Sometimes the attorney will ask for more, like proof of compliance. If this happens I either send them a copy of the bulk sale notice that went out, or a copy of the Bulk Sales law provisions showing that no notice was required in order to comply and a copy of the provision stating that the buyer has no liability for the claims of the seller's unsecured creditors as long as the buyer complies with the Bulk Sales laws, and then the claim goes away.

If, on the other hand, the purchase agreement says the parties waive compliance with Bulk Sales laws, which I often see in purchase agreements, then the parties have given the attorney for the creditor ammunition to collect the debt from the buyer if they cannot collect against the seller – or even if they can. While the attorney who puts this provision into an agreement might benefit from additional legal fees if they are a litigator, the client will not. I routinely replace the waiver, whether I am representing the buyer or the seller, with language stating that the parties will comply with the Bulk Sales laws. The reasons why are obvious if I am representing the buyer, but even when I am representing the seller I know if the buyer is sued, the seller is going to have defend the buyer under typical indemnity provisions. Although some attorneys will take the position that the indemnity provision is enough to protect a buyer, I see my job as a lawyer as protecting my client from litigation, which costs my client time and money even if they win.

Secured Creditor Claims. Secured creditors claims must also be eliminated so the buyer does not have liability for them in an asset purchase. If secured creditors liens are not removed prior to closing of an asset purchase, the buyer will usually buy the assets subject to those liens. This means the assets can be confiscated in litigation to pay for the amount due. The only exception to this is if there was no public record of a security interest that was granted by a seller and the buyer did not otherwise know about it.

There are several areas in which secured claims can arise. The most common area is by agreement, which typically entails a seller having signed a security agreement permitting the secured party to file a UCC-1 financing statement in the state in which the entity which owns the asset is incorporated and in the state in which the asset is located. A buyer must do a search of both states' UCC records to determine whether any UCC-1 lien notices have been filed. Once the notice is filed, the buyer is deemed to know of the lien whether or not the buyer ever sees the notice of the lien (the UCC-1). This is known as constructive notice. If a buyer has constructive notice of the lien or has actual notice of a lien on an asset the buyer is purchasing, the buyer takes the asset subject to the notice. This means the creditor can seize the asset to pay for the debt secured by the lien if the debt is not otherwise paid. These liens will have to be paid and removed by filing a UCC termination statement prior to closing so that the buyer receives the assets free and clear of the liens.

Tax Liability. Other areas in which secured claims can "follow assets" vary from state to state. For example, in California employment taxes, sales taxes, use taxes, and franchise taxes owed by a seller attach to the assets of the seller without the need for any security agreement or UCC filing and become the obligation of the buyer if they are not paid by the seller. It makes no difference in this situation whether the buyer ever had notice of the unpaid taxes; the buyer can still have liability. To eliminate the buyer's exposure the buyer can obtain a tax clearance certificate or tax release, depending on the circumstances, stating that the buyer will have no liability for the seller's taxes. These certificates or releases can sometimes be obtained prior to closing, but in other circumstances may not be obtainable until after closing. A holdback in escrow of funds sufficient to cover any such taxes is the most prudent way to protect a buyer from liability for unpaid taxes when tax clearance certificates or releases cannot be obtained prior to closing. It will motivate the seller to get the releases or tax clearance certificates issues as soon after closing as possible. Sometimes a tax audit after closing can delay delivery of tax clearance certificates or releases, but a holdback will protect the buyer by providing escrow with funds and authorization to pay any taxes that might be owed.

A UCC tax lien search should also be done which may reveal unpaid taxes that have become a lien against the person whose name is searched. A search of the county real estate records, which can be ordered from a title company in the form of either a preliminary title report or an abstract of title, will reveal fixture filings as well as tax liens for unpaid real property taxes against real estate. The list above is not exhaustive, and often other issues can and do inadvertently result in successor liability.

Employee Claims. One of the most common areas in which successor liability claims arise is in dealing with employees. Typically a purchase agreement will provide that the seller will terminate all employees on closing and then give the buyer the right, but not the obligation, to hire any of the seller's employees or none of them. The purpose of this language is to avoid a claim of successor liability. Buyers' counsel or buyers too often inadvertently create opportunities for an employee to claim successor liability by promising to assume a seller's obligations to employees.

The two most common circumstances I have seen are in connection with vacation time and pay. Well meaning sellers can create a huge headache for themselves by providing confidential payroll information of employees to a buyer without the employee's consent. While the receipt of confidential information by a buyer will not re-

sult in a claim of successor liability against a buyer, sometimes use of the information received can. For example, if the buyer learns the vacation time to which each employee is entitled and offers to carry over the vacation time or seniority policy for all employees hired, or even for certain employees, the decision to do so can result in successor liability. The argument is that the buyer in fact assumed the obligations of the seller with respect to employees rather than hiring each employee anew.

A better way for a buyer to accomplish the same goal would be to simply ask the employee how much vacation time they were receiving in the last position, confirm it in the same manner as for any other prospective employee, and then offer them the same amount of vacation rather than framing it as a carryover or agreement to provide the same vacation the seller did. By simply treating the employee as they would any other new employee being interviewed, they can eliminate the risk of successor liability while accomplishing the same goal.

On a deal I did a couple years ago, I got a call from an attorney who represented one of the seller's employees whom the buyer did not hire. He claimed that my client had successor liability and was responsible for this woman's wrongful termination. The woman had been out on disability leave when the closing occurred so she was not interviewed and was not hired by the buyer. The client had already called his insurance carrier who had agreed to pick up the defense when I heard about it. I spoke with the insurance carrier and asked them to let me call the attorney who was threatening to sue. He went away after a phone call and a letter explaining the law, which was backed up by cases.

My client could have had successor liability, but he did not because the contract said, among other things that were helpful, the seller would terminate all of its employees at closing. It also said the buyer was not obligated to hire any of the seller's employees. In addition, the buyer had not promised employment to any of the seller's employees until he hired them and had not told any of them that he would carry over their benefits from the seller. There has only been one time in thirty years when I have not been able to get rid of one of those calls after closing with relatively little effort. Sometimes people insist on pursuing frivolous claims and there is nothing you can do about that except fight it. However, in any of these situations, had the buyer agreed to "carry over" the same benefits, or assumed the obligations of the seller to any employee either under a medical insurance policy or employment contract, it could have opened up the buyer to exposure for liability to all of the seller's employees who sought to add the buyer as a defendant to any claims, whether by class action or otherwise, against the seller.

In summary, successor liability means the buyer is treated as though s/he bought stock and is responsible for all of the seller's liabilities. However, typically the buyer will have paid more to buy assets than they would have to buy stock, because of the ability to limit liability. There are ways to limit a buyer's liability; however, purchasing assets alone is not enough.

The Bulk Sales laws protect a buyer from liability for the seller's unsecured creditors claims if, and only if, the parties comply with the state's Bulk Sales laws, but not if the parties waive them.

A UCC search, tax lien search, and title search will reveal secured liens against the assets in most cases. Liens must be removed before closing or they follow the assets. State statutes must be reviewed to determine if liens that require no filing attach upon transfer of assets in the state where the assets are located. For liens that require no notice to follow the assets, the best remedy is a holdback agreement and indemnity agreement.

Being careful not to assume seller obligations to employees and providing that only specific obligations will be assumed that are clearly spelled out in the contract are also important. Violations of federal law can also result in successor liability. Provisions can be drafted and steps can be taken to protect against these liabilities as well.

Avoiding successor liability is important, but so is getting the deal done. Both can be accomplished through sound logic, good communication, and a well drafted purchase agreement. ■

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Executive Director's Message

Erin H. Murphy
NADC Executive Director

I am pleased to report that our 12th Annual NADC Member Conference in Palm Beach, FL, May 15-17, was yet another successful event! Two hundred NADC members attended the conference, making it our highest attended conference to date! The warm weather (appreciated by those of us in the Northeast) and the beautiful ocean scenery could only be matched by the excellent program. Thanks to the Conference Planning Committee for providing attendees with an outstanding, timely program.

The conference opened with the annual meeting of the membership during which the NADC membership elected Melinda Levy-Storms, of The Niello Company, to her first term. Three directors were elected to their second term: Michael Dommermuth of Fairfield and Woods, P.C.; Russell McRory of Arent Fox LLP; and Tim Sparks of Sonic Automotive, Inc. The directors will serve a three year term.

The officers were then elected to their second year in office by the new Board of Directors. Stephen Linzer of Tiffany & Bosco, P.A. was elected President, Diane Cafritz of CarMax and Andrew Weill of Benjamin, Weill & Mazer were elected Vice Presidents. Lance Kinchen of Breazeale, Sachse & Wilson, L.L.P. was elected Treasurer and Johnnie Brown of Pullin, Fowler, Flanagan, Brown & Poe, PLLC was elected Secretary. Oren Tasini of Haile, Shaw & Pfaffenberger, P.A. will continue to serve as Immediate Past President.

Andy Koblenz, Executive Vice President of Legal and Regulatory Affairs and General Counsel for NADA, and Paul Metrey, Chief Regulatory Counsel, Financial Services, Privacy, and Tax for NADA, kicked off the conference program with a presentation highlighting the many federal regulatory proceedings in which NADA is engaged.

Next, Eric Case with Bressler, Amery & Ross, P.C., and Mike Charapp with Charrap & Weiss, LLP, discussed selected leading topics in the law for car dealers during 2016.

A panel consisting of Donna Danielewski with The Carl and Ruth Shapiro Family National Center for Accessible Media, Robert Fine and Marc Koenigsberg with Greenberg Traurig, LLP, and Doug Greenhaus with NADA provided an overview of the Americans with Disabilities Act of 1990 and its impact on auto dealers.

Attendees were then treated to lunch and an FTC Workshop discussion led by Andy Koblenz with NADA, Paul Norman with Board-

man & Clark LLP, Joe Roesner with The Fontana Group, Inc. and Richard Sox with Bass Sox Mercer.

After lunch, speakers John Ehlinger with DriveTime, Patty Covington with Hudson Cook LLP, and Dan Soto with Ally Bank discussed how the emergence of the CFPB and the requirement for finance companies to have a Compliance Management System ("CMS") has significantly impacted the auto finance industry.

Diane Anderson Murphy and Sid Tobiason with Moss Adams LLP closed out the day with a discussion on various structuring decisions that can be made prior to a transaction, or within the transaction process, to reduce the tax liability of the seller as well as provide potential advantages to a buyer.

The second day of the conference started with a panel discussion focused on dealer participation programs and products. Speakers Brent Griggs and Mark Barnes with Portfolio and Andy Weill with Weill & Mazer discussed how different programs present different risks and rewards.

Following that session, Kirk Contrucci and Zachary Nienow with Ayres & Associates and Gary Antoniewicz and Eric Baker with Boardman & Clark LLP shared their experience with leverage technology in a recent market-share based termination jury trial involving a farm equipment dealer.

Next, Patrick Anderson and Jonathan Tsarong-Blomker with Anderson Economic Group discussed how to prove dealer damages in territory incursions.

Last, but not least, Michael Semanie with Killgore, Pearlman, Stamp, Ornstein & Squires, P.A. and Joel Winston with Hudson Cook LLP, captivated the crowd until the very end with a presentation on new and developing issues in dealer advertising.

On Monday morning, a breakfast session was offered to the in-house counsel members of NADC. Bob Mizar of The Scali Law Firm offered a presentation on the challenges and pitfalls of ride sharing companies.

Thank you to all of the speakers who presented at the conference. I encourage all of you not in attendance to visit our website at www.dealercounsel.com and benefit from the conference materials that will be uploaded. Please look under the Conference, Workshop and Webinar Handouts section in the eLibrary (12th Annual NADC Member Conference).

I would like to thank all of our event sponsors for their contributions to the Annual Conference. These sponsors help to elevate the quality of the event while keeping the cost low for our members. Many thanks to Anderson Economic Group. Capital Automotive Real Estate Services, Inc. (CARS); CounselorLibrary.com LLC; Dealer Market Exchange (DMX); Dealer Risk Services, Inc.; The Fontana Group, Inc.; GW Marketing Services; Haig Partners LLC; Kerrigan Advisors; Moss Adams LLP; Portfolio; The Presidio Group; and Rosenfield & Company, PLLC.

Be sure to Save the Date for the 2016 Fall Conference! The Conference will be held October 23-25, 2016 at the Radisson Blu Aqua Hotel in Chicago. All NADC educational programs rely on members' suggestions for topics and speakers. If you have a suggested session and/or topic you think should be covered at Fall Conference, please email me at emurphy@dealercounsel.com. ■

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Dealer Counsel Alert – WATCH YOUR EMAIL!

Please watch your email for a mid-week news alert from the National Association of Dealer Counsel. This e-newsletter will focus on current news stories that are relevant to NADC members. *Dealer Counsel Alert* will be sent to the membership in the form of a weekly newsletter every Wednesday and will be archived on the NADC website. This added benefit will further establish NADC as a go-to resource and industry thought leader. All members will have the option of unsubscribing from the e-newsletter. *Dealer Counsel Alert* will launch in June!

Developing & Implementing a Compliance Program for All Departments of a Car Dealership

Feature Article

By Mark Zanan
Total Dealer Compliance

It is no secret that the teams who work inside auto dealerships function primarily as sales organizations, and their main focus is on selling cars, parts and labor, and with good reason. Auto dealers are under tremendous daily pressure due to monthly sales cycles and quotas set by car manufacturers. Consequently, compliance is not always treated as a priority and often set aside to spend more time focused on hitting sales targets. As a result, auto dealers can easily find themselves in hot water with government regulators for cutting corners and not strictly adhering to regulations connected to departments across the dealership including Sales, BDC, F&I, Fixed Ops, HR, and IT.

Proactive and aggressive regulators – many of whom see the opportunity to impose a big fine or enforce a stiff penalty as a way to boost their public profiles for career advancement–see car dealers as low-hanging fruit for a headline-making score. That is why dealers need to be proactive when it comes to compliance. It all starts with the total commitment and engagement of senior management. Without a leadership team setting an example, junior staff will never take it seriously. To avoid that scenario, it is important to design a dealership-wide compliance program that applies equally to all departments.

Another primary benefit of taking compliance seriously is the fact that customers will feel more comfortable doing business with a dealer who adheres to all federal regulations.

Here are a few tips to help your dealership avoid becoming the target of ambitious regulators and costly fines and penalties:

- Hire a third party compliance consultant to conduct an audit of all departments to see where the dealer stands. Based on those findings, the dealer should build a compliance program or training.
- In order for the program to work effectively, be sure to schedule internal quarterly audits.
- Continuing education is key to help dealerships cope with high turnover. Online courses are a great tool for existing staff and new employees who do not have time to attend classes in a traditional academic environment. Be sure to sign up for a program that provides certification upon successful completion of the program. This way you can use that documentation to prove to regulators that your employees are properly trained in compliance issues. It will also put your customers at ease during the sales process.
- Invest in pre-employment screening to be sure you are adding the right people to your team and avoiding any headaches associated with criminal or past fraudulent activity in the workplace. Screening is a great proactive and preventive tool.

The bottom line is auto dealerships must take compliance seriously, and develop and implement an effective compliance program to preserve the income they generate selling cars and avoid making headlines. Doing so requires an investment, but the return is well worth it. In short, you can pay a little now, or pay a LOT later. ■

Max Zanan is the President and CEO of Total Dealer Compliance.
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NADC Topical Practice Groups

In accordance with the NADC Strategic Plan the Board of Directors has decided to activate the following two topical practice groups:

* Regulatory Compliance
* Consumer Litigation

If you are interested in being involved in either practice group, please contact:

Erin Murphy at emurphy@dealercounsel.com.

Call for Presentations – NADC 2016 Fall Conference

Are you interested in presenting at the NADC 2016 Fall Conference?

If you have an interesting and informative program idea, please submit the following to Erin Murphy at emurphy@dealercounsel.com by **Monday, June 27, 2016**:

- Session Topic
- Outline and/or short description of session
- Names and bios of presenters
- Requested length of time

The Program Planning Committee will review all proposals. Proposals not chosen for the Conference will be considered for future webinars and/or the 2017 Annual Member Conference.

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NADC
NATIONAL ASSOCIATION OF DEALER COUNSEL

Volume XII, Number 5
MAY, 2016

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