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Dealer Sales and Service Agreements have pitfalls; buyers beware

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If you are not in the habit of reading documents the Manufacturer puts in front of you to sign, it is time you started. Whether you are signing new documents because you are buying a dealership or renewing your Dealer Sales and Service Agreement, what you find if you read it carefully may surprise you. Manufacturers have been making more revisions that erode dealer rights to their Dealer Sales and Service Agreements in the last five years than in the prior 25 years combined.

Some states protect dealers from overreaching provisions, but even where there are protections many dealers haven't been standing up to the manufacturers by refusing to sign unreasonable documents. Dealers are unwittingly agreeing to things such as allowing the manufacturer to charge their account for money owed to the manufacturer by the selling dealer.

This can cost a dealer hundreds of thousands of dollars. Make sure you give any documents a Manufacturer asks you to sign to your attorney to review before you sign. A manufacturer cannot, in many states, refuse to approve a buyer because the buyer will not agree to unreasonable provisions contained in a Dealer Sales and Service Agreement, or required as a condition for approval of a new Dealer Sales and Service Agreement.

How do you get a manufacturer to do what you want them to do? It's easy. Read your dealer agreement before signing it. Consult with your attorney to find out if any of its provisions violate your state's laws. For example, many states make it unlawful for manufacturers to terminate a franchise without good cause or to fail to approve a buyer without good cause.

Poor sales performance or failure to sign a new dealer agreement are NOT typically good cause for termination. Refusal to agree to unreasonable terms in a dealer sales and service agreement is not good cause for refusing to approve a buyer. Here is a sampling of some of the provisions I have seen for the first time in the last five years:

1. A provision stating the dealer agrees to include in their purchase and sale agreement, if they sell, that the buyer will agree to all the manufacturer's current dealer agreement

provisions as a condition of the manufacturer's obligation to approve the buyer. This provision is prohibited by many state laws that provide that a manufacturer cannot unreasonably withhold consent to a buyer. If a seller has agreed to a provision like this one, the manufacturer can argue that withholding consent was reasonable because an otherwise qualified buyer would not agree to include provisions in the dealer agreement that the prior dealer had agreed to, even if they are illegal. The dealer can still argue the provisions are illegal, it just gives the manufacturer more ammunition to fight that argument.

2. A provision giving the manufacturer or its assignee the right to perform an environmental inspection for purposes of determining whether it will exercise its right of first refusal. It sounds reasonable on its face, but if the buyer has already waived its due diligence and the manufacturer wants to open that can of worms again, it could create a problem for the seller. In some states if the manufacturer exercises the right of first refusal, it must perform all the obligations of the original buyer so that the seller does not lose the benefit of their bargain with the original buyer. This provision erodes the seller's argument that the manufacturer must perform on all the same terms and conditions on which the buyer agreed to perform. Even if the state law does not require it, this is a basic tenant of a right of first refusal. This provision gives the manufacturer the right to exercise their right of first refusal and then walk away leaving the seller without a buyer unless the original buyer wants to step back in after the manufacturer has essentially damaged if not destroyed the deal. Don't agree to it.

3. A provision stating that the manufacturer's sales performance standards are reasonable. They typically are not reasonable and agreeing they are without being able to understand how to meet them is a huge mistake. This is the manufacturer's attempt to circumvent recent case law protecting dealers from incomprehensible and unreasonable performance standards.

Many states have laws protecting auto dealers including California, Connecticut, Delaware, Georgia, Indiana, Louisiana, Minnesota, Nevada and Washington to name a few. If your state's laws protect you, have your attorney write a kind, but firm, letter to the manufacturer educating them. Manufacturers are dealing with 50 states laws. It is easy to think they know the laws of all states, but they generally don't. You have to tell them. When you do, they go to their legal department who checks what your attorney wrote for accuracy. If it is accurate, they will typically back off.

California law provides a good example of how this can work. It protects dealers from termination of their franchise by a manufacturer when the dealer agreement expires. If a new agreement is not signed, the old agreement just continues. It cannot be terminated without giving the dealer the opportunity to be heard before the state Administrative Agency, the New Motor Vehicle Board.

The New Motor Vehicle Board determines, in California, what are reasonable grounds for termination, not the manufacturer. Refusal to sign a new dealer agreement is not reasonable grounds for termination. Rather, failure to sign just continues the old agreement so the dealer does not have to agree to terms different than the ones on which it made its original investment.

Even if you state has not codified such a law, the argument can still be made that the manufacturer cannot cause the dealer to lose their investment by forcing unreasonable new terms on the dealer and there is case law in other states, and maybe even in your own state, that will support this argument. The dealers who are in the best position to fight the manufacturer are the dealers who have not agreed to the new terms when they hurt the dealer.

Many of these provisions could affect you if you try to sell your dealership. For example, manufacturers are notorious for requiring buyers to sign agreements to expand the facilities after purchase. Many states have laws that limit the frequency with which manufacturers can require expansion or remodeling of a facility. In addition, if the expansion requirements are unreasonable based on economic circumstances, natural barriers within the market area, or other relevant factors, a manufacturer can often be prevented from requiring that change as long as the dealer has not agreed to it.

Your attorney can help you work through negotiations with the manufacturer. Before you agree in writing to remodel or expand, find out if your state provides protection from unreasonable demands. If you are going to sign the agreement, make sure the agreement is specific and gives you plenty of time to complete the expansion. Once you have agreed to it in writing you are likely going to be bound to complete it.

Getting the manufacturer to sign the building plans once they have agreed to them may save you a lot of money. Manufacturers are notorious for changing their minds after approving plans after the dealer has spent thousands of dollars and many hours getting it completed and approved by the manufacturer, the city and even pulling permits.

Getting your attorney involved can save you hundreds of thousands of dollars. Don't be penny wise and pound foolish.

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This article is not intended as legal advice.