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EMPOWERING IOWA'S AUTOMOBILE DEALERS

DEALER LAW REVIEW

ISSUE 13.4

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DID YOU RECEIVE A LETTER FROM THE FACTORY? DON'T JUST STICK IT IN A FILE; IT CAN COME BACK TO BITE YOU. MAKE SURE YOUR ATTORNEY KNOWS ABOUT IT AND RESPONDS.

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Do Incentive Programs Hide Two-Tier Pricing?

The Program: Over the last decade, manufacturers have attempted to standardize each customer's buying experience by requiring consistent brand imaging for dealerships. Thanks to favorable franchise laws in Iowa, manufacturers generally cannot terminate a franchise because a dealer failed to satisfy the latest factory image requirements. But what if the failure to satisfy the image requirements only costs a bonus? This bonus, or "factory-mandated dealership franchise upgrade program" payment is an attempt to get around strong franchise laws such as Iowa law.

For example, GM introduced the Essential Brand Elements ("EBE") program in 2009, shortly after its bankruptcy. This program, "rewards dealers who voluntarily meet customer experience standards." Currently, nearly every manufacturer has a similar program, and, because of the lucrative bonuses, the programs have a high level of participation. However, some argue that this incentive program is actually a two tier pricing system that is structured to avoid the Robinson-Patman Act, which offers protections against price discrimination.

The Update: Meeting the image requirements can be very expensive for dealers. Take Norman Braman of Braman Management in Florida for example.

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BrakeDown: Do Facility Enhancements Sell More Vehicles?

Phase 1: In response to members' demands, the NADA created and fast tracked the new Industry Relations Task Force ("IRTF") to focus on factory-mandated dealership upgrades and stair-step incentive pricing programs. In particular, IRTF sought to examine the "fairness" of these programs.

To evaluate these issues, NADA began an intensive fact-based study in October of 2011. In January of 2012, independent industry consultant Glenn Mercer completed phase one of the study. In that study, Mercer pointed out the significant financial burdens that these programs could place on dealerships. The executive summary of phase one concluded that absolutely no solid data or evidence was found that a dealer will sell even one more vehicle by investing $1 million in facility upgrades as required by the manufacturer. Mercer explained that these programs may be building dealerships for today instead of thinking of the dealerships of the future.

Phase one made three recommendations regarding value, costs, and the future:

1. Franchisors should make more persuasive business justifications for the large investment dealerships must make

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Do Incentive Programs Hide Two-Tier Pricing?

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He was informed that in order to meet GM's brand image requirement, he would need to cover the exterior walls of his showroom with limestone. Unfortunately, his current structure would not support the weight, and due to local zoning and building laws, he would have to demolish his showroom and rebuild in order to comply. Braman suggested that he put in an alternative material that looked like limestone, but GM refused to allow this alteration.

Braman sued in Florida, claiming that the EBE program was a violation of the Robinson Patman Act. This suit was the first of its kind and could have resulted in big changes for incentive programs. However, the parties delayed trial at the end of May and reached a settlement agreement instead.

What does that mean to me?

Since the Braman case settled, there is no court decision and the uncertainty for Iowa dealers continues. Incentive programs will likely continue until there is another test case.

What can I do?

Keep an eye on the legal news, IADA, and NADA updates. The Arenson & Maas blog at www.arensonlaw.com/blog is a good place to check for emerging legal developments. If the incentive program is creating a significant financial burden for you or if you have legal questions, contact experienced auto dealer counsel. ■

BrakeDown: The NADA Reports on Incentive Programs

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2. Cost levels for the programs are far too high, especially for smaller dealerships even under tiered programs, and they should be reduced
3. There should be a greater emphasis on changes based on future needs of the dealerships

In September 2012, NADA initiated a full page ad in *Automotive News* entitled “Stair-Step Incentive Programs are Bad for the Auto Industry.” When NADA presented the results of phase one to manufacturers, however, there were mixed reviews. Some slowed their programs while others refused to alter the programs.

Phase 2: NADA completed its Phase 2 study in mid-July. Phase 2 confirmed Phase 1 by using a case-study approach that involved in-depth interview with dealers, OEMs, and other experts. In addition, Phase 2 focused on recommendations for the “dealership of the future.” The following is a condensed version of those recommendations:

1. Dealership design needs to be flexible enough to adapt to constantly changing expectations.
2. The process of buying a car, not just the vehicle itself, needs to be personalized for each individual.
3. Consider all of your options for making the buying process more convenient for your customer.
4. As technology increases and becomes more required than optional, dealership inventory may sharply decrease.
5. Dealers may need to get creative to compete with their own OEM's online presence.
6. As vehicles tend to have many of the same features, customers are looking at other things that may set the vehicle apart, such as the dealership itself and service packages. Creating a strong image and support mechanism for your customer will be essential.
7. Overall, dealers should keep in mind that changes in our technology-driven society today are happening much faster than historical changes.

To see more about Phase 2 of the report, check out the Arenson & Maas blog at www.arensonlaw.com/blog. Contact experienced auto dealer counsel if you have questions about these reports.■

Did you know?

The first Fords had Dodge engines.

In 1916, 55% of the cars in the world were Model T Fords, establishing a record that still stands today.

Insurance Concerns in a Hard Market

Due in large part to the many natural disasters in the past several years, the insurance industry has shifted from a soft market to a hard market. Generally, a soft market provides wider coverage, lower premiums, and lower credit standards. Today's hard market, however, involves less coverage, higher prices, and an increase in the required credit standards.

How does this apply to me?

The most obvious way that this shift applies to you is that your insurance prices are likely on an upward slope, and experts expect that

Hard Market Creates Insurance Concerns

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trend to continue for the next several years. You may not notice right away, especially if the insurance company is raising rates through the back door— by raising the deductible instead of raising the premiums.

What should I do? Take a hard, active look at your current insurance situation. If you haven't already, consider subdividing your insurance policies so you can get the best coverage for each situation. Consider how much you actually need for each insurance type. Are you losing a great deal more because of hail rather than theft? Then you should adjust your insurance plans accordingly. Make your insurance carriers work for your business.

You should also be sure that your insurance company will notify you if there are going to be any changes in your policy. Many policies state that the agent *may* inform you of changes or cancellation of your policy, but that simply isn't good enough. Iowa law provides some protection for you:

- 10 days' notice of cancelation for cause after the first sixty days of the policy
- 30 days' notice is required if cancelation is due to the insurer's loss of reinsurance
- 45 days' notice if the insurer intends to refuse renewal of the policy

Seriously consider having your attorney look over your current policy. As a precaution, you should allow an attorney to look over any new policies that you are considering. Contact experienced auto dealer counsel to assist you with determining your insurance needs. ■

Iowa Supreme Court Defines "Oppression:" Lessons for Closely-Held Corporations—Including Auto Dealers

Under Iowa law, a court can order the dissolution of a corporation if the minority shareholder can prove oppression. If the company dissolves, the minority shareholder will receive their appropriate share of the company's assets. In addition, the Iowa Business Corporation Act ("IBCA") provides a similar statutory remedy for oppression, but also allows the majority shareholders to purchase shares instead of dissolving the company in its entirety. However, Iowa law did not define "oppression" until *Baur v. Baur Farms*, which was decided on June 14.

The Court held, "majority shareholders act oppressively when, having the corporate financial resources to do so, they fail to satisfy the reasonable expectations of a minority shareholder by paying no return on shareholder equity while declining the minority shareholder's repeated offers to sell shares for fair value." In this holding, the Iowa Supreme Court provided an expansive definition of oppression based on reasonable expectations. The Court will determine whether a minority shareholder is being oppressed by considering the minority shareholder's "reasonable expectations" regarding return on their investment. Additionally, the Court will also consider all of the circumstances of the business before determining whether there is oppression.

In *Baur*, the minority shareholder could sell his shares to a third party, but he first had to offer his shares to the other shareholders, and they could purchase the shares at fair value. This provision is somewhat common in closely-held corporations, including some auto dealership corporations. However, the majority shareholder refused to buy the shares at reasonable value and refused to pay any dividends to the minority shareholder. As a typical minority shareholder, he had little market outside of the corporation.

The bylaws in *Baur* provided a method for calculating the "fair value" of the shares, but the company failed to update those numbers since 1984. Since the value of the corporation's assets skyrocketed, if the minority shareholder sold his shares at the 1984 price, then he would be selling them at a significantly reduced value. Importantly, the Court made it clear that if the "fair value" had been computed properly, then the written agreement would have been upheld. Therefore, if the written contract is reasonable, then it will be upheld.

Baur provides two major lessons to closely held corporations, including auto dealership corporations. First, majority shareholders should take an objective look at how they are interacting with their minority shareholders. A majority shareholder's actions should be within the *Baur* standards. If you are concerned that your actions might fall into the Court's definition of oppression, then you should speak to an experienced business and auto dealer attorney.

This case also illustrates that the bylaws of closely held corporations may need to include provisions that realistically address adjustments to corporate control and shareholder buyouts. The Baur family would have saved time and money with a well-developed set of bylaws. Since the Court will generally uphold written agreements, you should have an attorney examine your corporation's bylaws if you are concerned about future corporate governance. Contact experienced auto dealer counsel to discuss what this case means to your closely held corporation. ■

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