MLG AUTOMOTIVE LAW

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DEALER'S VOICE

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MLG Files Historic "Takings" Case Against the U.S.

September 2008 marked a chilling moment in our nation's history. That month Wall Street goliath Lehman Brothers filed bankruptcy, ending its 158-year history in the financial industry. That same month Merrill Lynch was sold over a weekend, sending shockwaves throughout the nation that our financial market was collapsing around us.

As the Great Recession began to form, auto sales plummeted to 10.6 million in 2009, down from a high of 17.8 million just years before. Many will recall the scene of the chief executives from the Detroit 3 appearing before congress, claiming they would go dark without immediate financial assistance. Industries were beginning to topple.

Chrysler, a private company owned at the time by private equity firm Cerberus Capital Management, asked for $12.5 billion from the Troubled Asset Relief Program (TARP). In support of its request, Chrysler presented the Treasury Department with a viability plan for how it planned to use the public funds. The Treasury rejected Chrysler's plan, claiming that it was not aggressive enough. Among other things, the Government required that Chrysler terminate a substantial portion of its dealer base.

Chrysler's revised plan was approved by the Government, and on April 30, 2009 Chrysler filed a consolidated petition for bankruptcy in New York. The "pre-packaged" restructuring plan was approved by the Bankruptcy Court on a Sunday, just 31 days later.

Under the sale, most of the assets of Chrysler were to be purchased by a new entity in which Fiat would own 20 percent, and Chrysler ridded itself of billions in debt. The bankruptcy also enabled Chrysler to avoid its franchise agreements, and in doing so it terminated 789 of its franchised dealers.

The manner in which Chrysler – and the Government – handled the termination of the dealers was nothing short of inhumane. Knowing that many of these franchises had been vested in families for generations, the terminated dealers were given no notice that they were being terminated, and just 22 days to cease all operations once notified.

It gets worse. Because the termination process was completed through the Bankruptcy Court, Chrysler was not required, as it normally would be in the case of a termination, to take back any of the new vehicle inventory the dealers had in stock. However, because the terminated dealers were no longer Chrysler-franchised dealers, they were prohibited from selling the vehicles to the public. The only option for the dealers was to sell the vehicles to other dealers for pennies on the dollar, because they already had units on their lots that they couldn't sell.

Yet, while their franchises were taken from them, the dealers' ordinary financial obligations of rent, mortgages, payroll, term loans and floor plans all remained intact. The net result of this was that a private company was given $12.5 billion in tax payer money, and 789 dealers lost what were in many cases life-long businesses, virtually overnight.

MLG Files Historic "Takings" Case Against the U.S. (Continued)

The Special Investigator General Audits the Process

In June 2010, the Special Investigator General for the Troubled Asset Relief Program completed its review of the Chrysler bailout, issuing a comprehensive written report. The investigation revealed that Chrysler's viability plan was reviewed, and rejected, by a team of 15 people assembled by the Administration, called the Treasury Auto Team. Yet, none of the Auto Team leaders or personnel had any experience in the auto industry.

The Special Investigator General further found that under Chrysler's original plan, it sought to slowly consolidate its dealers from 3,181 in 2009 to 2,000 in 2014 through its Project Genesis. The Auto Team, however, was focused on having Chrysler emulate the "Toyota" model of having fewer dealerships in metro areas, and hence it rejected Chrysler's gradual consolidation approach. The termination of 789 dealers on 22 days' notice was the result.

MLG Sues the U.S. for Violating the 5th Amendment

In December 2012, MLG Automotive Law filed a lawsuit against the U.S. on behalf of numerous terminated Chrysler dealers in the U.S. Court of Federal Claims in Washington D.C. The lawsuit, entitled Spitzer Motor City v. U.S., alleges that the U.S. violated the Takings Clause of the 5th Amendment, which prohibits the government from taking private property "without just compensation," when it conditioned Chrysler's receipt of TARP funds on Chrysler terminating 789 of its dealers. Spitzer Motor City is now consolidated with two other dealership "takings" cases in the Court of Federal Claims, consisting of 307 terminated dealers.

The Justice Department has filed motions to dismiss, as well as an interlocutory appeal to the U.S. Court of Appeal, all claiming that the complaints did not state a case. The trial court and the court of appeal have refused to dismiss the claims, repeatedly holding that while the claims do not fit neatly into a normal takings framework, they could result in liability against the U.S if proven to be true.

Deep in Discovery

The parties are now deep in discovery, with the Government having produced over 150,000 documents, consisting of millions of pages. The parties have also slotted out 60 depositions, consisting of the heads of Chrysler, as well as key players in the U.S. Treasury and the Bush and Obama Administrations. To date, Robert Nardelli (former CEO of Chrysler), Peter Grady (former director of dealer operations at Chrysler) and James Press (former vice chairman and co-president of Chrysler) have been deposed.

To facilitate an orderly administration of the trial, the Court of Federal Claims has established 10 model plaintiffs for the liability phase of the trial. If liability is established – that is, that the Government is responsible for taking the dealerships' franchise rights by coercing Chrysler into terminating their franchises – then the actual damages sustained by each dealership will be assessed separately. Trial is tentatively scheduled for 2018.

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"Nothing great in the world has been accomplished without passion."

– Georg Wilhelm Friedrich Hegel

The Trade-In Dilemma

Closing a sale that involves a trade is one of the cornerstones of the car business. And taking a trade may not only be necessary, but it can also greatly enhance the financial aspect of the deal. Many consumers are willing to give away their old vehicles to get in something fresh and new. And when a trade is taken in far below market value, a significant margin can be made on resale, whether it is at retail or at auction.

California's Retail Installment Sales Contracts give the dealer the right to cancel the contract if the dealer is unable to sell the paper within 10 days of the contract. If the consumer is able to be financed, all parties are happy. But what happens when the dealer cannot find financing, and the consumer wants their trade returned? Real issues arise when the trade is no longer available because it has already been sold.

California Civil Code § 2982.7 states that when a trade has been sold, the dealer is required to give the consumer the greater of what the dealer sold the car for, or its fair market value. This could result in a substantial financial hit for the dealer, particularly if the trade was wholesaled for less than fair market value. If the dealer fails to tender payment to the consumer within five days of rescinding the deal, the consumer can bring a civil claim against the dealer, which can include a claim for attorneys' fees incurred in bringing the claim. And this is where the tail wags the dog.

Many a dealer have discovered the hard way that refusing to refund the consumer top dollar for their trade can end up costing tens of thousands of dollars in attorneys' fees in litigated claims. And there are countless predatory law firms in California that make their living off of suing dealers for nominal claims, only to recover the statutory attorneys' fees.

To make matters worse, even when the value of the car is tendered to the consumer, the dealership could still have a problem on its hands. When a deal is rescinded, two facts usually prevail: 1) the consumer is now without a car to drive, and 2) they have been found to be un-bankable. So, if they cannot get financing, and are now without a car, what is the consumer to do?

This dilemma could lead some consumers to feel they were misled when they entered into the transaction, which could lead to a claim for violation of the Consumer Legal Remedies Act. The CLRA can be a dealer's biggest nightmare – it not only calls for payment of the consumer's attorneys' fees, but it also has elements that touch upon class action claims. Thus, a seemingly innocuous claim by a consumer could lead to a consumer rights law firm climbing through your deal-jackets looking for any violation of consumer lending laws.

As with many things in life, an ounce of prevention is worth more than a pound of cure. If you find yourself with an un-bankable consumer and their trade has been sold, consider every option to keep them from coming unglued. This could include financing the transaction yourself, or taking the excess capital you would have had to pay the consumer for the fair market value of their trade, and using that to put them in a deal that works.

While no one likes to lose money on a transaction, the cost of a disgruntled consumer can be staggering if not handled properly. Be smart and try to avoid being on the receiving end of that stick.

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DEALER SPOTLIGHT

If you would like to share your story and have it read by thousands, send your submission to jmichaels@mlgautomotivelaw.com.

Each dealer featured in our Dealer Spotlight will receive a bottle of Opus One, compliments of MLG!

The California New Motor Vehicle Board At a Glance

The California New Motor Vehicle Board was created in 1967 to help resolve disputes between franchised dealers and manufacturers of new motor vehicles. The primary purpose of the Board is to offer California new car dealers a fair, fast and efficient means of resolving disputes with their respective manufacturers.

The disputes usually center on franchise terminations, add points, forced moves, and other franchise modifications. Often, a dealer's dispute with its manufacturer leads to a full-scale trial before the Board where witnesses are called, evidence is admitted, and attorneys argue the dealerships' case to the Board. The Board then issues a binding ruling, or judgment, regarding the dispute.

The New Motor Vehicle Board has no shortage of dealership disputes to keep it busy. In the first two months of 2017, manufacturers issued 79 notices of termination or modification to their franchised dealers in California. Based on these notices of termination or modification, the Board received 28 new protest cases, and had 53 protest cases pending before it. The 53 protests pending before the Board consisted of:

- 15 terminations of a franchise agreement
- 28 franchise modifications
- 1 establishment of a new dealer
- 1 relocation
- 5 warranty reimbursement cases
- 2 inventive program reimbursements
- 1 export or sale-for-resale case

In 2016 alone, manufacturers served nearly 200 notices of termination or modification to their franchised dealers in California. Many of these terminations and modifications resulted in hearings before the New Motor Vehicle Board. We encourage you to check back with each new issue of the Dealers Voice, where MLG Automotive Law will provide its readers with an update regarding new and notable cases pending before the New Motor Vehicle Board.

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- Manufacturer disputes
- Complex litigation
- Add point/ termination cases
- Facility upgrades
- New Motor Vehicle Board hearings
- Consumer litigation
- Buy-sells
- Writs and appeals
- Mediation
- Arbitration

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