



DO'S AND DON'TS WHEN YOU ARE SELLING A DEALERSHIP

By Erin K. Tenner, Esq.

There are many things to know and do when you are preparing to sell a dealership. First and foremost is to maximize profitability, so that you can maximize the purchase price you are able to get when you sell. Here are a few of the other, less obvious, do's and don'ts for **SELLERS**:

1. **Nondisclosure Agreements**: Do get a binding non-disclosure agreement signed **before** you give a potential buyer any information about your business that you would not share with the general public. Make sure it has some teeth. It should cover disclosure of the fact that you are considering selling and there needs to be a consequence for violation of it. At minimum a substantial payment for each violation should be required. It can and should also provide that anyone who is going to be given access to your financial statements, or to any other information you provide, must first sign the non-disclosure agreement. The agreement should hold the buyer responsible for making sure to get a binding commitment of confidentiality from any third party to whom information is given and should require the buyer to give you a copy of the agreement signed by any third party. Exceptions:
 - a. Factory reps generally will not agree to sign a non-disclosure agreement, so don't tell them about the deal until you have a signed purchase agreement because they will sometimes tell people. Dealer agreements are being revised to give them this right because they have been doing it for years.
 - b. A non-disclosure agreement is generally not necessary for lawyers because of the attorney/client privilege, the obligations of the client will carry over to the lawyer representing them. If a buyer's lawyer discloses information even without the consent of their client, the client can be sued and then the lawyer can be held accountable by the client. The same is not necessarily true of accountants who surprisingly have much less of an obligation to hold information shared by the client in confidence.

Because a lesser duty of care applies to accountants and brokers, they should be required to sign non-disclosure agreements.

2. **Letters of Intent**. Do hire an attorney to help you with a letter of intent. Letters of intent can be binding obligations even if they say they aren't. There is a lot to know to make sure yours does not become binding for both buyers and sellers. Dealers often negotiate

goodwill and sign an LOI with a buyer before hiring an attorney. An attorney who handles buy sells will be in a good position to help you figure out whether the price you are asking is too low. Lots of money can be left on the table if you are not well informed going into negotiations.

3. Don't Allow Due Diligence Without A Signed Purchase Agreement! Although it is common, it is inappropriate. The ONLY exception to this is financial statements. If you are using a broker who compiles your information into a nice booklet for potential buyers, that is fine, but the information included does not have to include confidential trade secrets such as analysis of your financial statements, projections or even planning potential. All it needs to include is your financial statements for the last three years (and any add backs if, for example, you have an owner and a general manager taking a salary or if you incurred a large out of the ordinary expense in a given year), pictures of your facility, and other public information. This can include brand imaging requirements, and whether they have been met, what franchises are included and market information about the location of the dealership and the makes being sold. Don't let a buyer start their due diligence, except by reviewing financial statements and publicly available information before you have a *signed* purchase agreement. When you do, you are less likely to get a signed deal, and a done deal. Why? Because it tells the buyer two things: 1) You don't know what you are doing, and 2) You can be taken advantage of. By the time you figure out they are trying to take advantage of you, you will either have to agree to a lot of things you never should have agreed to, or your deal won't get done.

Instead, tell the buyer that you will give representations and warranties on issues that concern them. Warranties and representations can be made and reduced to writing in a purchase agreement without disclosing any of your trade secrets. A buyer can tell you what assumptions they are making before you have a signed purchase agreement. These warranties and representations can be verified during due diligence AFTER the purchase agreement is signed with all contingent agreements attached. Although many sellers do allow due diligence prior to signing a purchase agreement, it is not a good practice and leaves a buyer unnecessarily exposed to people who are just hunting for information on their competition. In addition, no buyer is going to want to purchase a dealership if confidential information has been shared with competitors. Don't do it!!

4. Attach Exhibits Before Signing. All exhibits that can be attached prior to closing need to be attached prior to signing. This includes any agreements that will be signed at closing. If you fail to attach these agreements in their final form with blanks only for information that cannot be obtained until closing, you give the buyer a right to walk. All the buyer has to do if they want out is not agree on the form of some required agreement. Courts generally will not enforce agreements if documentation is not certain enough for the court to determine what the agreement was. As a result, if it was a contingency to closing to sign

the agreement, and you don't have it attached as an exhibit to the purchase agreement, you can't enforce an obligation to sign it at closing.

5. Taxes. Do make sure you save receipts for work done to improve any assets you are selling. Keep track of any capital improvements to real estate no matter how big or small and make sure your accountant is adding them to the basis of your assets each year. When you sell the real estate, things like factory image updates or remodeling expenses can increase your basis and reduce your taxes because the basis will be deducted from the net income from sale to determine how much tax you owe.
6. Insurance. Do ask each of the following questions of your insurance agent prior to entering into negotiations so you know where you stand for planning and negotiating purposes (and consider getting a non-disclosure agreement from your agent first, if he or she represents other dealers):
 - a. Does my corporation or limited liability company need to remain in existence to get post-closing insurance to cover things the factory will not pick up after closing like negligent repair causes of action or personal injury claims arising out of negligent repair?
 - b. Can I get a personal umbrella policy of insurance to cover claims after closing in the event the corporate veil is pierced or the corporation is dissolved leaving shareholders exposed to liability?
 - c. If you will be leasing your property to the buyer, will the carrier provide coverage for loss of rents and if so, will you have to pay for it, or can it be part of the insurance the tenant is required to carry?
 - d. Make sure you understand the difference between loss of rents and business interruption insurance that your carrier offers and the limits on each. The former is typically purchased by the landlord to cover lost rents. The latter is typically purchased by the tenant so they can pay rent and other business expenses notwithstanding business interruption.
 - e. Does the carrier provide insurance that may be useful in negotiations such as warranties and representations insurance or pollution liability insurance and if so, how does it work and how much does it cost?
7. Understand the Financial Consequences of Selling. Sit down with your accountant and lawyer and have them brainstorm all the costs that will be associated with your sale and all your potential exposure after sale. Here are some of the questions you should ask:
 - a. What will they help you with and what won't they help you with? For example, will they be at the closing calculating the purchase price for vehicles? Hundreds of thousands of dollars can be left on the table at closing by not having both your attorney and accountant involved at closing to make sure the purchase agreement

is followed. Your attorney should be at the dealership at closing to answer questions and to help you negotiate closing details, and your accountant or another person who can help calculate purchase price accurately, if your attorney isn't doing it, needs to be there also. Not having them there is penny wise and pound foolish.

- b. How much should you budget for legal and accounting fees?
- c. How will taxes be calculated on assets sold? Which assets will require payment of ordinary income tax, and which will require capital gains tax?
- d. How much is likely to be owed at closing for final payroll and for employment taxes that will need to be paid at closing?
- e. Are there events or circumstances that could impact your taxes like C corporation earnings, conversions or mergers that took place in the past, or even tax elections?
- f. Is there anything you should be looking at to clean up for sale?

The answers to these questions will not be the same for every seller and things like whether your dealership is operated by a corporation, or an LLC, and what tax elections have been made can make a big difference from dealership to dealership. For example, the tax consequences to an LLC that has elected to be treated as a corporation may be different than the tax consequences to an LLC that has not made that election. Also, whether the corporate treatment is as a C corporation, or an S corporation will make a big difference in decision making when planning to sell. Conversions from one entity to another can also impact taxes on sale even if they happened long before the sale. Not all accountants are tax accountants, so make sure you are talking to someone who knows the tax law if your accountant doesn't.

8. Remember the Privacy Laws. There are a lot of them! You may want to tell a potential buyer all about your employees but doing so could violate privacy laws. Don't disclose any more information to a buyer about an employee, even after they have signed a purchase agreement, than you would disclose to any other person looking to hire one of your employees. Don't provide employee names to a buyer without a signed agreement and a plan for how and when they will be contacted and what they will be told. If possible, wait until due diligence is completed before announcing the sale to employees or the public. Otherwise, you are giving away leverage if further negotiations are required as a result of due diligence. Job categories and pay scales can be provided as well as total payroll, but specifics will only get you into trouble, not only by potentially violating privacy laws, but also potentially exposing the buyer to successor liability. A buyer who ends up with successor liability may come back and sue you for it depending on what your purchase contract says about it.
9. Do Your Due Diligence On Any Potential Buyer. Find out what other dealerships the buyer owns, if any. If they don't own any other dealerships, or don't own the make you are selling, make sure they will be able to qualify with the manufacturer to purchase your dealership. Do they have a qualified general manager to run the dealership? Do they have

the financial wherewithal to make needed facility improvements and to weather a financial downturn in the auto industry? These are the things the factory is going to want to know. If they do have a dealership of the same line make, obtain financial statements and performance evaluations that have been provided to or by the factory. Even though it is difficult for a manufacturer to turn down a buyer based on performance at another location – because if they were approved for one that means they are most likely qualified for another – the last thing you want is a call from the factory saying they don't like your buyer and they want you to find another one.

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