GRAY•DUFFY, LLP

CALIFORNIA AUTO DEALER®

December 2022

Buy/Sells: Avoiding the Pitfalls

By Erin K. Tenner, Esq.

Selling a dealership can be bittersweet, and buying a dealership can be exciting and full of surprises. It's what you don't know that can hurt you whether you are buying or selling. Foresight comes with experience. Here are a few things to consider if you are thinking about selling your dealership, or if you are buying:

1. NEW WARN ENFORCEMENT. WARN Act notices are required upon sale or closure of most auto dealerships in California under the federal and/or state WARN Act. Effective January 1, 2023, failure to comply with WARN Notice requirements will be subject to new state enforcement resources. Historically, WARN Notice violations were typically only sought by unions because they were the only ones who had access to employee information that would enable them to determine whether a WARN Act Notice was required if none was given. Under a new law, the CA Labor Commissioner will now have authority to examine the books and records of a business to determine whether WARN Act Notice compliance requirements have been met. Failure to comply can result in large penalties, and enforcement is no doubt going to be stepped up.

2. GET AN EXPERIENCED ATTORNEY'S HELP. Have you heard the saying that an attorney who represents himself has a fool for a client? Thinking you can do it yourself without an attorney is without a doubt going to cost you a lot more than using an attorney, and possibly millions more. Even attorneys use attorneys when they are buying or selling a dealership. Why? Because you will save money in the long run. When you have a knowledgeable attorney on your side and you take their advice, not only will the deal go more smoothly, you will save money, and maybe even get more money if you are selling. It could even save you millions…yes, millions. I have seen more than one person cost themselves millions by thinking they could do it themselves or by changing the terms of an agreement without getting proper legal advice. If you are working with more than one attorney, don't change a signed agreement without the advice of the drafter! They know the agreement better than anyone. A skilled attorney will save you a lot more than they will cost you.

3. LISTEN TO **YOUR** LAWYER. Whatever you do, don't take legal advice or referrals from your opposing counsel. They may seem friendly, but they are not going to make sure you are protected. They are representing the other side, not you. If they refer you to an attorney, it may just be to someone who will make their life easy rather than someone who will

protect your interest. You don't want an attorney who will just rubber stamp everything or just go along to get along in a buy/sell. There is too much to lose. A knowledgeable attorney with experience in buy/sells will know when to push and when to back off. In 30+ years of negotiating buy/sells, I have seen only a handful that have not been completed once negotiations started, and only a couple that were not my client's choice – and only one of those my client later confirmed would not have closed due to issues that would have been discovered in due diligence. Don't let a tough attorney scare you. You need someone who can stand up to a strong opposing counsel with valid arguments and who will know a bluff when they see it.

4. COVERAGE YOU NEED. Insurance is an important consideration whether you are buying or selling. A Seller's failure to carry sufficient coverage for accidents occurring after closing with vehicles sold or serviced prior to closing can be disastrous. Make sure your liability insurance will cover accidents caused by negligent repair even after closing. This means you need a claims made policy. On the other hand, buyers need to make sure they have the following coverage in addition to standard garage liability: 1) coverage for officers' and directors' errors and omissions, including advertising errors, 2) an EPLI policy with limits sufficient to cover the mountain of employment claims available to plaintiffs, including coverage for both legal fees and damages, to the extent available, 3) employee theft coverage. These coverages are often overlooked. A personal umbrella to cover excess liability is also important. While coverage for wage and hour claims is scant if available at all, it should be included if it can be obtained. Consider a self-insured retention to significantly lower insurance expenses.

5. ALLOCATE LIABILITY. Waiver by the seller of the factory obligation to indemnify and defend at closing should never happen. Yet it is typical for the factory to deliver documents to be signed at closing that include it. Failure to catch this and revise it can be costly. Purchase agreements should allocate responsibility for obligations after closing. In a stock purchase the buyer is going to be responsible for pretty much everything, except those things for which the seller agrees to indemnify the buyer. A stock purchase should only be considered if you have a seller with good compliance practices that can be verified. Very deep pockets and a willingness to provide a personal indemnity agreement for breach of warranties are also important. Giving the buyer a holdback and personal indemnity is often a good compromise to get a seller the benefits of a stock purchase, which are enormous for a seller. Still, indemnification should not expose the seller to greater liability than existed prior to sale or than would exist if assets were sold. In an asset purchase, on the other hand, the buyer starts with a clean slate and the agreement, if well written, will clearly allocate responsibility for pre-closing and post-closing obligations in indemnity provisions. One liability that buyers often think will be their problem and just toss to their insurance carrier after closing is employment obligations. Any obligation of a seller arising prior to closing, should be allocated to the seller in the purchase agreement so that liability is not shifted to the buyer. Buyers should be actively working with their attorneys to enforce the provisions of their purchase agreement after closing so they are not taking on unnecessary liability.

6. SNDA'S AND WHY THEY ARE IMPORTANT. If you are leasing real property, you can be kicked out if the landowner defaults on their mortgage, even if you have paid all your rent as due. This is true unless you have a Subordination, Non-Disturbance and Attornment Agreement ("SNDA") with each lender and the landlord. These agreements are easy to get if you just ask for it and follow up. Even if the owner is a parent or other relative, an SNDA protects both the tenant and the lender, so lenders are very willing to provide them. Once there is a default, they may not be as willing to negotiate with you. The landowner must also sign the SNDA, which is why negotiating it as part of the lease negotiation is important. Even if a lender already has an assignment of rents included as part of its deed of trust, it will agree to an SNDA. The lender can avoid court action to collect rents with an SNDA. The benefit to the tenant is that the lender, in return, will agree not to evict the tenant as long as the tenant continues to pay the rent to the lender.

7. COMMISSIONS. If you are paying a commission, make sure it is to a person who is licensed to receive a commission. Accountants are not licensed to receive a commission. Paying a commission to a person not properly licensed to receive it is illegal. You can however pay a "finder's fee" to anyone. If you do pay a finder's fee or commission, don't let the person receiving the finder's fee or commission negotiate the deal. They have an inherent conflict of interest and may make unnecessary compromises that could cost you, just to get their fee.

Erin K. Tenner is a partner with Gray·Duffy, LLP and has been legal counsel representing auto dealers in buying and selling auto dealerships for more than 30 years. She can be reached at 818-907-4071 or etenner@grayduffylaw.com.

Return to the newsletter.