

The Importance of a Succession Plan

General Motors has launched a highly visible campaign for its dealers to have succession plans in place. You may ask, "Why does General Motors care?" GM and other vehicle franchisors care a lot that successful dealership operations do not grind to a halt because of the death or incapacity of the dealer.

As any dealer owner or manager knows, successfully operating a car dealership requires hard work, constant vigilance, and solid leadership. Changes or disruptions that are mismanaged can quickly cause a successful dealership to struggle.

A succession plan will maximize the opportunity for a successful transition in the event of the loss of leadership and management resulting from the death or disability of the dealer. This will protect the dealership's successful performance and protect the value of the dealership.

Your franchisor is not the only one who wants to know you have a succession plan in place. Dealers depend on financial institutions for floorplan, working capital loans, real estate loans, and other financial needs. If something happens to the dealer, finance sources want to know who will lead and operate the dealership. They want to know there will be quality management to continue the business and that the business will have the financial strength to survive.

We have not even mentioned the most-important people affected by a dealer's death or disability – the employees who have worked with the dealer to make the business a success and the family members whose livelihoods depend on the dealership.

Plan continued on page 2

IN THIS ISSUE...

The Importance of a Succession Plan

page 1

Franchisor Mandates – The Chickens are Starting to Come Home to Roost

page 1

Franchisor Mandates – The Chickens are Starting to Come Home to Roost

Recently we reported on the National Labor Relations Board's attempts to hold the franchisor of McDonald's restaurants liable for alleged employment law violations in some of its franchisee restaurants. The NLRB argues that the franchisor has such control over franchisee personnel policies that it should answer for alleged violations.

A recent decision from the U.S. District Court for the Western District of Virginia used the same rationale to deny a car manufacturer's motion to be removed as a defendant in a lawsuit by a dealership customer. In the case, the plaintiff customer slipped and fell on a wet service department floor. The customer sustained serious injuries and sued the franchisor as well as the dealer.

Franchisor continued on page 4

Plan from page 1

No matter how healthy you are, what will happen to your business if you step off a curb and are hit by a bus? Who will be in control of the dealership? Will you have quality management to successfully continue your business? Will your business have the financial strength to survive?

These are not questions for which your franchisor and your lenders should guess the answers. Have a sound succession plan.

What should that look like? One cannot describe a one-size-fits-all plan to suit everyone. Each dealer will have his or her own situation, and the structure of the succession plan depends on what businesses the dealer has, what real estate is involved, the dealer's family situation, and numerous other factors. Here are things that all dealers should consider.

Planning Team

Sound succession planning requires teamwork. At a minimum, you must involve your estate/tax attorney, your business attorney, and your accountant. They must work together to develop an effective plan.

Even gathering the planning team is not one size fits all. Many dealers have unusual family circumstances. A spouse may want control if something happens to the dealer. There may be multiple children vying for control. There may be children involved in the business and those who are not involved, leading to challenges in balancing rights of ownership, operation, and compensation. Situations with competing family interests that can cause discord often lead dealers to avoid the question of succession planning. That is the wrong response. Complex family situations make a succession plan even more important than less complicated situations. Specialists understand how family dynamics can affect car dealerships and the difficulties of creating a succession plan. A planning team may need

to include an individual with that expertise and experience.

Estate Plan

The heart of any succession plan is your will and, probably, trusts. How should your estate be structured? Should you be making gifts to family members during your life? Should you create trusts to avoid the difficulties of probate and to defer taxation? Only a qualified team can help you design this.

Estate taxes must be considered in any plan. Many types of trusts can be used while the dealer is alive or upon death. Just a few years ago, franchisors balked at the concept of a trust owning dealership equity. In recent years, however, many dealers have formed trusts for equity ownership of dealerships, and franchisors today are used to seeing and approving those arrangements. They should be considered in your estate planning.

Funding

If something happens to you, how will the transition to a new control and management structure be funded? Will unencumbered business and personal financial resources be sufficient so there are no critical funding shortages during the transition? Will there be insurance funds available to help overcome short-term financial dislocation? How will you fund the payment of estate taxes? Planning for this will require the efforts of your entire team working with an insurance professional.

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Plan continued on page 3

Implementing the Succession Plan While You Are Alive

If there may be competing family interests, implementing the succession plan during your life can be difficult. How will you involve your family members in planning? How will they react to your plan? How will you fit them into the roles you develop for or with them as part of your plan? How will this affect family members active in the business? How will you protect and provide for those not in the business so they do not feel neglected? How will you harmonize the interests so the announcement of your succession plan does not lead to rancor and family division?

As noted before, experts have dealt with issues of competing family interests. It is often a time consuming process to create a successful plan. Family members must meet and become involved, their interests must be considered, their interests must be accommodated, and the plan must be implemented in full consideration of all these factors. Delaying this process will only enhance the difficulty.

Operating the Business Immediately After Your Death

If you die tomorrow, who will be in charge? How will the company continue? Answering these questions is a critical aspect of any succession plan.

Have a dealer successor designated by your franchisor. That person will be in a position to step in as dealer if you are no longer available. To list a dealer successor, many franchisors require that the person have some equity interest in the dealership. Structuring an ownership interest for your successor should be considered as part of your overall plan.

It is not enough to name a successor. Your dealer successor must understand your wishes and should have a plan to keep management in place. What plans can you put in place to calm fears if you die? What incentives can you install to prevent loss of managers and employees

during the transition to new management? These issues should be addressed in the plan.

Loan Terms and Due on death clauses

Any succession plan must consider existing loan commitments. What are the continuing conditions of your loans? How will your death and implementation of a succession plan affect those conditions? If you die, having your finance sources pressure your heirs or even call your loans can ruin even the most carefully designed plans.

This brings us to the subject of due on death clauses. These are common in loans to dealers, whether one is discussing real estate loans or working capital loans. A due on death clause provides that if a dealer dies, the lender may call the outstanding loans.

If you die, your survivors already have enough issues without having the bank on the dealership's doorstep calling your loans. Eliminate due on death clauses. This will require you to have a succession plan in which your lender can have confidence.

Operate or Sell?

Will your heirs be in a position to continue your business or is selling the appropriate strategy? If a sale is appropriate after your death, how can your heirs maximize the sale price?

There is no worse time to sell than when potential buyers think you have no choice. If possible, the succession plan should be geared around continuing operations. This will allow your heirs to best determine when a sale can take place at the most effective price and terms.

If you believe that sale of the dealership once you die is the best way to protect your heirs then develop a process that will lead to that. Get the business set up to maximize the ability of your heirs to sell on their timetable, if that is your wish.

Plan continued on page 4

Franchisor from page 1

The customer contends that the floor had an inherently dangerous, high gloss finish that obscured potential wet spots. Since the manufacturer required the dealer to use the high gloss floor finish, the plaintiff says, the manufacturer should be liable for the customer's injuries.

The franchisor moved to dismiss the lawsuit, arguing that the dealer's customer had no standing to sue it. It argued that it owed no duty of care to a dealership customer breached by simply prescribing a floor finish. In denying the franchisor's motion to dismiss, the court ruled that by requiring the use of what the plaintiff alleged was an inherently dangerous floor product, the manufacturer could be found to owe a duty to visitors to the service department.

Many dealers complain about manufacturer mandates, especially for building size, design, upgrades, and finishes. Dealers complain that they have to pay the high prices for manufacturer consultants and for their sometimes extravagant schemes. Dealers have a point. Factories envision cookie cutter facilities as a way to make dealer customers identify as manufacturer customers. The one-size-fits-all factory plans often fail to account for local zoning requirements, architectural traditions, or consumer preferences. The designs are often impractical, and as many dealers lament -- they do not sell cars.

The Virginia case is an addition to these often-stated concerns with a customer claiming that the factory requirement is inherently dangerous. In ruling against the franchisor in the case, the court followed precedent in cases from several states where franchisors' attempts to dismiss cases against them for mandated practices were denied. We are thus starting to see a trend of franchisors suffering the fallout of excessive interference in the business decisions of their franchisees. They are being called to answer for damages or injuries suffered as a result. A dealer sued because of

manufacturer mandates should keep this developing trend in mind. New car dealers regularly seek indemnification for lawsuits arising from alleged defects in vehicles. This federal court decision and the cases on which it relied increase the scope of potential indemnification for a dealer sued because of requirements imposed on it by its franchisor. In such a case, the dealer may want to seek indemnification from its franchisor, even where the plaintiff does not sue the manufacturer directly. A franchisor that injects itself into its franchisee's business through mandates should expect to answer when those cause problems.

Plan from page 3

If your heirs decide to sell, will unfunded liabilities, questionable occupancy rights, suspected environmental issues, or other problems interfere? Nothing causes a buyer to reduce an offer like questions about problems that can carry over to the new operation. Eliminate uncertainty. Step into the shoes of a buyer, and take a balanced look at your business. What unfunded liabilities or problems would concern you if you were looking to buy your store? Solve those problems.

Effect on Expansion

Lenders or franchisors that are unsure of your company's future will factor this into any decision-making process if you choose to expand your business. Do not allow this issue to cloud your future. A dealer with a solid succession plan is one franchisors and lenders can support in future endeavors.

Purchase Auto Dealer Law: the Definitive Legal Guide to the Purchase, Sale, and Operation of Vehicle Dealerships at www.autodealerlaw.com.