

DEALERSHIP STATUTES VS. CONTRACTS

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In last month's article, we looked at state equipment dealer laws and identified a number of statutory issues to be considered when negotiating a dealership agreement with a manufacturer.

In this month's article, we'll look at how to address those issues in a dealership agreement, and then drill down into some critical operational issues (including equipment types, parts provisioning, purchase requirements, prices, payment terms, exclusivity, etc.) that can bear heavily on the health of the manufacturer-dealer relationship over time.

Coverage: As a threshold issue, you need to know whether your state has enacted a dealership statute (most have, but the types of equipment they cover can vary substantially from state to state). Assuming it has, you will need to determine whether the statute covers your type(s) of equipment. If not, you may have to rely solely on your dealership agreement, a franchise statute (if applicable) and/or equity concepts for your rights and remedies.

The starting point is, therefore, locating your state's "fair dealer" or "equipment dealership" (or similarly titled) statute (Be careful; some states, such as Kansas, Alabama and Georgia, have more than one), and reviewing the "definitions" section for your type(s) of equipment.

This can be far more difficult than it sounds. Statutory coverage can range from "agricultural equipment" to "industrial equipment" to "heavy equipment" (among many others), without ever defining those terms, or for that matter, providing more than a rudimentary indication of what these designations might or

might not include - which sometimes makes it necessary to look to other unrelated areas of the state's law and/or prior judicial interpretations in order to get a sense for whether these important statutory protections might extend to a given dealership arrangement in your state.

Why is this so important?

Obviously, as a dealer, if you can access statutory protections that cannot be overridden or circumvented by your dealership and/ or related agreements), your risk, and therefore, the need to meticulously review and negotiate those agreement(s) might be reduced. That, however, raises a number of related questions: If a dealer statute applies, can it be waived, overridden or circumvented? If so, how might a manufacturer accomplish that? Does it provide you with enough types of protection in terms of the operational issues mentioned above?

Are the levels of those protections sufficient for your particular operation?

Ultimately, even in states where dealership laws apply, they often address only some (not all) of the relevant issues, do so at levels that are wholly or partially insufficient, and/or lend themselves to being circumvented, such as through captive and/or cross-de-faulted financing relationships with manufacturers (more on that later). Consequently, even in states where dealership laws appear to offer substantial protection, careful review and negotiation of dealership agreements is imperative. A discussion of how the statutory concepts identified in last month's article intersect with dealership agreements appears below:



1. Waiver of Statutory Coverage:

Even if you've identified a state dealership that law appears to apply to your equipment and operation, can the coverage be waived by inclusion of an express waiver in your dealership agreement? Many dealers start with the assumption that it cannot. Be careful, although a number of states' statutes (for example, California's, Colorado's and Florida's) restrict or invalidate such waivers, many states do not. Also, consider the likelihood that a dealership agreement may call for application of the laws of the state in which the manufacturer, rather than the dealer, is located - meaning that, even if your state restricts such waivers, if the laws of your manufacturer's state permit them (or perhaps don't cover your type(s) of equipment), you might find that your operation has little or no statutory protection - not the place to be if you decide to sell your dealership and/or seek enforcement of a repurchase obligation.

2. Modifications: Surprisingly enough, dealership agreements often include a unilateral right in favor of the manufacturer to modify the agreement "upon written notice to the dealer." Importantly, some dealership statutes prohibit unilateral modifications that "change the competitive circumstances" of the relationship (for example, North Carolina, Ohio, Oregon and Tennessee), but: (a) many more states leave this to the parties to decide; and (b) even in states that restrict such modifications, do you really want to litigate what constitutes

a "change of competitive circumstances?" So, in a case where a manufacturer changes a dealership agreement by, for example, modifying an exclusive territory, extending warranty requirements, or perhaps increasing staffing, advertising and/or purchase requirements, the issue might be subject to a statutory limitation in some states, but more often, it will be a question of what the dealership agreement says. If your initial thought is: "How can that be?" (or some variation thereof), you should probably have your dealership agreement reviewed by an attorney.

3. Transferability: Most dealership agreements we review include a restriction on transferability that reads something like this: "Neither the Dealer nor any of its owners shall sell, transfer, assign or otherwise convey substantially all of the assets and/or voting control of the Dealer without first obtaining the written consent of the Manufacturer, which consent may be granted, conditioned or withheld in the sole and absolute discretion of the Manufacturer." Many, though far from all, state dealer statutes limit manufacturers' rights to restrict such transfers and/or require that "such consent shall not be unreasonably withheld." So, if you're doing any estate and/or succession planning, or perhaps you just want to factor in the possibility that you might someday wish to sell your dealership to a third party, you will want to determine up front whether: (a) the applicable dealership law affords you any protection; (b) such protec-

tion is waivable; and (c) a right, even if limited, to transfer your operation should be included in your dealership agreement.

Note: Manufacturers can often be persuaded to allow for intra-family transfers and/or limited rights to transfer to third parties who demonstrate reasonably sufficient industry knowledge and experience, creditworthiness and financial capacity.

4. Notices of default and cure periods:

Depending on the terms of the contract, defaults can come in many forms. Though payment defaults are virtually always identified, other types of defaults, such as failure(s) to meet and/or maintain financial ratios, staffing levels, sales quotas, advertising standards, facilities requirements, geographical sales limits, etc., can motivate a manufacturer to attempt to terminate and/or modify a dealership arrangement.

In some cases, a dealer may not even realize it has failed to satisfy one of these "non-monetary" requirements. In others, neither party may bother to pursue the issue - at least not until management changes, sales drop, and/or some other motivating factor manifests itself (e.g., a new or larger prospective dealer in the same area. Not surprisingly, a non-monetary default can come as a big surprise to a dealer, unless the dealer has a right to "notice and opportunity to cure" before being declared in default (for example: "In the event of any alleged non-monetary breach by Dealer, the Manufacturer shall deliver to Dealer written notice of the nature of the alleged

breach and the cure reasonably required therefor ("Notice of Breach"), in which event, the Dealer shall have not less than 90 days from and after its receipt of such Notice of Breach in which to cure the same to the reasonable satisfaction of the Manufacturer before being deemed in default"). Again, although some state dealership statutes include similar "notice-and-opportunity-to-cure" requirements, many do not, meaning that a dealer could find itself the subject of a business-destroying "surprise" termination, unless the necessary provision is included in the dealership agreement.

5. Termination (whether good cause is required): While we're on the subject of terminations, it might seem natural to assume that only a dealer's "material" breach should be sufficient to warrant termination of a dealership agreement by a manufacturer. This mistake has, unfortunately, left many dealers without recourse when they found themselves on the wrong end of a manufacturer's termination for what the dealer assumed were "minor" infractions. Unless the applicable dealer statute and/or dealership agreement require(s) "good cause" for such termination, the dealer could literally find itself being terminated for something as seemingly benign as failing to timely deliver a financial statement, upgrade an advertisement, and/or hire an additional salesperson. Though the majority of state dealer statutes require "good cause" for termination, a surprising number of them do not. Also, bear in mind that there is no universally accepted definition of "good cause" for these purposes.

Most states include a specific list examples, including bankruptcy,olvency, material misrepresentations, legal violations and material breaches of dealership agreements. Others, for example, California, simply require a "... failure by a dealer to comply with the requirements imposed on the dealer by the dealer contract..." Thus, even in states (including California) where the dealership law appears to override many conflicting provisions of dealership agreements, the importance of such dealership agreements cannot be overstated.

6. Repurchase obligations: Finally, when a dealership agreement is validly terminated, the obligation, if any, of the manufacturer to repurchase the dealer's unsold inventory is usually paramount. Such obligations vary dramatically from agreement to agreement and from state to state. Many dealership agreements offered by manufacturers or distributors either ignore such requirements or include language to the effect that: "The Manufacturer has no obligation to repurchase any equipment, parts, materials, supplies or other items from the dealer." Most (though not all) dealer statutes, however, impose repurchase obligations on manufacturers to one degree or another, and go on to invalidate contrary contract provisions. Some, however, appear at first glance to do so, but then back away from such requirements in whole or in part - leaving the dealer in the untenable position of perhaps being stuck with equipment and/or parts it can't sell, can't require the manufacturer to repurchase, and/or can't support. Thus, given the danger that an unfavorable

statute and/or judicial precedent might be applied, making certain the dealership agreement includes the right of the dealer to require the manufacturer to repurchase unsold equipment and parts upon termination can be critical to the dealer's survival - even in instances where the dealer originally (but mistakenly) believed a favorable state dealership law would apply.

Drilling Down: Now that we've addressed the broader legal concepts, let's turn to some of the more important functional/operational issues driving all of this. Why? Because if these issues are not carefully considered and negotiated with respect to your specific operation and then, where possible, factored into your dealership agreement, all the legalese in the world won't help you.

- **Operations Generally:**
- **Purchase Requirements:**

Identify the minimum number of machines, and levels of parts, supplies, consumables and other items) the dealer will be required to purchase and when;

- **Stock Levels:** Determine the minimum levels of stocks of parts and supplies that will be required and how/when they will be supplied;
- **Availability:** Identify a selection and sufficient quantities of desirable equipment and required parts, supplies and consumables to be made available by the manufacturer;
- **Changes to Equipment Designs and/or Specifications:** Negotiate for a right to return and exchange obsolete machines for new designs/

specifications. At a minimum, require reasonable levels of part and consumables support for the lives of all machines (including those discontinued or rendered obsolete by design or specification changes), and if possible, make certain those requirements don't expire or terminate when the dealership agreement expires or terminates (remembering that the dealer may have customers who require support long after that);

- **Timing:** Require reasonable timing for deliveries of equipment, spare parts, supplies, consumables, etc.; for example, no more than [] days/ weeks from date of order (equipment downtime tends to severely impact future sales);
- **Prices:** Specify pricing for each of the above, and determine whether, when and how much those prices might be adjusted during the term (knowing that manufacturers often start with a blanket right to adjust prices as and when they see fit). Require reasonableness and where possible, include most-favored nations status (a requirement that the prices you pay must be no higher than the lowest prices paid by any other dealer in the manufacturer's network), caps on price increases, and extended advance notice for any such increases;
- **Rebates and Discounts:** Will the dealer be entitled to any rebates, concessions, subsidies and/or discounts? If so, identify levels and preconditions, and if any of them are material to the dealer's ability to perform profitably, identify

them as "a material portion of the consideration flowing to Dealer;"

- **Payment Terms:** Identify sale and payment terms for items to be purchased from the manufacturer, and require written approval of both parties for changes (or either or both of the ability to terminate and require repurchase, and/or most-favored-nations status, as a fallback if the manufacturer insists on flexibility to change payment terms);
- **Warranty Support and Reimbursement:** Identify the level(s) of warranty service, if any, the dealer will be required to provide and customers will be entitled to receive, and whether that service requirement will extend to equipment sold by the manufacturer and/or other dealers within the dealer's territory. If so, the dealer will also need to know how and when the dealer will be compensated (Note: Remember that reimbursement rates that look good today might not look so good in a few years, particularly if the dealership agreement doesn't include adjustment mechanisms for the cost of parts and labor, or at least inflation generally);
- **Facilities Requirements:** Identify types (offices, showrooms, storage, cleaning, repair and maintenance facilities, warehouses, yard, etc.) sizes (square footage / acreage), specialized equipment (lifts, hoists, diagnostic equipment, etc.), finishes (interior and exterior, including signage and security) of, and how many facilities the dealer be authorized or required to operate, and where;


- **Financing - of Dealer Purchases:** Determine whether any special and/or floorplan financing might be available from the manufacturer or any third-party lenders who might maintain special relationships with the manufacturer. Important: Be particularly careful with respect to financing agreements that include "cross-defaults" with dealership agreements. Even if your state maintains a favorable dealership law, you might find yourself being foreclosed on by a lender who has the right to declare a default and seize your equipment because you refused to acquiesce to what you perceive to be an unreasonable (and perhaps otherwise legally unenforceable) demand of a manufacturer.
- **Financing - of Customer Purchases:** Identify whether any special (conventional and/ or lease) financing might be available through the manufacturer for customers and the associated requirements.
- **Rentals:** Determine whether, and to what extent, the manufacturer and/or lender intends to restrict rentals of equipment purchased and how such restrictions might impact any proposed rentals or leases of your equipment.
- **Other Requirements:** If other operational requirements will be shouldered by the dealer (e.g., records retention, insurance, financials, signs, promotional materials, advertising, marketing, staffing, etc.), make certain these are spelled out and that the dealer has the right to prior notice and opportunity to cure if

the manufacturer intends to declare a default if the dealer overlooks any of them.

- **Exclusive Territory(ies):**
- Will the dealer be granted the right by the manufacturer to sell the manufacturer's products (or certain lines) exclusively within a defined territory and without competition from the manufacturer and/or other dealers?;
- If the manufacturer and/ or any other dealers) is/ are to be entitled to sell to "national accounts" or to other customers within that territory, will the dealership be entitled to be paid a commission on such sales? (at what rate?; how will the sales be reported?; what happens if the seller fails to report and/or pay?).
- **Transferability:** As noted above, transferability can be critical to maintaining the value of your business as well as for purposes of estate, succession and retirement planning. For sales of the dealer's business or transfers upon death of the owners), negotiate for automatic approval of at least family members and other proposed transferees who can demonstrate reasonably sufficient industry knowledge and experience, creditworthiness and financial strength. At a minimum, require that the manufacturer's approval not be unreasonably withheld.
- **Other Elements of Value:**
- In most cases, the dealer is going to have to agree to pay specified prices for products purchased

from the manufacturer, perhaps based on different levels and/or volumes of purchases, but other items, including in some cases, facilities improvements, advertising, signage, diagnostic equipment and/or other items might be wholly or partially funded (or reimbursed) by the manufacturer.

- The dealership agreement may well include a provision requiring the dealer to purchase supporting and/or peripheral products (machinery, attachments, parts, supplies, specialized tools, diagnostic equipment, software, computer hardware, advertising materials, consumables, etc.) only from the manufacturer, and not from other dealers or third parties. In exchange for that, negotiate for at least: (a) most favored-nations status with respect to pricing and terms; and (b) the right to obtain, use and sell non-OEM products when OEM products are unavailable (Note: This can be particularly important for agreements with overseas manufacturers as well as others who require long lead-times).
- **Expiration and Termination:**
- How and when does the dealership agreement expire and/or terminate, and for what reason(s) (e.g., upon default, for "good cause" or "at either party's discretion")? Will it renew automatically, or does it simply expire on some predetermined



date? If the latter, it may be advisable to negotiate an automatic renewal or at least a renewal option; provided the dealer is not then in breach. **What happens upon termination** - for example, what "repurchase" and/or post-termina-tion provisioning/supply obligations with respect to equipment, parts, supplies, consumables, software updates, etc. will exist? Include at least a requirement that unsold and "new and unused" (often "under 50 hours and undamaged" with respect to equipment, and with respect to other assets "undamaged and still in the original packaging") equipment and parts, specialized tools, equipment and computer hardware, and all advertising/display items and other peripherals, other than items the dealer elects to keep, be repurchased by the manufacturer (Note: Include 5% for handling, packing and loading whenever possible) - remembering that the state whose laws are ultimately deemed to apply may not yet have adopted a statutory repurchase obligation and/or if it has, may not apply it to your specific type(s) of equipment.

Conclusion:

Dealership arrangements can be immensely valuable, but this is an area where state laws tend to vary substantially and "form" agreements are almost non-existent - for good reason. Most manufacturers treat dealers well, and most dealers reciprocate, each recognizing the other's importance to their overall business efforts. But mar-kets, like relationships, tend to change over time, and what looks like a great deal today may not be as appealing tomorrow. So, consider your options, and be prepared to negotiate these agreements carefully. Attempting to do without, or simply signing the first agreement offered to you can have disastrous consequences. Fortunately, most manufacturers will attempt to accommodate a certain number of modifications to their dealership agreements; provided such changes are reasonable and designed to advance the relationship. For most dealers, getting this right before the relationship commences is critical, as few have the time, available cash or desire to spend years litigating over a poorly negotiated or written dealership agreement. **As always, feel free to contact us if we can help at www.jwlinternational.com or 866-582-2586.**

ABOUT THE AUTHOR

JAMES WAITE is a corporate and transactional attorney and the founder of law firm JWL International, with more than 30 years in the equipment industry. His practice focuses on representation of manufacturers, distributors, dealers and lessors of mining and construction equipment and parts, both domestically and internationally.

