NADC
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DEFENDER

The National Association of Dealer Counsel Newsletter MAY 2011

The Enemy Within: Part II, "To Have or Not to Have"

By Johnnie Brown, Pullin, Fowler & Flanagan, PLLC

When counseling dealer principals about employee issues, it is surprising to encounter the view on whether it is prudent to have an employee handbook. Many single location dealers seem to believe that the employee handbook is a hindrance to their ability to "run" their stores as opposed to being a method of protection.

I have seen employee handbooks range from 3 pages to 40 pages. While the former is certainly insufficient, the latter is probably overly complicated and not easily followed. It is my recommendation that dealer principals use a handbook to prevent claims of discrimination, and to prevent claims of breach of contract or implied contract of employment. This is important in at-will employment states.

The purpose of this article is to provide some suggestions on the drafting of handbooks and a partial list of basic principles and issues that should be addressed. Please do not believe this to be an all encompassing list of topics to be addressed. While state laws can require the adoption of additional sections, or perhaps some deletion of those suggested herein, these can hopefully provide you with a good starting point in drafting an employment handbook.

The Acknowledgment Page: The acknowledgement page should affirmatively and clearly state that the employee is at-will and that the handbook should not be considered a contract, expressed or implied. It should affirmatively state that changes to the handbook can be made without notice, and that verbal changes from any individual can not be considered binding upon the employer. It should affirmatively state that changes can only be made in writing by the dealer principal.

I recommend that the normal language that states that the employee acknowledges receipt and has read and understood the handbook be changed. I recommend having it state that the employee acknowledges receipt, the responsibility to read the information contained therein, and to ask questions if needed. I have had a plaintiff's lawyer embarrass a dealer principal by having him

In this Issue:

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admit that an employee who receives the handbook two minutes before being asked to sign the acknowledgment page could not have read and understood its content.

Vacation and Sick Leave: The handbook should clearly state the employer's vacation and sick leave policy, and whether it is paid or unpaid. Frequently, these two items are combined into personal days. The policy should state when the annual accumulation of leave accrues and is available to the employee, such as, the beginning of the year or the employee's anniversary date, and how many leave days can be accumulated or carried over from year-to-year. If state law allows, I recommend stating that all vacation pay and sick leave are forfeited at the time of the employee's departure from the dealership.

Drug Testing Policy: If state allows random drug testing, the handbook policy should define that testing does take place and the consequences of an employee's failure or refusal to engage in drug testing. Note that some states do not allow random drug testing as they consider it an invasion of privacy. However, most states that maintain this position do allow random drug testing to take place in "safety sensitive" positions. An employer can drug test when there is reasonable suspicion of an employee being under the influence of alcohol or drugs. Most states allow drug testing to take place post-hire/pre-work for employees, but if the state prevents random drug testing due to privacy laws, be careful about requiring a drug test after an accident. You may still need probable cause. I also recommend stating that the employee has the responsibility to report to any supervisor his taking of any prescription medication which he believes is impacting his ability to perform his work in a safe manner. Obviously, we do not want supervisors to know everything about an employee's medical history, but certainly they should know that which impacts workplace safety.

Discipline: I am not a fan of progressive discipline, but freely admit some view it as being "fair." I find it to be too restrictive for an employer. Even if one uses different sections, which provide a laundry list of items that may result in a written warning, then suspension, or termination, I always recommend a provision under each section which states that the employee is advised that discipline is not restricted to the general principles stated above and that the employee may be disciplined, including up to termination, for any of the listed items. Also, state that the list is not intended to be exhaustive. While progressive discipline can prevent claims of discrimination, we certainly do not want to tie the hands of dealer principals when it comes to the rare employee who is trying to "work the system."

Family Medical Leave Act: While this section does not need to be extremely detailed, it should provide general information to the employee about their eligibility, rights, and responsibilities under the Family Medical Leave Act. I recommend referring any questions to the human resource director. The policy should clearly state when the annual leave period will begin for the employee, for example, upon date of hire, at the beginning of any calendar year, or other designated year. This can be important for determining FMLA leave from year-to-year should the situation arise. Furthermore, your policy should state how family medical leave is handled in conjunction with vacation and sick leave, and if your state allows, with any workers compensation leave. Employers have the opportunity to have them run concurrently if clearly stated within their handbooks. Under a worst case scenario, if the latter is not included, an employee could take vacation and sick leave, any workers compensation time off and then receive an additional 12 weeks of unpaid leave and protection under the Family Medical Leave Act. We certainly want to avoid this if possible. The United States Department of Labor has an excellent website for FMLA questions.

Sexual Harassment and Other Discriminatory Practices: While this one is quite obvious, I have seen the requirement that the employee place such complaints in writing. The law is that once an employee makes a complaint, verbal or written, to a supervisor, the supervisor must undertake a prompt and reasonable investigation in the matter. It is not an excuse to fail to conduct the investigation if the employee refuses to place the same in writing, but the failure of the employee to cooperate can be considered a factor in any subsequent suit. The policy should also clearly state who such matters should be referred and generally how they will be handled. I also believe that language should be contained within this section strongly suggesting that the employee keep such complaints confidential and stress that the process is a confidential employee matter and should be kept as such.

Use of Company Property: *i.e.* telephones, computers, tools, equipment, vehicles: The handbook should make clear that these items are company property and should only be used for company purpose, or if some personal use is allowed, its limitation.

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It should be made clear to the employee that the use of company phones or computers means that all information contained on these devices are considered company property and can be monitored at the discretion of the owner. By stating this, we can avoid claims of invasion of privacy.

Social Media: This is the hot topic that is absent from many dealer's policies at this time. There should be a clear policy on the use of media such as Facebook and Twitter and how much of the dealerships practices and work can be revealed by the employee. The policy should state that confidential business practices and employee matters not be discussed on these social tools nor should any customers' names or information be revealed. While these can be tools for salesmen to maintain contact with potential customers and existing customers, they can also be fraught with danger when handled by a disgruntled employee or perhaps a boastful salesman putting on his Facebook account how much commission or profit he made on the sell of any particular vehicle.

Legal Compliance: The handbook should clearly state that the employer expects the employee to obey all state and federal law applicable to his/her position, that the employee will conduct themselves with honesty and integrity toward the customer, and that he/she will be legally compliant with all consumer and disclosure paperwork.

Outside Employment/Conflicts of Interests/Gifts: These items should be addressed separately but are somewhat related. The handbook should address that employees, particularly managers and salesmen, are prohibited from accepting gifts from third-party lenders and that they should not engage in any activities which would create a conflict of interest between the employee and the dealer principal. Furthermore, the dealer principal should make the decision whether a salesman or an employee is allowed any outside employment from the dealership. This can be important. I encountered a situation in which a sales manager was running a towing and delivery service, and unbeknownst to the dealer, was having his own company transport dealership vehicles and making quite a handsome sum on the side.

Overtime: How overtime is paid and calculated should be clarified. It appears that the United States Department of Labor has the industry somewhat confused on how to handle overtime with service technicians and other previously exempt employees. Formerly exempt employees may be no longer exempt, and overtime may have to paid to them unless they meet certain other exemptions under the Fair Labor Standard Act and your state wage and hour laws.

Military Leave: The policy should clearly state that the employer follows both the federal and state requirements on military leave. Please see the Uniformed Services Employment and Reemployment Rights Act ("USERRA") at 38 U.S.C. 4301 et seq. It is beyond the ability of this article to discuss this in detail due to its complexity, but be aware of the employer's duties and the employee protections mandated by both federal and state law. Furthermore, under the Family Medical Leave Act, military service can more than double FMLA leave to 26 weeks from the normal 12 weeks, and expand its applicability to childcare issues.

Benefits: The policy should clearly state the type of benefits that are generally available through the employer when they became available, and who may or may not be eligible. I do not recommend that the provision become too specific, but simply refer any questions to your human resource director or the dealer principal for details. This can prevent claims that such benefits were promised when they were not.

Again, I encourage you to understand your specific state laws on these general principles and issues addressed above. Hopefully, this can assist you in limiting the exposure of our dealer principals from the enemy within. ■

Johnnie Brown is an Equity Member of the law firm Pullin, Fowler & Flanagan, PLLC in Charleston, West Virginia. For the last ten years, his practice has consisted of representing automobile dealers in all aspects of consumer and commercial litigation. He provides consulting and compliance counseling to his automobile dealer and manufactured housing clients on a continuing basis. He is member of the NADC Board of Directors.

Executive Director's Message

Erin K. Hussey
NADC Executive Director

140 NADC members traveled to Chicago April 3-5th for the 7th Annual NADC Member Conference. Once again, attendees of the Conference enjoyed the breathtaking views and first class service at the Trump International Hotel & Tower.

The Conference planning committee strived to provide attendees with a first-class program and top notch speakers. In fact, the committee came up with so many valuable sessions that it was decided to extend the program ½ a day. I think all of the folks who attended the last session on Social Media, presented by Jami Jackson Farris of Parker Poe Adams & Bernstein LLP and Meredith Tolar Penninger of Sonic Automotive, would agree that the extension was a wise idea!

Rob Cohen of Auto Advisory Services, Inc. and Aaron Jacoby of Arent Fox, LLP kicked of the Conference with a presentation focusing on the recent class action suits brought against dealers. The duo discussed key preventative measures and specific defense strategies.

Andy Koblenz, General Counsel of NADA and popular NADC speaker, returned to the podium with an update on the NADA's efforts on a variety of regulatory and legislative matters. NADC President Patty Covington of Hudson Cook LLP invited Joel Winston, Associate Director for Financial Practices with the Federal Trade Commission to join her on stage to discuss the FTC's new authority to issue rules under the FTC Act for dealers.

There were a total of ten engaging sessions presented over the full 2 days. I encourage all of you not in attendance to visit our website at www.dealercounsel.com and benefit from the conference materials that have been uploaded. Please look under the Conference, Workshop and Webinar Handouts section in the eLibrary (7th Annual NADC Member Conference).

I would like to thank all of our event sponsors for their contributions to the Annual Conference. These sponsors help to elevate the quality of the event while keeping the cost low for members. Many thanks to Anderson Economic Group, Capital Automotive REIT, Counselor Library.com, LLC, Dixon Hughes Goodman LLP, The Fontana Group, Inc., Moss Adams LLP and Portfolio General Management Group, Inc.

I would like to take this time to ask you to Save the Date for the 2011 Fall Conference! The Conference will be held October 9-10, 2011 at the Trump International Hotel & Tower in Chicago. All NADC educational programs rely on members' suggestions for topics and speakers. If you have a suggested session and/or topic you think should be covered at Fall Conference please email me at ehussey@dealercounsel.com. ■

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Dealer Rights in a Termination of or Change of Distributor

Many distributors assume that if they resign or they transfer the right to distribute vehicles, they can simply terminate dealers. They assume that they can just notify dealers that the party is over, and everyone just walks away.

And if a distributor is financially insolvent, that may be the practical effect since there will be little to gain in a lawsuit. However, where the distributor is financially solvent, and it makes the voluntary decision to stop distribution, that is not the case. Every state has a statute that prevents the franchisor from terminating or refusing to renew a dealer's franchise unless the franchisor can meet the state standard for that action in an administrative or judicial proceeding if requested by the dealer. A dealer thus has the right to continued existence as a franchised dealer.

A franchisor that makes the voluntary decision to stop distributing vehicles and supporting its franchisees breaches that agreement and violates state law on termination of a dealer. This will give the dealer the right to damages for breach of contract and any damages allowed under state law for breach of the distributor's statutory responsibilities. If the distributor is transferring distribution rights, a dealer may even have a claim against the new distributor to require it to continue the dealer's franchise depending on state law.

Minimizing the Effect of "Hell or High Water" Clauses in DMS Financing Leases

Feature Article

By Mark A. Counts, Counts & Bonacci, LLP

Two of the major DMS' vendors utilize separate finance companies to lease DMS hardware to auto dealers. These leases usually state that they are finance leases governed by Chapter 2A of the Uniform Commercial Code and contain clauses denying the lessee the right to revoke acceptance of the goods or to make a claim for cancellation, termination, modification, offset or rescission. These leases also contain clauses requiring the dealer to make all lease payments "come hell or high water" by employing phrases along the lines of "Your obligations under this lease are absolute and unconditional." On occasion, clauses of this nature have been used to unfairly penalize dealers for what would otherwise be a justifiable lease termination. Fortunately, these clauses are susceptible to attack.

A prime example can be found in the case of *Info. Leasing Corp. v. Chambers*, 789 N.E.2d 1155 (Ohio App. 1 Dist. 2003)("Chambers"). In *Chambers*, a small restaurant owner, Chambers, leased an ATM from a vendor ("CCC") through a commercial lease with a lessor ("ILC"). After the lease was executed, CCC filed for bankruptcy and Chambers stopped remitting payments on the lease. Chambers repeatedly notified ILC that the ATM was available for repossession and that ILC should repossess it. Despite receiving several notifications, ILC made no efforts to repossess the ATM. Rather, ILC brought suit against Chambers seeking to accelerate all amounts owed under the finance lease.

Using prior Ohio precedent, the *Chambers* court found that an acceleration clause was void if it failed to incorporate a requirement of the lessor to mitigate its damages. The court stated:

> "In Ohio, "[a]cceleration clauses in leases have generally been upheld **as long as the lease also requires the lessor to mitigate damages**." In the leading case, *Frank Nero Auto Lease, Inc. v. Townsend,* the motor vehicle lease agreement allowed the lessor to accelerate lease payments and to repossess the car. The default provision allowed the lessor to relet or resell the car and collect rents for the entire lease term, thus allowing double payment for the leased car. **The court concluded that the clause was against public policy because it bore "no reasonable relationship to the damages incurred." It held that the lease provision was invalid and unenforceable**."

Id. at 1164 (emphasis added)(internal citations omitted). Based on this precedent, the court concluded:

> "We conclude that, under Ohio common law, the **acceleration clause in this lease agreement was not enforceable** as a matter of public policy because it **failed to include an obligation on the part of ILC to minimize its damages**."

Id. at 1165 (emphasis added).

This finding did not mean that the lessor's claim for damages was prevented. Rather, the *Chambers* court found that the "gap filler" provisions of the Ohio UCCC would determine the measure of damages. Ultimately, the Court concluded that "… the lessor, ILC, was entitled to the unpaid rent and the present value of the future rent, less the value of the ATM, plus any incidental damages." *Id.* at 1170.[1] In reaching this conclusion the Chambers court stated:

> "**Under [the Ohio UCC] … if the goods are in the possession of or available to the lessor, and if they have some reasonable lease or sale possibility, the lessor is under a duty to make such a sale or lease. Failing so to re-lease or sell, the lessor loses the rents that it could otherwise recover from the lessee. This section is a large incentive to the lessor to mitigate."**

Id. at 1167-1168.

Chambers strongly indicates that the negative effect of a "hell or high water" clause in a DMS lease can be mitigated. In order to achieve this goal, dealers (and their counsel) should take the following precautionary actions:

1. Inform the vendor in writing of the location of the goods covered by the lease;

2. Make repeated demands for the vendor to repossess the goods;

3. Make repeated demand on the vendor to make a reasonable attempt to release or resell the goods;

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[1]In mentioning incidental damages, the *Chambers* court stated that the Court should consider "expenses saved in consequence of Chamber's default." *Id.* at 1170. Thus, in contesting damages, the dealer should prepare an accounting of the costs the vendor avoided by being relieved from performance of the lease.

4. Make repeated demand for an accounting of the goods after their repossession;

5. Obtain and present lay and expert opinion on the fair market value of the goods at the time of their purchase, repossession and/or tender of repossession;

6. Obtain and present lay and expert testimony that there was a market for the goods repossessed and/or tendered for repossession;

7. Present a claim that the residual value of the goods at the time of repossession and/or tender of repossession was ***equal to*** or ***in excess of*** the remaining lease obligation;

8. Obtain and present expert testimony on the costs the vendor avoided by not performing the lease; and

9. Present a claim that the acceleration clause is void because it fails to require the vendor to minimize its damages (thereby triggering the UCC gap filler provisions). ■

Mark A. Counts is the managing partner of the law firm Counts & Bonacci, LLP in Houston, Texas.

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