



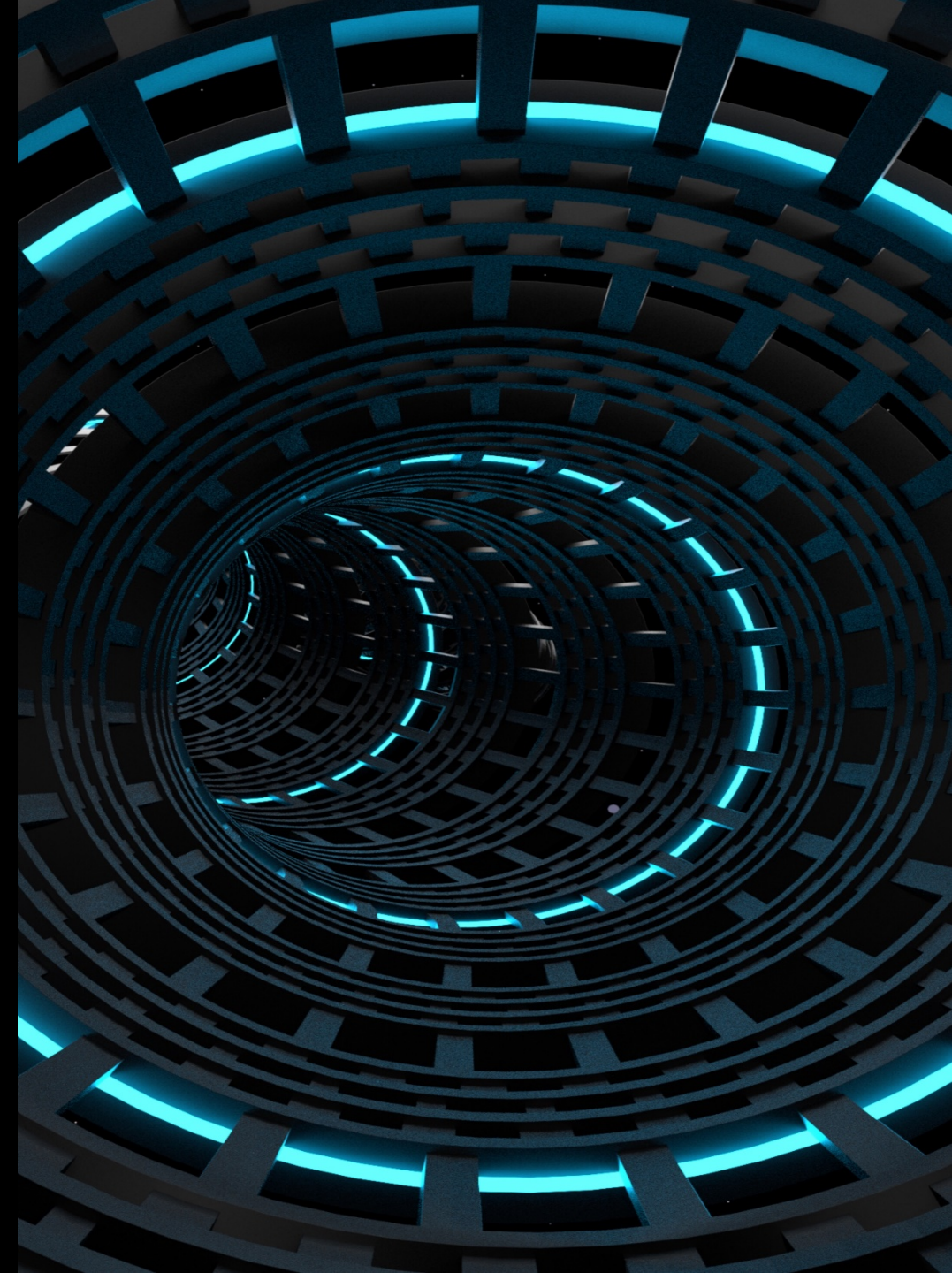
# Distressed Dealerships — Impact of COVID-19 on Dealer Networks

*Future of Automotive Return to  
Business Mini Series*

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**Seyfarth Shaw LLP**

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# Speakers

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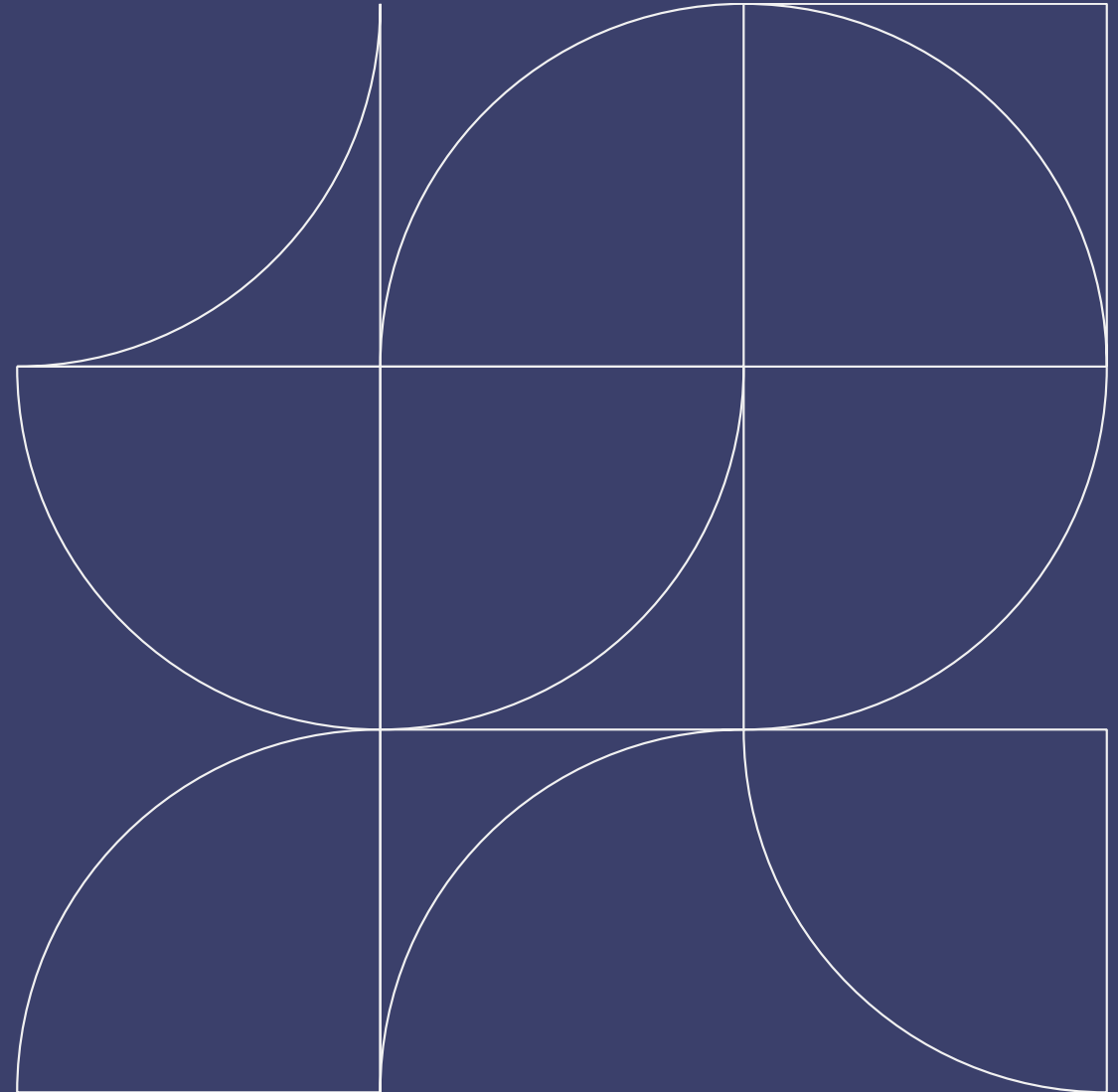


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# Agenda

- What Lies Ahead – Who Is At Risk in the Post-Pandemic Auto Industry
- CARES Act – Band-Aid or Long-Term Solution?
- A Silver Lining – Opportunities for Innovation and Change
- Strategies for Responding to the Distressed Dealer

# What Lies Ahead – Who Is At Risk?



# Immediate Impact of COVID-19 Pandemic on Dealers

- COVID-19 pandemic forced dealers to cease operating showrooms for past three months.
- Mike Jackson, acting CEO of AutoNation, recently stated in an interview that during the COVID-19 pandemic, 40+% of transactions have been online.
- According to a recent NADA survey:
  - 91% of dealers surveyed will use or continue to use digital retailing after COVID-19.
  - Dealers who identified as having a digital retailing capability reported that their GPPV increased versus dealers who did not.
  - Average number of units delivered per salesperson as reported during the survey period doubled, from 9 to 18.

# Reopening and Meeting Changed Consumer Preferences

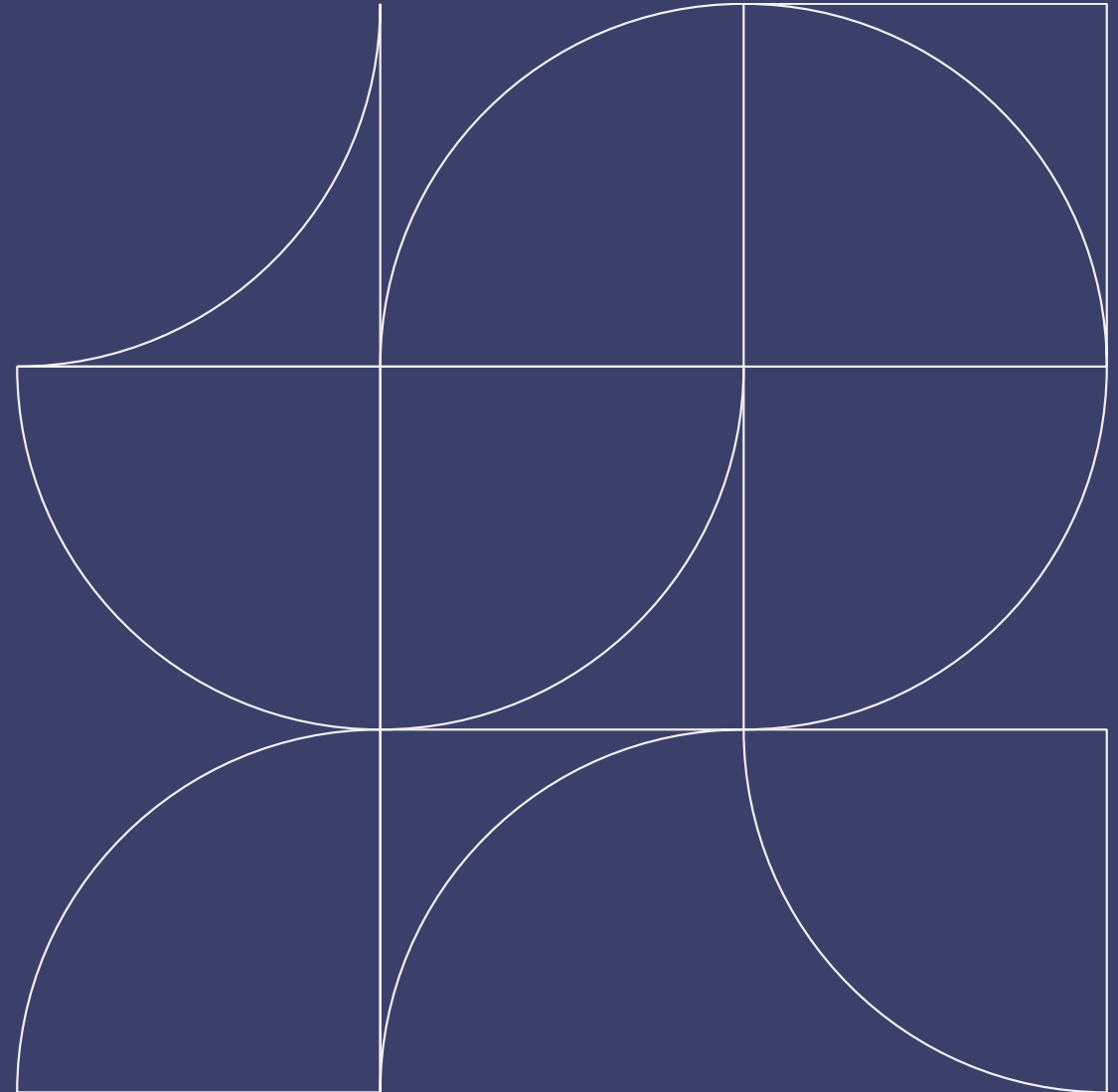
- Dealers need to comply with state and local opening requirements and adopt “reasonable” measures to protect guests from potential infection.
- Compliance will impose increased costs on dealers, and dealers will be exposed to heightened risk of consumer claims.
- Consumers are likely to demand new ways to access vehicles sales and service, including
  - Paperless in-store experience
  - Blend of online and in-store experiences
  - Fully digital experience with the only physical contact at delivery
  - Vehicle pick-up and delivery for sales and service
- Some will not be prepared for new retailing environment.

## Other Trends Threatening Traditional Dealer Model

- COVID-19 affecting ancillary markets (e.g. travel) which will impact OEMs and dealers; dramatic changes in rental car market.
- EV industry producing “maverick” firms like Tesla and Rivian not using the traditional dealer distribution model to bring their product to market.
- AVs still likely to create new competitive pressures for OEMs and dealers as consumers may rethink traditional car ownership.
- Legislative and regulatory changes (e.g. A.B. 5 in California) present additional challenges (and costs) for traditional franchising model.
- Who is at risk? EVERYONE
- Like other major events, financial distress for many dealers is inevitable.



# CARES Act – Band-Aid or Long Term Solution?



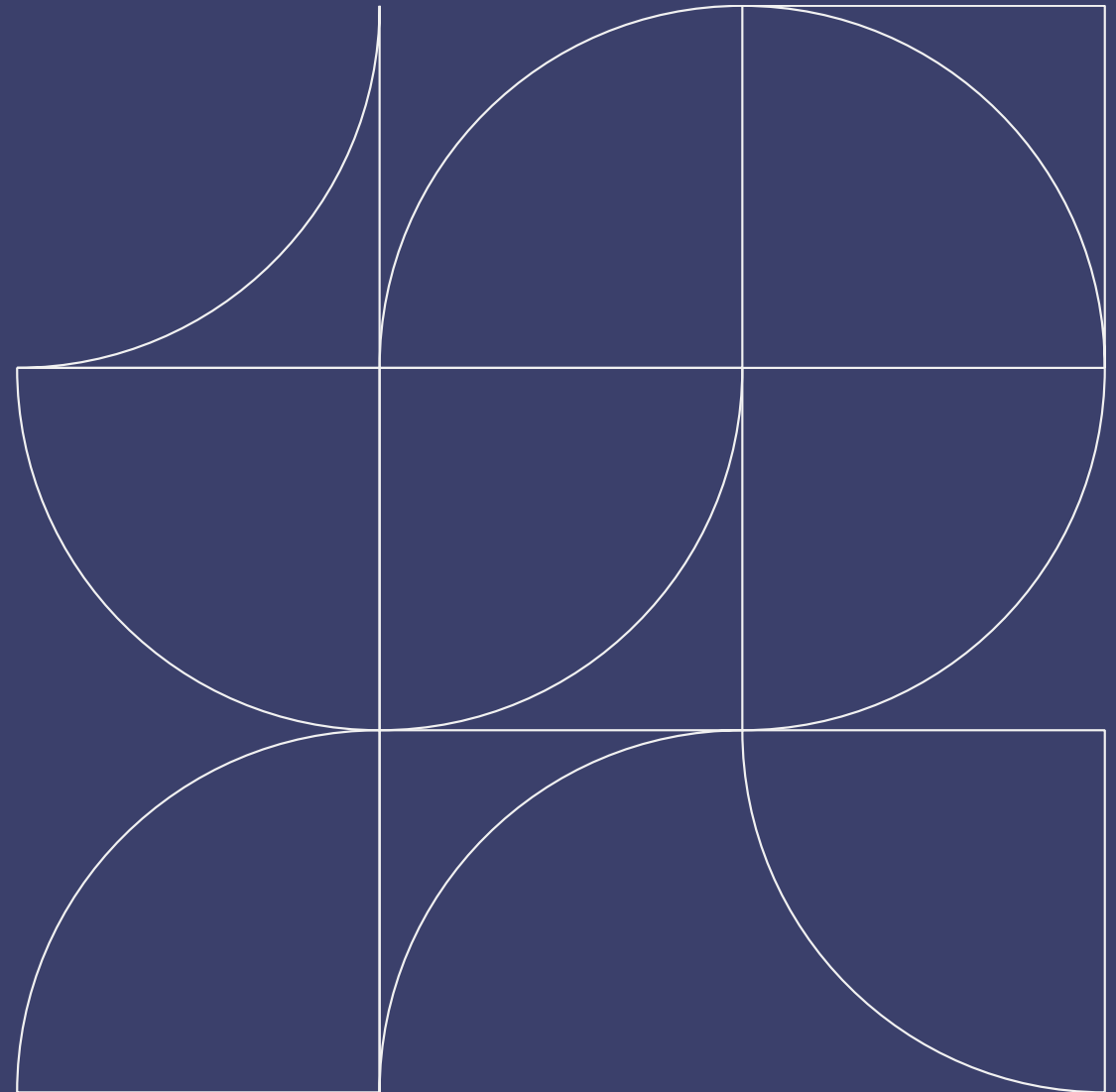
# **CARES Act Offers Dealers Short Term Economic Relief**

- CARES Act enacted by Congress in response to COVID-19 pandemic offers short term economic relief for dealers.
- Small Business Administration Paycheck Protection Program makes loans of up to \$10 million available to dealers and ownership groups – designed to encourage employers to keep employees on staff by offering loan forgiveness for certain payroll expenses based on how much of workforce the employer keeps employed.
- Federal Reserve Main Street Loan Program underwrites low interest loans to small and medium sized businesses; available to companies with fewer than 15,000 employees and 2019 revenue of less than \$5 billion.

# Loans Cannot Fix Systemic Challenges

- Federal loans can help dealers bridge the gap on a short-term basis, but they add debt and do not address impact of systemic changes on dealer bottom line.
- Dealers need to consider how they will address new challenges:
  - Fewer personnel?
  - Allocation of resources between brick-and-mortar and digital marketing capabilities?
  - Economies of scale?
- OEMs should anticipate that dealers will face these challenges with varying degrees of success and varying degrees of willingness to make the changes and investments necessary to succeed.
- Industry needs to plan for dealership failures.

# A Silver Lining – Opportunities for Innovation and Change



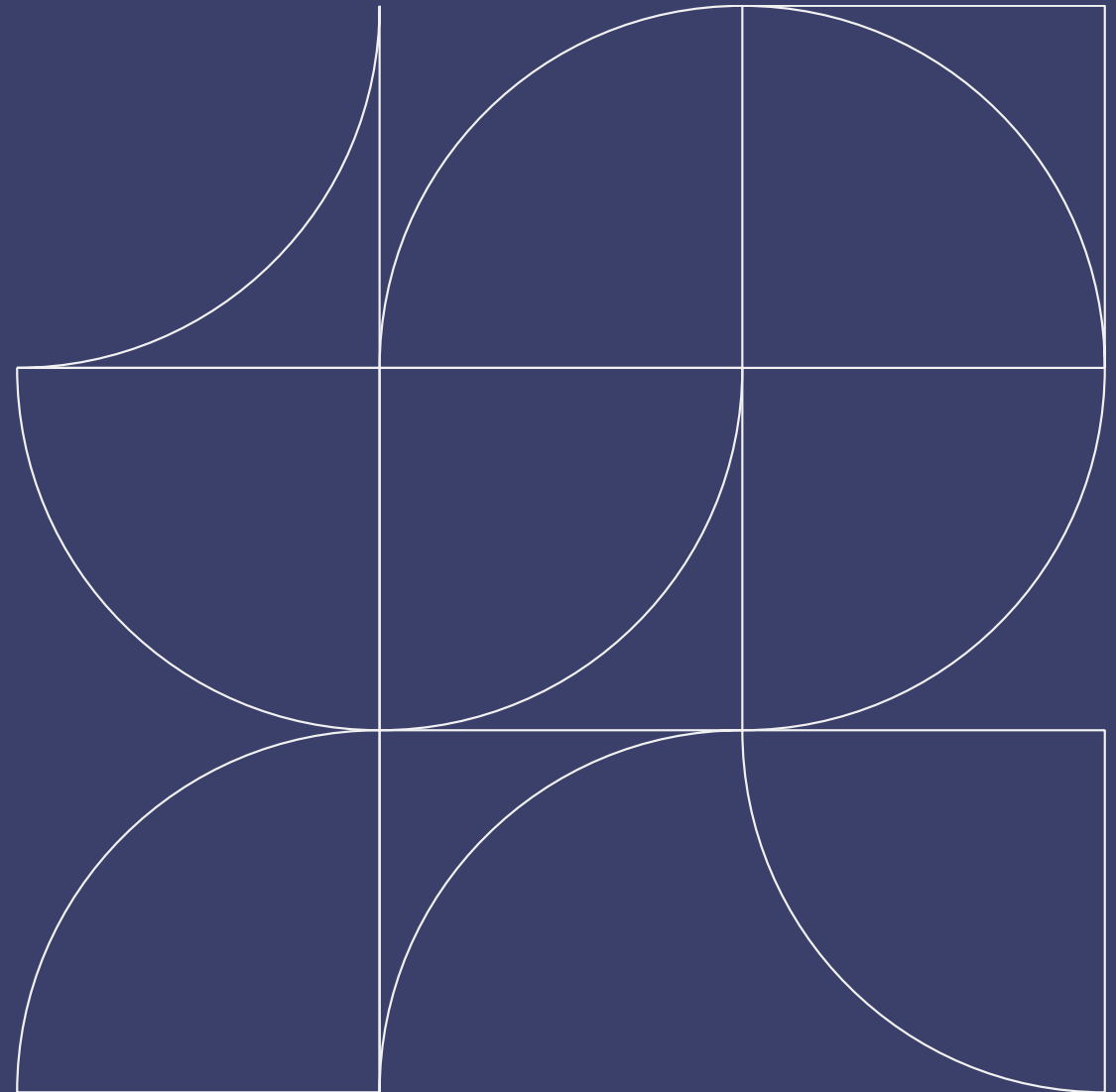
# Distressed Dealer Options

- Distressed dealers have three options:
  - Close
  - Reorganize
  - Sell
- Closing likely least attractive option, unless the real estate has become so valuable that it can be put to more productive/profitable use; dealer loses all goodwill.
- Reorganization only works if a dealer has access to additional capital and a plan for long-term survival.
- Ownership groups will see opportunities to expand and consolidate in attractive markets; selling dealers in less attractive markets will have fewer options.

# How OEMs Can Protect Their Interests

- State dealer statutes generally prohibit direct sale of vehicles by OEMs, ownership of dealerships by OEMs, and competition by OEMs with dealers.
- State dealer statutes also generally limit the ability of OEMs to reject proposed buyer of dealership assets, although OEMs typically enjoy broader ability to exercise a right of first refusal in connection with the sale of dealer assets.
- OEMs are not required to prop up dealers who are failing because of lack of innovation, skill, or investment in the business.
- OEMs can and should constantly evaluate the markets in which they compete to identify strategic opportunities.

# Strategies for Responding to the Distressed Dealer



# OEMs Need A Proactive and Comprehensive Strategy

- A dealer bankruptcy should never come as a surprise: <https://www.seyfarth.com/news-insights/the-financially-distressed-dealership-strategies-for-auto-franchisors.html>
- Telltale signs of financial distress:
  - declining sales
  - deficient working capital
  - slow pay on parts
  - increasing trade payables
  - floor-plan irregularities
- All are reflected on monthly operating reports. OEMs need a system which monitors dealer financial health and proactively identifies troubled dealerships.
- Early identification should prompt analysis, increased audits, contractually required notices, and steps to address dealer account issues.



# The Automatic Stay In Bankruptcy Changes Everything

- The automatic stay under 11 U.S.C. § 362 alters the relationship between the OEM and the dealer.
- It is a “fundamental debtor protection” and gives the debtor time to structure a potential reorganization by stopping all adverse actions, including NODs, NOTs and enforcing operational or performance obligations.
- Also affects otherwise routine operation of “Dealer Account.”
- Violations of automatic stay impose significant penalties.
- There is no “business as usual” after a dealer files for bankruptcy.

# Elements of an Effective OEM Bankruptcy Protocol

- OEM should have a bankruptcy protocol in place that includes:
  - Immediate notification to all applicable departments
  - Stopping any electronic funds transfer procedures without specific authorization
  - Analyzing the “dealer account” to determine monies owing, recurring monthly charges, and any assignments or pledges in favor of a lender
  - If permitted, implementing cash on delivery or similar procedures
  - Determining how to handle vehicles sales and allocation in the absence of floorplan
  - Communication with the debtor

# Key Elements of OEM Responses to a Dealer Bankruptcy

- File an appearance, engage the debtor and monitor the docket.
- Key events affecting OEM rights:
  - motions for use of cash collateral,
  - motions to assume executory contracts,
  - motions to sell assets, establish sale procedures
- Assess viability of the dealer and its market:
  - can it be served effectively by others
  - is a strategic workout desirable
- Prepare for litigation:
  - bankrupt dealers will blame others and look to recover inevitable losses
  - key risks: recently established, recently upgraded facilities, failing to qualify for incentives

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