



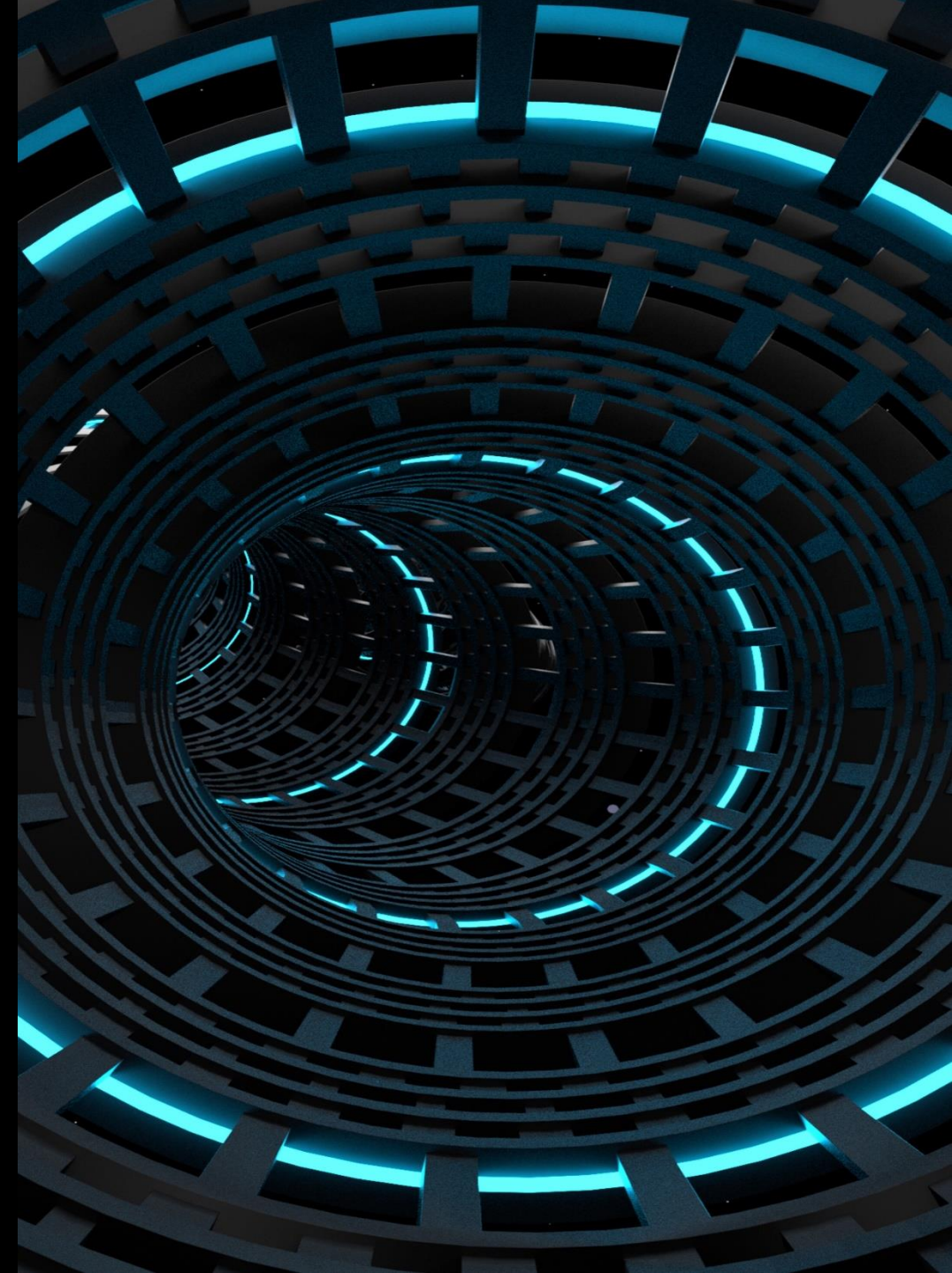
# Bumper-to-Bumper Coverage of 2023-24

*Key Trends in the  
Manufacturer/Dealer Relationship*

July 31, 2024

**Seyfarth Shaw LLP**

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# Speakers

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**John Skelton**  
Partner  
BOSTON



**Sam Rowley**  
Senior Counsel  
BOSTON



**Lisa Haines**  
Senior Counsel  
BOSTON



**Katherine Moskop**  
Counsel  
BOSTON



**Cathryn Johns**  
Associate  
BOSTON



# Agenda – Significant Trends & Implications

- 1 Significant Decisions in 2023 – 2024
- 2 Warranty Reimbursement
- 3 EVs – Still the Future?
- 4 Evolving Ownership Models Should Mean Changes to the OEM / Dealer Relationship
- 5 FTC’s CARS Rule – Enhanced Consumer Protection
- 6 OEM Incentive Programs – An Essential But Heavily Scrutinized Tool

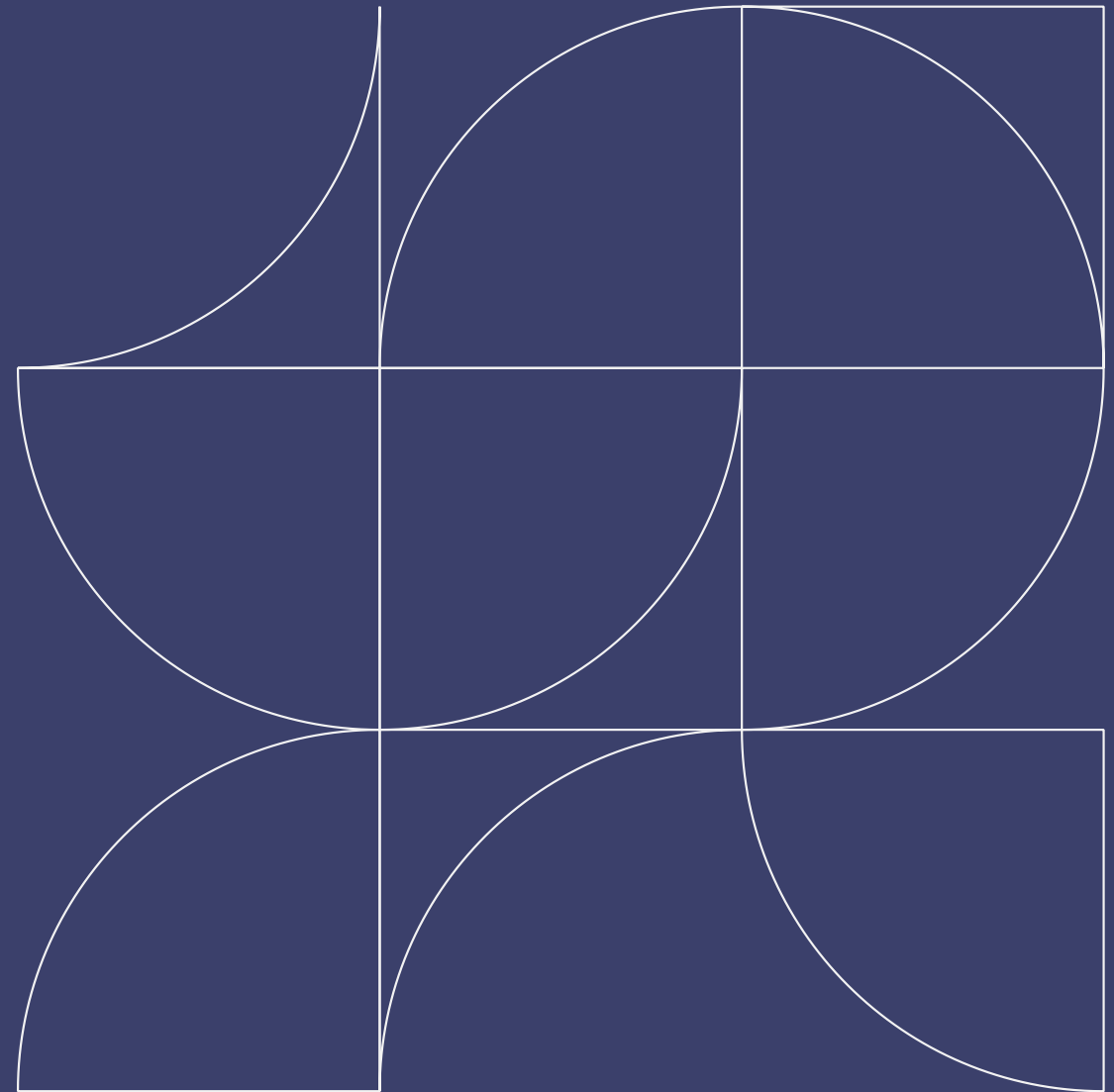


# Significant Decisions in 2023-2024

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1. ***Volkswagen Grp. of Am. v. Ill. Sec’y of State*, 2024 WL 2020036 (N.D. Ill. May 6, 2024)**: Federal court dismissed VW’s constitutional challenge to Illinois’ 2022 warranty labor time amendment, based in part on determination that OEMs can recover costs through in-state price increases. Decision highlights critical challenges and opportunities for OEMs’ efforts to mitigate increasing warranty reimbursement costs.
2. ***JP Motors, Inc. v. Mercedes-Benz USA, LLC* (File MVRB 339-23), Order of the Illinois Motor Vehicle Review Board (May 20, 2024)**: Board held that OEM lost DSSA rights upon expiration of agreement, even though OEM and dealer continued to operate on same terms for a decade. OEMs must be vigilant about managing the OEM/Dealer relationship – which is being tested by the ever-increasing consolidation to larger dealer groups ([Recent Illinois Board Decision Reinforces Need for Vigilance on Dealer Agreement Renewals | Seyfarth Shaw LLP](#)).
3. ***Mall Chevrolet Inc. v. General Motors LLC*, 99 F.4th 622 (3d Cir. 2024)**: Affirming termination of dealer for submitting false warranty reimbursement claims. Dovetails with FTC CARS Rule – somewhat of a changing tide – dealers bear responsibility for their conduct and better focus on the consumer.
4. ***Premier Ford New York Inc. v. Ford Motor Co.*, No. 206893/2022 (N.Y. Sup. Ct. Sept. 20, 2023)**: Court granted dealer’s request to enforce stay prohibiting Ford’s EV program requirements from taking effect; ***Al Piemonte Ford Sales, Inc. et al. v. Ford Motor Co.* (File MVRB 337-22), Order of the Illinois Motor Vehicle Review Board (Nov. 16, 2023)**: Board held that Ford’s new EV requirements violated the Dealer Act.

# Warranty Reimbursement



# Warranty Reimbursement - Challenges and Strategies

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- **Updated Legislative Landscape** - though OEMs have seen some policy advocacy success, the wave of increasingly restrictive regulations continues.
- **Labor Time** - dealer / regulator focus shifts to warranty labor time reimbursement based on use of third party time guides. Volkswagen's challenge in Illinois unsuccessful.
- **Rate Manipulation** - even in states without labor time provisions, OEMs seeing some manipulation of customer-pay labor times in dealers' statutory labor rate calculations.
- **Mitigation** - available strategies for OEMs to mitigate warranty costs



## Warranty Reimbursement – Legislative Landscape

1. Most states require OEMs to use dealers to provide warranty service.
2. Every state except Wyoming now requires reimbursement (upon request) at dealers' retail rates for warranty parts and labor
  - defined to exclude promotional discounts or routine services, resulting in requirement that OEMs pay “super” retail rates charged to the least price-sensitive customers
  - 43 states now have a specific mechanism (i.e., repair order average) for establishing dealers' retail labor rate and parts markup
  - 36 states permit OEMs to challenge “reasonableness” of dealers' requested retail rates for parts, labor, or both
3. Increasing number of states extend compensation requirements beyond base warranty (express/implied warranties, recalls, service contracts, maintenance programs, authorized goodwill repairs).
4. More than half of states now ban cost recovery.



# Warranty Reimbursement – Legislative Landscape (cont'd)

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## “Victories” Are Often Short-Lived:

- Incremental victories have been quickly erased through legislative amendment.
  - “Reasonable compensation” requirements replaced by “no less than retail” language and statutory formula based on 100 ROs. (e.g., SC, TN, MS, IL, LA amendments in 2021)
  - 27 states require manufacturers to pay dealers their average retail mark-up on parts the manufacturer provides to the dealer at “no cost” (or at “reduced cost”) for use in warranty repairs (e.g., SC, MS, IL, LA, WV)
    - Impacts exchange programs
  - Some states prohibit manufacturers from establishing different part numbers for certain parts replaced under warranty.
  - Surcharges met with cost recovery bans. (e.g., WI, SC)
- Constitutional challenges in Maine, Florida, Connecticut, and Illinois proved unsuccessful.

# 2023-2024 Legislative Developments

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- **The “Good” News**

- 12-3 on labor time guide bills in 2023-2024 (losses in MN & AK; NY awaiting Gov. signature)
  - **Total industry savings from defeated LTG bills in 2023 ~\$1.2b/yr**
  - 2024 WA bill with LTG (WI approach) and no-cost part provisions died
  - 2024 NJ bill with LTG provision (1.5x multiplier), revised labor rate calculation methods, cost recovery ban, and audit/chargeback procedures hasn't gone anywhere yet
  - Only other time guide laws – IL and MT in 2021-2022; WI back in 2011
- No CA warranty bill!
- MA bill banning cost recovery stalled

# 2023-2024 Legislative Developments (cont'd)

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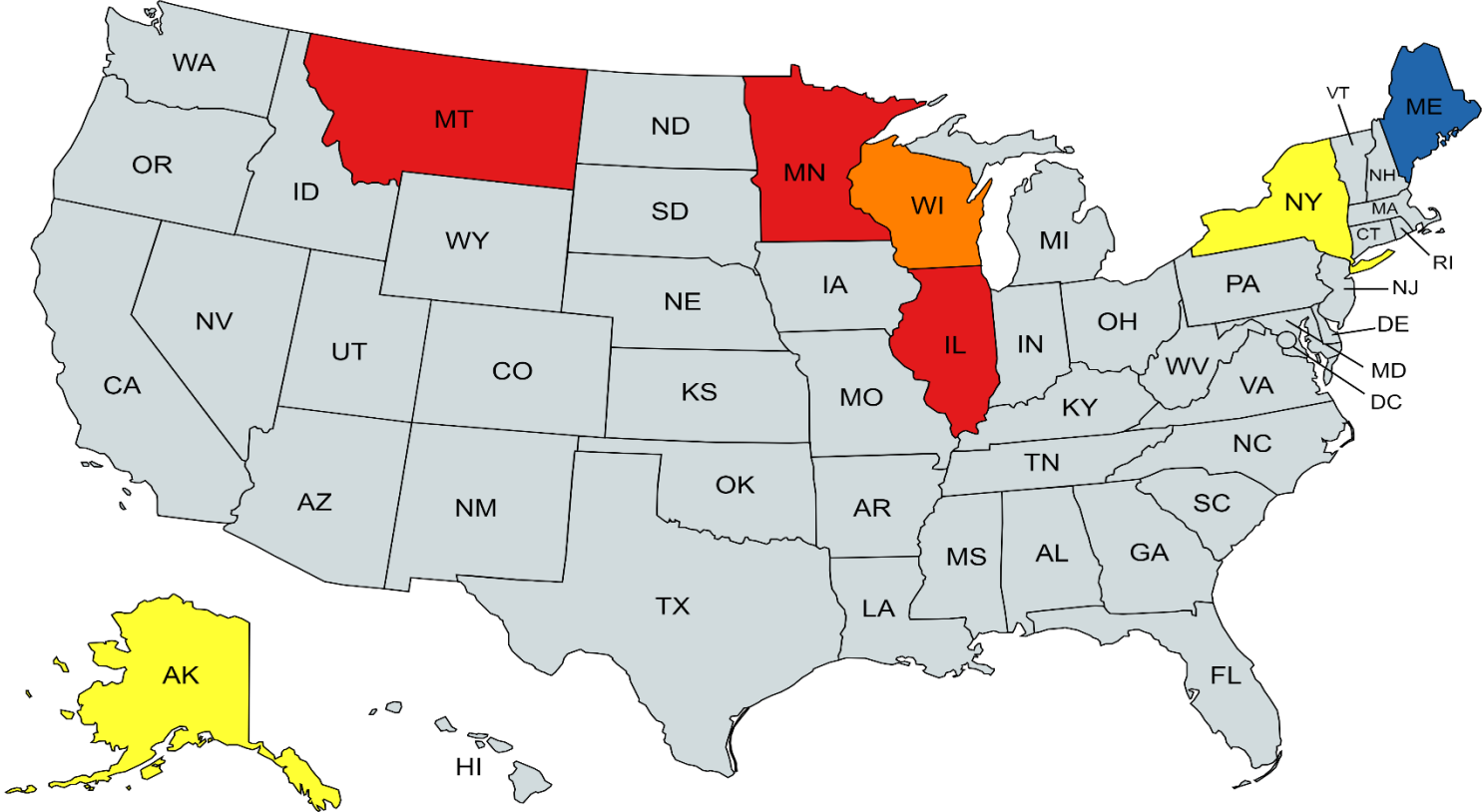
- **The “Bad” News**
  - **New York** legislature passed third-party labor time guide bill, now awaiting Governor’s signature
    - Expands payment classes for retail reimbursement to extended warranty, recall, diagnostic work, and all factory-compensated repairs
  - **Alaska** legislature passed bill (1) requiring labor time reimbursement to match third-party LTGs, and (2) prohibiting warranty cost recovery via surcharges, fees, and/or reductions in reimbursement. (just signed by Gov., takes effect Oct. 27, 2024)
  - **Delaware** legislature passed multi-faceted warranty reimbursement amendment, now awaiting Governor’s signature
    - Expands scope of services for which dealer retail reimbursement rates apply from warranty only to recall, OEM-sponsored extended warranty and maintenance programs, OEM-issued service contracts, CPO, and parts exchange programs
    - Requires retail compensation for parts furnished by OEMs at no cost or reduced cost for warranty, recall, and campaign service repairs
    - Gives dealers 180 days to submit reimbursement claims and reduces OEMs’ time for auditing warranty claims from 1 year to 180 days
  - **Oklahoma** bolstered its retail reimbursement requirements:
    - Expanded payment classes beyond warranty to include recall repairs and “assistance requested by a consumer whose vehicle was subjected to an over-the-air or remote change, repair, or update to any part, system, accessory, or function by the manufacturer and performed by the dealer”
    - Included more specific retail rate/markup calculation formulas, and eliminated reasonableness/comparable dealer language
    - Added cost recovery bar
  - **Utah** - added more specific retail rate/markup calculation formulas, and eliminated reasonableness/comparable dealer language
  - **Colorado** and **Missouri** – eliminated reasonableness/comparable dealer language
  - **South Dakota** – component manufacturers subject to retail reimbursement

# Focus Shifts from Parts Markups to Labor Times

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- OEMs conduct labor time studies to determine the actual repair time.
- Most dealers use third-party time guides that use “Estimated Work Times” that are often 50%+ higher than OEM LTGs.
- Application of third-party guides to warranty repairs results in 50%+ increase in warranty labor reimbursement.
- Some dealers sought third-party labor time reimbursement even before statutes specifically addressed.
- Many state legislatures have considered labor time guide bills in the past few years.
  - So far, only 3 states (IL, MN, and MT) have enacted LTG amendments.
  - New York and Alaska legislatures passed LTG amendments in 2024. NY bill is awaiting governor signature; AK bill just signed, takes effect Oct. 27, 2024.
  - Wisconsin addresses labor time through warranty labor rate calculation process, by requiring customer labor charges in sample ROs to be divided by **hours allowed under OEM time guide** instead of hours sold to customer.

# States with Specific Labor Time Provisions



- 3 states (IL, MN, and MT) have enacted LTG statutes.
- New York and Alaska legislatures passed LTG amendments in 2024 that are awaiting Governor signature.
- WI provides that warranty labor rate calculated by dividing customer labor charges in sample ROs by hours allowed under OEM time guide instead of hours sold to customer.
- A Maine court has held that under ME retail reimbursement law, dealer was entitled to labor compensation at times listed in commercial time manual customarily used by dealer rather than OEM's LTG.



# Current Statutory Labor Time Provisions

- **Wisconsin** (eff. Dec. 21, 2011): “The effective nonwarranty labor rate is determined . . . by dividing the total customer labor charges for qualifying nonwarranty repairs in the repair orders by the **total number of hours that would be allowed for the repairs if the repairs were made under the manufacturer’s . . . time allowances used in compensating the dealer for warranty work.**”
- **Montana** (eff. April 29, 2021): “the motor vehicle franchisor shall reimburse the motor vehicle franchisee for the labor as rendered, using the franchisor's labor time guide or **the labor time guide used by the dealer for labor furnished other than pursuant to warranty**, at the dealer's election...”
- **Illinois** (eff. Jan. 1, 2022): “Adequate and fair compensation requires the manufacturer to pay each dealer no less than the amount the retail customer pays for the same services **with regard to rate and time**. Any time guide **previously agreed to** by the manufacturer and the dealer for extended warranty repairs may be used in lieu of actual time expended. In the event that a time guide has not been agreed to for warranty repairs, or said time guide does not define time for an applicable warranty repair, **the manufacturer's time guide shall be used, multiplied by 1.5.**”
- **Minnesota** (eff. Oct. 1, 2023): “Compensation for warranty labor must equal the dealer’s effective nonwarranty labor rate multiplied by **the time guide used by the dealer for nonwarranty customer-paid service repair orders**. If no time guide exists for a warranty repair, compensation for warranty labor must equal the dealer's effective nonwarranty labor rate multiplied by **the time actually spent to complete the repair order** and must not be less than the time charged to retail customers for the same or similar work performed.”
- **New York** (awaiting Gov. signature): “[R]easonable compensation shall be the reasonable labor time allowances defined by the **retail labor time guide reasonably utilized by a franchised motor vehicle dealer** for non-warranty customer paid labor operations.”
- **Alaska** (just signed, takes effect Oct. 27, 2024): “Unless otherwise agreed to by the manufacturer and the new motor vehicle dealer, the schedule of compensation may not contain ... time allowances less than **time allowances provided in independent labor time guides.**”

# Labor Time Litigation - Volkswagen Grp. of Am. v. Ill. Sec'y of State, 2024 WL 2020036 (N.D. Ill. May 6, 2024)

- **VWGoA sued IL SOS, AG & MVRB members, challenging constitutionality of warranty labor time guide amendments. (Case No. 1:22-cv-07045)**
  - “[R]edistributive legislation that takes hundreds of millions of dollars from some (but not all) motor vehicle manufacturers and, for no public purpose, deposits that money directly into the pockets of politically favored Illinois dealers.”
  - OEMs must pay 50% more time for warranty repairs, regardless of whether technician actually works that additional time.
  - Cost VWGoA an additional \$10 million more in labor reimbursement in 2022 alone.
  - **No Legitimate Legislative Purpose:**
    - Does not require or incentivize dealers to increase technician pay as proponents asserted
    - Does not address technicians employed by manufacturers that sell directly to consumers or technicians employed by franchise repair shops.
    - Illinois dealers already enjoyed significant profit margins on warranty work.
- **Auto Innovators Amicus Brief:** amendment estimated to increase warranty reimbursement costs nearly \$250 million per year.
- **In May 2024, Court granted Defendants’ Motion to Dismiss, holding:**
  - VW failed to state claim for violation of Due Process or Equal Protection Clauses under lenient “rational basis” review standard because Amendment was rationally related to State’s legitimate interest in ensuring fair and adequate compensation for dealers and technicians in light of “perceived disparities in bargaining power” between OEMs and dealers; and
  - Recoupment bar’s prohibition on “any form of cost recovery fees or surcharges” does not prohibit wholesale price increases as a form of warranty cost recovery. Because Illinois law permits OEMs to recoup costs by raising wholesale prices and communicate reason for doing so to consumers, VW lacked standing to assert claims under First Amendment, Commerce Clause, or Takings Clauses.
  - Court dismissed VW’s complaint without prejudice, and set deadline for VW to amend complaint if desired. VW opted not to file amended complaint.
- **On July 17, Audi announced plans to implement cost recovery surcharge in Illinois in the wake of recent decision on constitutional challenge. It seems likely that Volkswagen (and perhaps other OEMs) will follow.**

# Dealer Labor Time/Rate Manipulation

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- Prominent dealer groups manipulating hours component of statutory warranty labor rate calculation to artificially increase the labor rate OEM is required to pay
- Dealers are maintaining same historic total retail labor charges (numerator) but **reducing** the allotted labor time (denominator) for each repair by about 50%:

## **ORIGINAL LABOR PRICING APPROACH**

$$\frac{\$300 \text{ (Total Labor Charges)}}{2 \text{ (Flat Rate Hours)}} = \$150/\text{hour ELR}$$

## **REVISED LABOR PRICING APPROACH**

$$\frac{\$300 \text{ (Total Labor Charges)}}{1 \text{ (Flat Rate Hour)}} = \$300/\text{hourly ELR}$$

- Wisconsin approach - claim to be using OEM's labor time guides instead of third-party guide but are maintaining same historical retail labor charges

# Dealer Labor Time/Rate Manipulation Litigation

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## Putnam Automotive (CA) - GM, CDJR, Ford, Volvo, Subaru, Kia, Toyota, Nissan, Mazda, Honda, VW):

- Under CA statute, labor rate calculated “by determining the total charges for labor from the qualified repair orders submitted and dividing that amount by **the total number of hours that generated those charges.**”
- OEM contest proposed rate as “materially inaccurate or fraudulent” and request additional ROs, but no “reasonableness” challenge permitted.
- Putnam dealerships submitted requests for warranty labor rates of \$300-\$400 per hour – representing increases of ~ \$100 per hour in some cases.
- Some OEMs agreed; others rejected; Putnam filed protests before CA NMVB, most of which settled except Ford and Kia.
  - *KP Auto, LLC dba Putnam Ford of San Mateo v. Ford Motor Co.*, No. PR-2759-21 (Cal. NMVB June 28, 2024): Held that Ford correctly determined Putnam’s requested \$436/hr rate was “materially inaccurate” because there were many significant discrepancies in Putnam’s ROs (including “large discrepancies between actual hours and sold hours; customer labor charges associated with zero sold or actual hours; and the presence of flat rate charges”). Board did not reach question of whether “the hours that generated the charges” means actual hours or sold hours.
  - Kia hearing completed; proposed decision expected to issue this summer.

## Premier Companies (MA) – BMW, Audi, Volvo, Mazda, CDJR:

- Under MA law, dealer’s warranty labor rate is calculated based on average labor rate the dealer charges its retail customers when performing nonwarranty repairs, provided such rate is **not unreasonable**.
- As in CA statute, calculate by “dividing the amount of the dealer's total labor sales by the number of **total labor hours that generated those sales.**”
- Premier dealerships requested warranty labor rate increases of approximately \$100 per hour.
- Some OEMs initially refused to approve, which led to litigation that was ultimately resolved.

# Affirmative Litigation by OEMs – *DMO Methuen, LLC d/b/a Dan O'Brien Chrysler Dodge Jeep Ram v. FCA U.S., LLC* (D. Mass. Jan. 23, 2024)

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- FCA issued notice of termination to dealer after discovering dealer had submitted over 2,600+ fraudulent warranty and recall claims (totaling at least \$970,000) for airbag replacements the dealer did not perform.
- Dealer filed action in MA state court, naming FCA and two dealership employees as defendants and seeking preliminary injunction against termination.
- FCA removed case to federal court and filed counterclaims for (i) **violation of Mass. Gen. Laws Chapter 93A, § 11**, for loss "as a result of ... an unfair method of competition or an unfair or deceptive act or practice"; (ii) **violation of Chapter 93B, § 15(a)**, which gives cause of action to any "manufacturer[ ] or motor vehicle dealer" who suffers loss "as a result of an unfair method of competition or an unfair or deceptive act or practice" including "any act prohibited or declared unlawful" by Chapter 93B; and (3) **breach of contract, conversion, unjust enrichment, and fraud**.
- Federal court denied dealer's motions to remand and to dismiss FCA's counterclaims (except for claim under c.93A):
  - MA franchised dealer statute does not preempt a franchisor's common-law claims against a dealer who committed warranty fraud.
  - Franchisor can bring a damages claim under the franchised dealer statute itself (Ch. 93B, sec. 15(a)) without complying with the statutory procedure for warranty chargebacks.
  - FCA's claim under Ch. 93A was preempted by Ch. 93B because latter statute specifies with particularity "practices that are deemed to be unfair or deceptive" as between motor vehicle franchisors and franchisees and "provides FCA's exclusive Ch. 93 remedy."



# Maintenance Plan Litigation –

## *Colony Place South, Inc. v. Volvo Car USA LLC* (D. Mass. Aug. 29, 2023)

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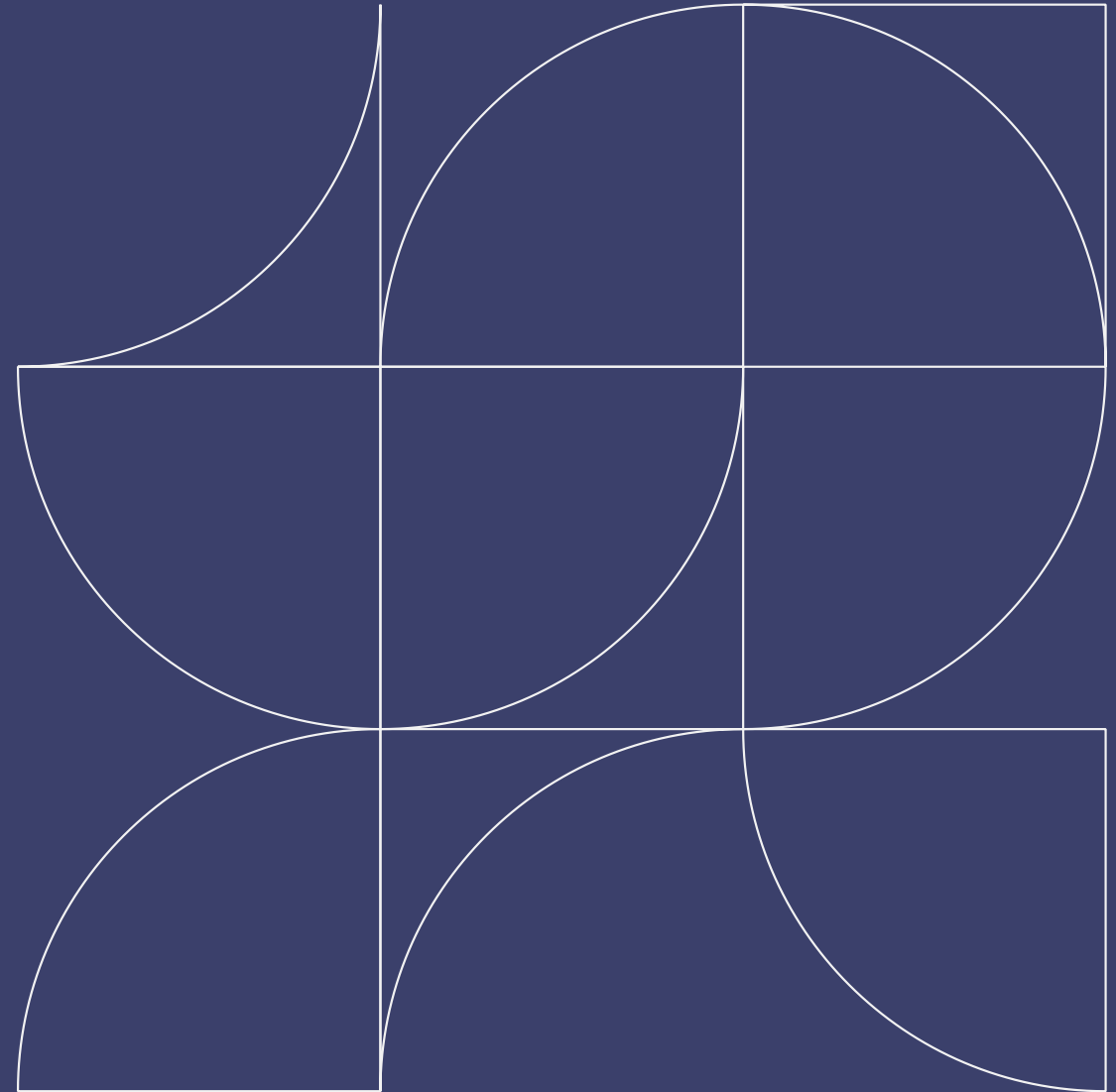
- Volvo dealers sued Volvo Car USA, its affiliated finance company (Volvo Car Financial Services), and an unaffiliated third-party (Fidelity Warranty Services), for failing to pay "retail" labor rates for Volvo Prepaid Maintenance Program ("VPMP").
- Mass. requires manufacturers and distributors to compensate dealers at their retail rates for "furnishing labor, parts, and materials under the...**maintenance plan...issued by a manufacturer or its common entity, unless issued by a common entity that is not a manufacturer**"
- Dealers argued the statute should apply because the VPMP is allegedly:
  - issued and administered for the benefit of VCUSA and
  - marketed by VCUSA as a "Volvo" program.
- Dealers also argued that VCUSA is evading its statutory obligations by having its finance affiliate administer the program.
- Federal court entered summary judgment, in a short docket entry with no written opinion, "substantially for the reasons advanced by the defendants", adding only that "[t]he parties involved in making available to Volvo owners post-warranty maintenance and repair financing cannot plausibly be understood to be 'manufacturers' or 'distributors' of motor vehicles as those terms are used in Chapter 93B of the Massachusetts General Laws."
- Currently on appeal before First Circuit.

# Warranty Cost Mitigation Strategies

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- Rigorous administrative verification of dealers' declared rates (e.g., confirm qualifying ROs, request additional ROs, verify calculation, monitor for labor time manipulation)
- Conduct "reasonableness" checks in states where permitted
- Confirm requesting dealers are actually using third-party LTGs for retail repairs in applicable states
- Post-submission rate verification audits, where permitted
- Cost recovery via statewide surcharge/price increase, where permitted
- Evaluate cost/benefit of voluntary programs (including on a state-specific basis where permitted) to offset increased warranty costs
- Limit reimbursement coverage to statutorily-mandated payment classes
- Base eligibility requirements for voluntary warranty programs on acceptance of contractual rates
- Consider affirmative breach of contract / fraud claims where appropriate as alternative to burdensome statutory procedures/unfavorable forum
- Pursue more effective legislative efforts

# EVs – the Future?





## EV Market Trends

- Biden administration has heavily promoted EVs while cracking down on ICE vehicles. But Presidential election could change this course.
- Sales of EVs continue to rise globally, but many OEMs have pushed back their EV targets and/or expansion plans.
- Failure of OEMs to meet their projected EV sales is driving changes to expectations for auto retail model and ICE contingency plans.
- Because of rapid pace of EV market growth, OEMs considering consolidation with each other while also collaborating to establish EV charging network.

# Government Regulatory Push for EVs

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- In 2021, Biden administration implemented ambitious EV goal: Half of new vehicles sold by 2030 will need to be electric or hybrids.
- In support of this goal, Biden administration has done the following:
  - 2021 Infrastructure Law - invested \$7.5 billion in EV charging, \$10 billion in clean transportation, and \$7 billion in EV battery components, critical minerals, and materials. With this funding, DOT approved plans from all 50 states to build national EV charging network.
  - 2022 Inflation Reduction Act - provided billions of dollars in credits for consumer's purchase of new and used EVs.
  - 2024 EPA Tailpipe Emissions Rule - strongest-ever pollution standards for cars and light trucks, which requires OEMs to increase sales of EVs while substantially cutting carbon emissions from ICE vehicles.
- California and 12 other states are requiring all new vehicles sold to be EVs between 2030-2035.
- Presidential election will be key to EV future, with Trump having said that he will “end the electric vehicle mandate” if he wins office. (Reuters, *Donald Trump might be bad for EVs, good for Tesla*).



# OEM Response: Meeting Goals and Timelines

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- Initially following Biden administration’s push, OEMs announced optimistic sales forecasts and targets for EV growth. However, based on consumer demand, lack of charging infrastructure and economic factors, the EV revolution is happening slower than many OEMs had promised or hoped for.
  - Automakers from Ford Motor, General Motors, Mercedes-Benz, Volkswagen and Jaguar Land Rover are scaling back or delaying their electric vehicle plans. General Motors and Ford recently paused work on new EV factories; Ford postponed around \$12 billion in planned EV investments; and Honda abandoned a \$5 billion plan to make affordable EVs with GM.
  - On the other hand, Toyota remains in expansion mode, recently announcing plans to invest another \$8 billion at its North Carolina battery plant and \$11.2 billion to the research and development of new EVs and sophisticated AI-based software systems. Nissan also announced goal of making 40% and 60% of its global portfolio comprised of EVs by 2026 and 2030, respectively.
  - In 2024, coalition of nearly 5,000 dealerships sent letter urging Biden to “hit the brakes” on EV push based on unrealistic consumer demand.
- As sales of EVs grow more slowly than expected, certain OEMs, including Toyota, Honda, Ford and Hyundai are focusing on hybrid vehicles.
  - Hybrids appease consumer demand and avoid costly penalties related to federal fuel economy and emissions standards.
  - Toyota, Mazda, and Subaru have joined together to invest in alternative fuels that can work in ICE vehicles.
- Seven OEMs - BMW Group, General Motors, Honda, Hyundai, Kia, Stellantis and the Mercedes-Benz Group - collaborating in joint venture to install 30,000 high-powered EV chargers along major highways and in urban locations in North America.

# OEM Implications – Next 3-5 Years

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- Despite falling below expectations, EV sales are growing faster than any other segment in the U.S. — and are on track to surpass 1 million annually for the first time this year.
- The Kerrigan OEM Survey:
  - 81% of OEM executives believe the transition to EVs will be slower than originally planned.
  - 64% do not expect to meet their EV sales goals, prompting 86% to reveal their organizations are developing contingency ICE production plans if EVs do not penetrate the market as expected.
  - Only 18% of respondents projected an increase in facility requirements over the next 5 years, while 60% believe they will remain the same, and 22% anticipate a decline.
- Collaboration and consolidation of OEMs in EV industry:
  - Consolidation due to financial pressures of scaling up and technological requirements.
  - Subaru and Toyota have partnered to co-develop three all-electric crossovers to be released by 2026.
  - Toyota, Mazda's and Subaru announced commitment to develop new engines with a goal to decarbonize ICE cars, with each collaborating on powertrains but creating own engines.
- Pressure to provide dealer EV incentives, free maintenance and advertising funds.
- OEM penalty for violating emissions standards is potentially billions in fines.

# Dealer Implications – Next 3-5 Years

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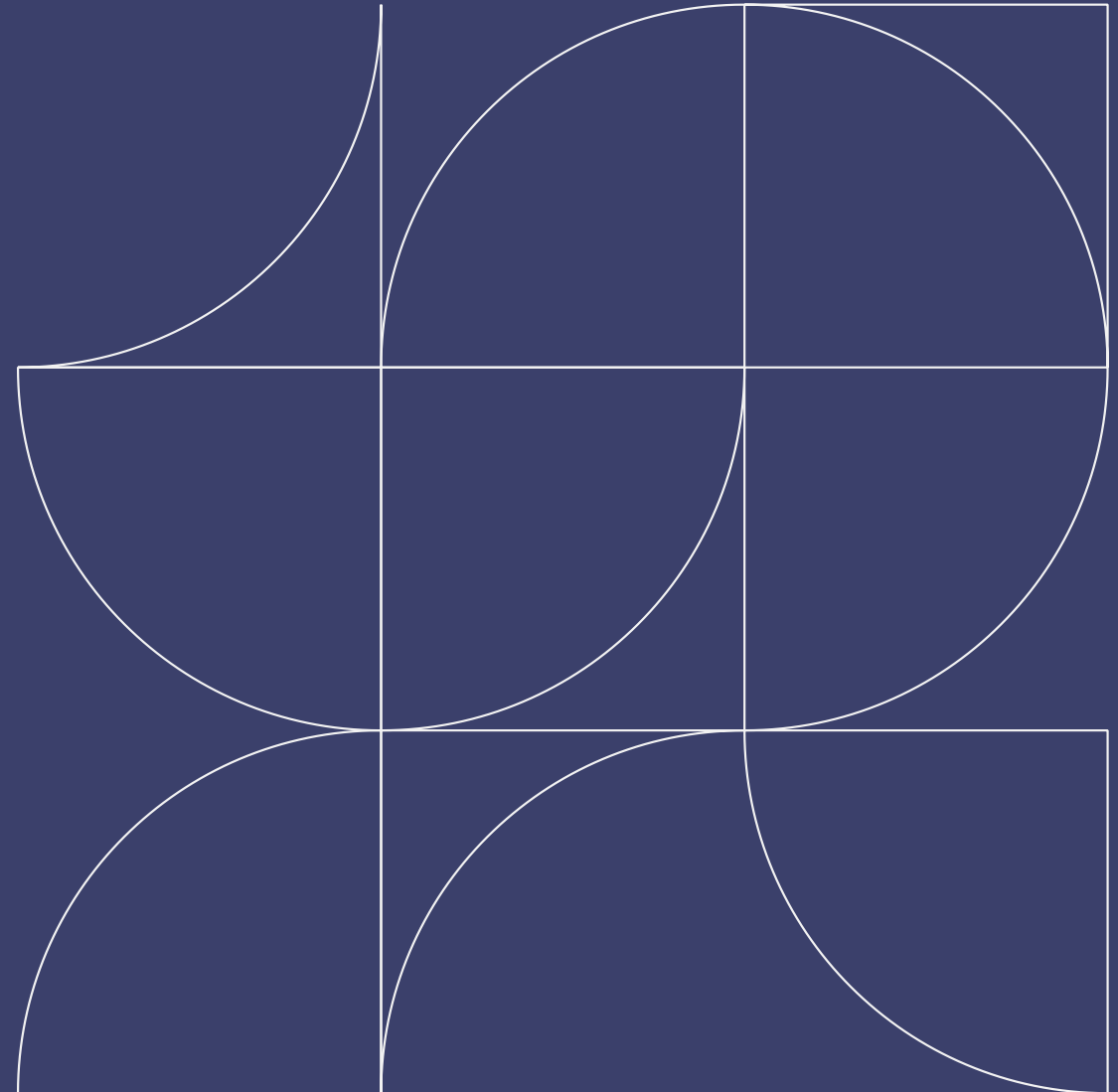
- Facility upgrades and inventory issues:
  - Dealers need to invest in public charging stations, in-dealership and remote EV servicing equipment and additional employee training; also, charging infrastructure with increased energy capacity from utilities is needed
  - GM required its Cadillac and Buick dealers to invest upwards of \$300,000 on dealership upgrades to accommodate EVs.
  - CEO of Asbury: “If you know the world is going to be electric, you don’t need stores to be as big as they are. Maybe a small showroom and smaller service centers” in more locations (Reuters, *Focus: Big U.S. auto dealers bet billions against the death of the dealership*).
  - EVs sell slower than ICE, so dealers must pay more in floorplan financing.
- Based on investment and infrastructure required, some dealers are backing out of EV:
  - Almost 1,000 Buick dealerships (47% of network) accepted buyouts from GM instead of investing to sell EVs.
  - Half of Ford dealers (1,550) opted to continue selling hybrid/ICE vehicles exclusively in 2024, deferring their decision on making substantial investments to embrace EVs.
  - Both Ford and GM have mandated substantial investments in charging stations and other upgrades for dealerships to sell and service EVs.
- 2024 CDK Global survey of 250 dealers:
  - Over 65% of dealers are pessimistic about the future of EVs positively impacting their businesses, underlined by the lack of customer interest, with nearly a third of dealers reporting that their customers are disinterested in EV technology.
  - Dealers face numerous challenges in transitioning to EVs, including adapting to new technologies, modifying facilities, and training staff. Although 89% of respondents represent brands that sell EVs, only 59% have begun transitioning their operations to accommodate these vehicles.
- 2024 Cox Automotive Path to EV Adoption Study of 526 dealers:
  - Dealerships have enjoyed increased OEM support in marketing, sales and service but express a need for additional resources beyond training in selling EVs. More EV incentives are high on their list, as are programs like free maintenance and funds for additional advertising.
  - Dealers also feel the urgency to sell: 65% of dealers report feeling pressure from their automakers to hit EV sales targets, up from 39% in 2019.
  - Among franchised dealers, 86% say they are likely or somewhat likely to continue making EV investments required by the automakers.

# Will this lead to Alternative Distribution Models?

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- Current Distribution Models:
  - Traditional dealer: GM, Toyota, Nissan, Hyundai, etc.
  - Direct to consumer: Tesla, Rivian, Lucid, etc.
  - Hybrid: Direct sales leverages existing (or new) dealer network for delivery/service
- State laws impose restrictions on direct-to-consumer sales, preventing legacy OEMs from bypassing dealerships.
- Kerrigan OEM Survey:
  - 57% do not expect the agency model to be introduced in the US in the next five years. As EV inventory levels rise, OEMs, such as Ford, are abandoning their plans to take a more active role in retailing. Many now recognize the dealer network is the most economic and efficient sales model for the OEM.
  - While OEMs are more supportive of the legacy sales model, a rising number expect to take a leading role in the customer relationship and data ownership. Just 14% of respondents project the legacy model, in which the dealer is the primary owner of the customer relationship, will remain.
- The OEM agency model of Tesla, Rivian and Lucid has prompted a variety of responses from traditional OEMs:
  - Toyota has expressed its commitment to the traditional dealer franchise model, seeing its extensive dealer network as a competitive advantage.
  - Ford has adopted a mixed approach, implementing a combination of agency and traditional dealer models depending on the market and specific vehicle lines.
  - Volkswagen has introduced an agency model for its electric vehicles under the ID. sub-brand in Europe, while maintaining a traditional dealer network for its ICE vehicles.
  - Ford, BMW, Audi and Jaguar Land Rover attempted and then dropped fixed-price dealership models in Europe.
  - In 2024, Hyundai commenced Amazon retail program - customers purchase a new car and arrange financing from local dealer on Amazon, and then pick it up or have it delivered by dealer.

# **Evolving Ownership Models Should Mean Changes to the OEM / Dealer Relationship**





# Evolving Ownership Models

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- 2023-2024: No slow down in trend of dealership consolidation
- Challenges that evolving ownership models present to OEMs
- Strategies to confront those challenges

# Dealership Consolidation: Evolving Ownership Models

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- **Traditional Ownership Model:**
  - Privately-held single (or multiple) dealership
  - OEM could rely on the experience, personal services and expertise of the individual owner / operator
  - Family-owned business passed down to children
- **Now:**
  - The Publics (Lithia, AutoNation, Sonic, Asbury, etc.)
  - Privately held dealer groups with large portfolio of multiple brands
  - Privately held dealer groups owned / controlled by Private Equity Investors
  - ESOPs (small, but growing)



# Dealer Groups Are Consolidating Ownership

***Family-owned dealerships are increasingly becoming part of large, more corporate groups through ongoing consolidation, driven by retirements and cash-outs as subsequent generations have chosen nonauto industry careers.***

Automotive News, May 13, 2024: “NADA Academy is schooling next-gen leaders for change”



# Dealership Consolidation: 2023 Trends

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- Kerrigan Advisors' *2023 Blue Sky Report*
  - Buy-sell activity up 6% year-over-year, with a record 397 transactions in 2023
  - 680 franchises sold, up 5.4% from 2022, even as the overall corporate M&A market declined substantially in 2023
  - “Despite negative headwinds of higher interest rates and declining profit margins, dealers continued to seek acquisitions, powered by their belief that scale is not only critical to future success, but essential to sustaining their businesses in the face of an evolving industry.”





# Dealership Consolidation: 2024 Expectations

- “We expect the consolidation trend, ignited by the pandemic-induced surge in industry earnings, to continue in 2024, as the industry has amassed nearly a quarter of a trillion dollars of pre-tax earnings since the pandemic.”
  - Kerrigan Advisors
- “The first quarter of 2024 was the busiest yet in terms of the number of dealerships changing hands, and there's no sign of acquisition activity slowing down.”
  - Automotive News, July 2, 2024

# Ownership Consolidation – What it Means for OEMs

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- Considerations, challenges and risks for OEMs:
  - Is the designated “Dealer Operator” really in control of operations?
    - Complex entities mean potentially unknown owners / investors
    - Influence / control by non-automotive owners/management
  - Capital / financial resources – how much actually dedicated to the individual dealership
  - Measuring and enforcing – individual dealership vs. portfolio performance
  - Business objectives (e.g., return on investment and exit strategies) likely at odds with OEM objectives (investment in brand and performance)
  - Outdated state dealer laws
    - Restrict ability to reject / limit acquisitions by dealer groups





# OEM Strategies for a Changing Ownership Landscape

- OEM Strategy No. 1 – Develop, implement (and publish) ownership policies and transfer procedures
- OEM Strategy No. 2 – Implement and follow an enhanced and focused APA review and approval process
- OEM Strategy No. 3 – Consider developing and implementing Portfolio Agreement



# OEM Strategy No. 1 – Ownership & Transfer Policies

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- Develop and implement updated Ownership & Transfer Policies:
  - Performance expectations – each dealership must meet all performance metrics
  - Ownership limitations – how many dealerships can one group control in a Market, Region or Nationwide
  - Deficient performance of one dealership is a disqualifier to acquire additional dealership
  - Require submission of an annual business plan which addresses individual dealer and overall portfolio performance
  - Right of First Refusal should require separate dealership valuation if multi-point dealership
  - Address cross-collateralization in loan documents. Defaults by one dealer entity should not jeopardize other entities

# OEM Strategy No. 1 – Ownership & Transfer Policies

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- Develop and implement updated Ownership & Transfer Policies:
  - Apply to all entities including the ultimate holding company / parent entity
  - Require disclosure of all owners
    - Maybe exception for owners holding small (e.g. less than 5%), non-controlling, investment interests, etc.
  - Expressly prohibit any change of ownership, entity structure or management without the prior written approval of OEM
    - Define any exceptions

# OEM Strategy No. 2 – Managing Consolidation Through The Review and Approval Process

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- While OEMs cannot withhold consent solely because the proposed buyer is a public company or large dealer group, it can and should:
  - Implement Strategy No. 1 – Develop, update (and publish) dealer network, buy/sell and approval/appointment policies
  - Insure buy/sell response letter identifies and requests all relevant information for all entities and proposed owners
  - Require submission of all corporate entity documents (i.e., operating agreements) and review and analyze those documents
  - Review proposals involving complex ownership structures or large portfolio on a case-by-case basis (sellers / buyers will accommodate OEM to facilitate approval)
  - Require compliance with OEM’s dealer network policies (e.g. ownership, management, capital, performance, multiple owner policy)
  - Meet with and interview proposed owners; document representations and commitments in approval letter
  - Consider ROFR whenever possible (important leverage)
  - Understand buyer’s business strategy and end game – is it complimentary with or adverse to OEM goals

# OEM Strategy No. 2 – Managing Consolidation Through The Review and Approval Process

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- Information to assess:
  - What are expansion or growth plans, including contiguous markets
  - How will dealer group / entity insure performance and compliance with standards by each individual dealer entity
  - If selling dealer is a poor performer, what is buyer's track record
  - Performance of buyer's entire portfolio (poor performing dealerships?)
  - How many OEM dealerships will be owned / controlled by buyer in market, region, or nationwide (how many eggs in one basket)

# OEM Strategy No. 2 – Managing Consolidation Through The Review and Approval Process

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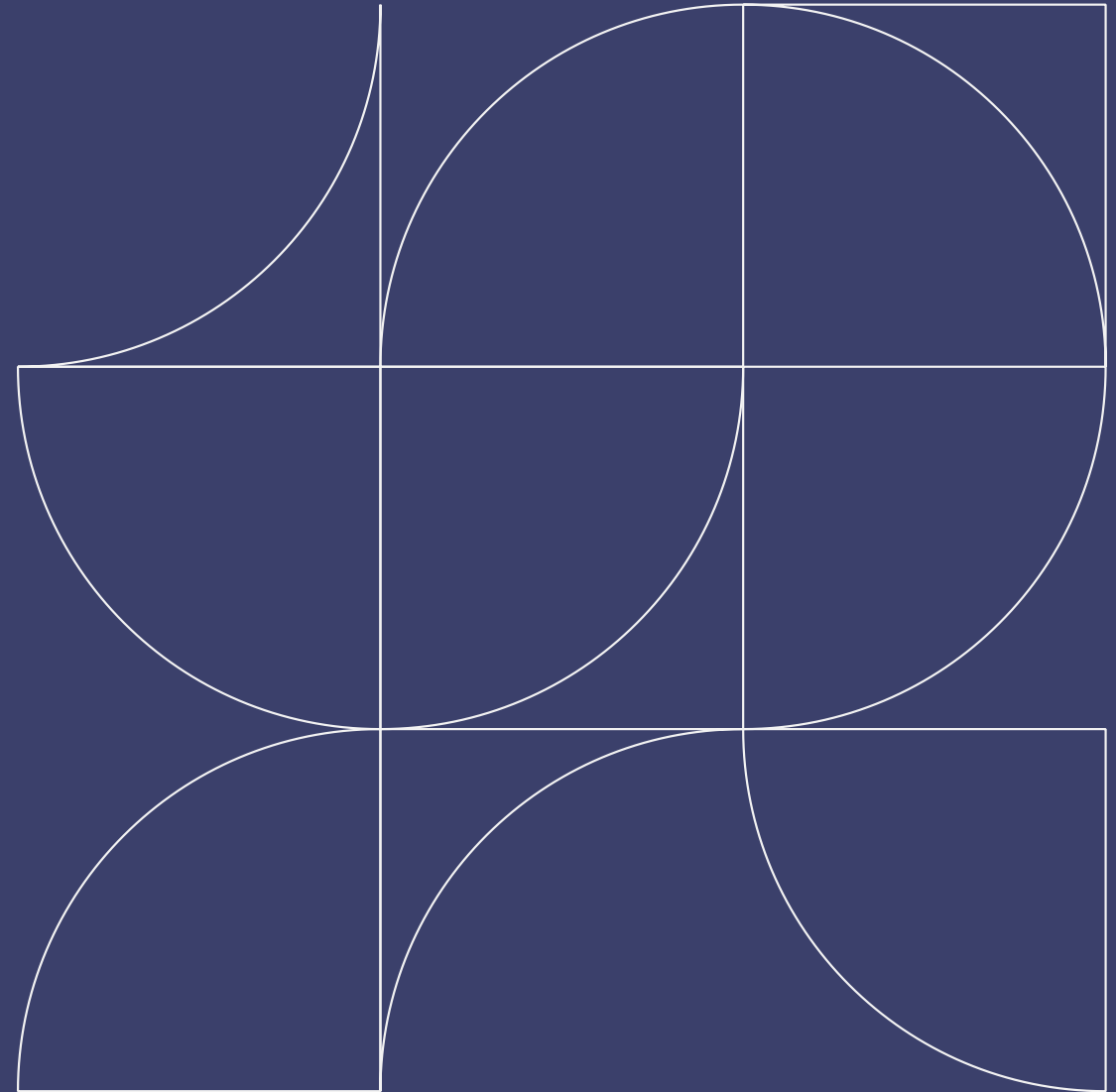
- Confirming ownership and management is essential:
  - Who will be the approved owner / manager (personal services / qualifications)
  - Who is actually in charge with authority to make key decisions and authorized to deal with the OEM
  - What authority/rights are reserved to unqualified investors
  - Can the approved operator / owner be removed
  - What happens in event of death / disability
  - Limit / prohibit the authority of the approved owner / operator to be changed

# OEM Strategy No. 3 – Consider a Portfolio Agreement?

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- Develop and implement a “portfolio” or “framework” agreement with the dealer group holding company which supplements individual Dealer Agreements
- Objective is to address / mitigate risks inherent in complex ownership structures and groups with large portfolios
- Important terms:
  - Each dealer entity to comply with all OEM policies, including ownership limits
  - Process / standards for potential acquisition of additional dealerships
  - Identify duly-authorized “portfolio” representative
  - Addresses facility / image standards and compliance
  - Addresses dealership management and potential changes
  - Addresses “successor” – including requiring formal successor addendum
  - Governance documents must provide that DP has sole decision-making authority and cannot be changed
  - Require annual business plan for portfolio
  - OEM agrees to facilitate and approve acquisitions (up to OEM defined limits)
  - Defines performance standards for individual dealership and portfolio with defined remedies, including divestiture of non-performing dealerships
  - Confirms OEM’s ROFR rights (and standards)
  - Parties agree not a DSSA and thus not subject to dealer laws and to Arbitration for any dispute

# Enhanced Consumer Protection: FTC's CARS Rule







## FTC's CARS Rule

The biggest priority for franchised new-car and truck dealers will always be the customer experience, and we have two obstacles to that this year. The first is the FTC Vehicle Shopping Rule, which NADA is challenging in court. This will make the vehicle-buying process longer and more confusing for consumers.

NADA's Chairman, Gary Gilchrist on 2024 challenges.

"New NADA Chair Will Help Dealers Navigate New Challenges," [wardsauto.com /retail/new-nada-chair-will-help-dealers-navigate-new-ftc-rules-ev-mandates](https://wardsauto.com/retail/new-nada-chair-will-help-dealers-navigate-new-ftc-rules-ev-mandates)





# FTC's CARS Rule

- December 2023: FTC issued final rule effective July 30, 2024 for new motor vehicle dealers: Combating Auto Retail Scams or “CARS” Rule
- Follows “recurrent issues” in FTC enforcement and by consumer complaint:
  - 50+ FTC enforcement actions, 2 nation-wide sweeps, and 181 state-level enforcement actions in the past decade
  - 100,000+ auto-related consumer complaints over the last several years
- Seeks to impose greater transparency by dealers during the sales process

# FTC's CARS Rule

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- **More bluntly:**
- “The Federal Trade Commission has proposed a rule to ban **junk fees** and **bait-and-switch** advertising tactics that can plague consumers throughout the car-buying experience. As auto prices surge, the Commission is seeking to eliminate the **tricks and traps** that make it hard or impossible to comparison shop or leave consumers **saddled** with thousands of dollars in **unwanted junk charges.**”

(FTC Press Release, June 23, 2022)

# FTC's CARS Rule

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- (1) Prohibits dealers from misrepresenting material information that would affect the buyer's purchase choice, such as the vehicle's price, financing options, add-ons, and availability.
- (2) Requires dealers to clearly disclose to buyers the offering price – the full cash price any buyer could pay for the vehicle or the “drive-off-the-lot” price, in the first communication with buyers. Buyers also must be told that optional add-ons are optional and can be refused.
- (3) Prohibits “bogus” add-ons that do not actually provide a benefit to the buyer, such as add-on purchases that a particular vehicle cannot possibly use, like a service contract for oil changes on an electric vehicle.
- (4) Requires dealers to obtain buyers' express, informed consent before imposing *any* charges as part of a vehicle purchase. It must be clear that the buyer understands why and how much they are being charged.





## FTC's CARS Rule

- 2020 FTC consumer study concluded that “add-on” products are the “single greatest area of confusion” by consumers.  
(Buckle Up: Navigating Auto Sales and Financing, FTC Staff Report, July 2020)
- Consumers were:
  - Unaware of which add-ons they purchased;
  - Unable to identify add-ons in the paperwork;
  - Unclear as to what those add-ons included; and
  - Sometimes did not realize they had purchased add-ons at all.

# FTC's CARS Rule

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- January 2024: FTC announced it was staying effective date of CARS Rule pending resolution of challenge brought by NADA and TADA filed in the Fifth Circuit
  - “NADA is challenging the FTC in court to stop this rule because it will add massive amounts of time, complexity, paperwork and cost to car buying and car shopping for tens of millions of Americans every year.”
    - NADA Press Release: <https://www.nada.org/nada/nada-headlines/nada-files-federal-court-challenge-stop-ftcs-vehicle-shopping-rule>
  - FTC: NADA’s arguments are based on “inaccurate claims that it will require dealers to overhaul their practices and substantially increase compliance costs.” To the contrary, according to the FTC, the CARS Rule “does not impose substantial costs, if any, on dealers that presently comply with the law, and to the extent there are costs, those are outweighed by the benefits to consumers, to law-abiding dealers, and to fair competition.”
    - FTC Order Postponing Effective Date of Final Rule: [https://www.ftc.gov/system/files/ftc\\_gov/pdf/P204800CARSExtensionOrder.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/P204800CARSExtensionOrder.pdf)
- NADA’s challenge is tentatively scheduled for oral argument in October 2024

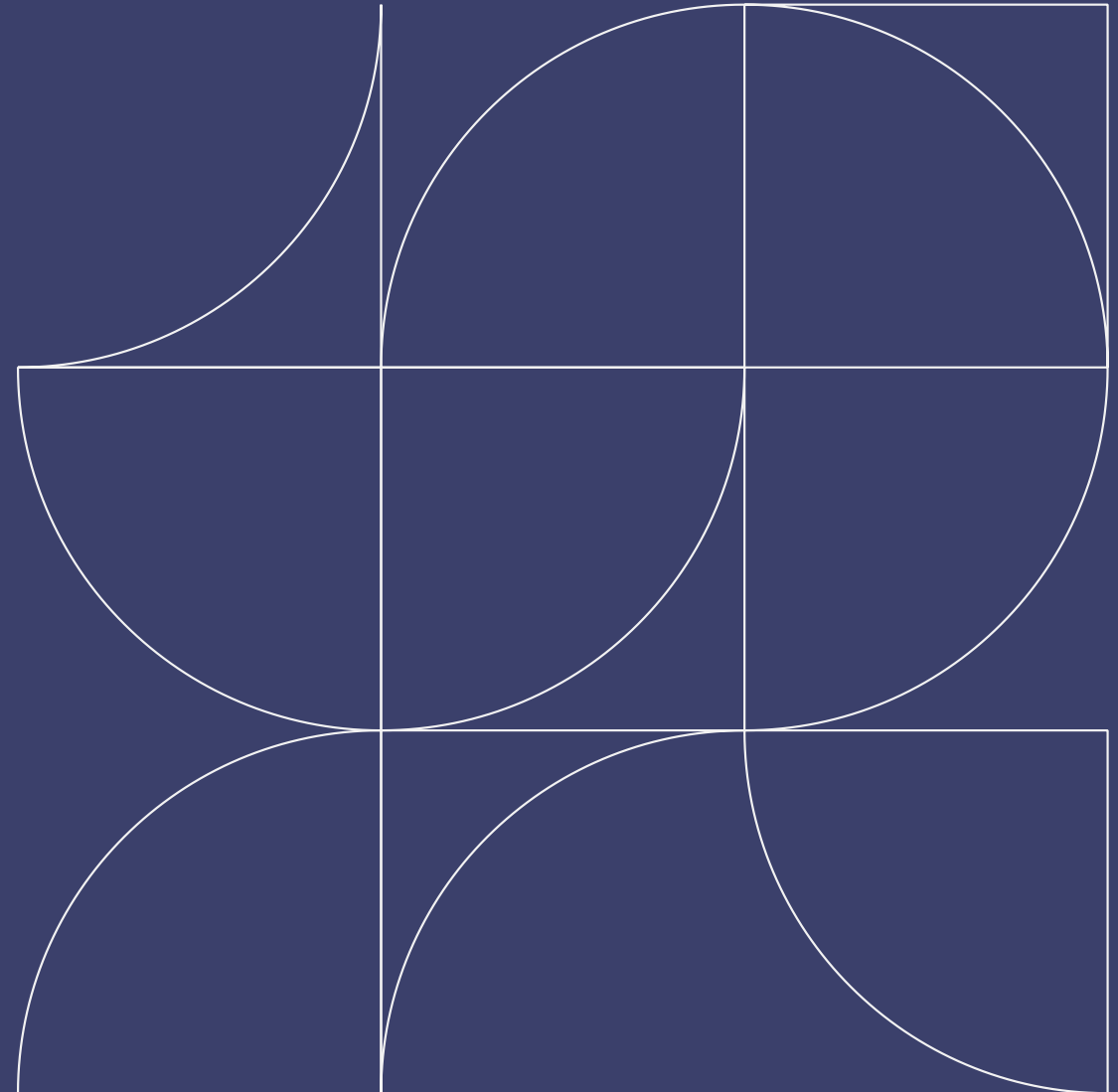
# FTC's CARS Rule: OEM Takeaways

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- Potential ancillary impact on OEMs
  - OEM financing arms may need policies in place to ensure dealer compliance with CARS
  - Interplay of “Tier 1” advertising and advertising policies or guides with dealer advertising



# OEM Incentive Programs – An Essential But Heavily Scrutinized Tool



# Incentive Program Trends, Challenges, and Takeaways

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- Tying back to earlier theme: Heavy focus on EV and sustainability programs, with less than encouraging results for OEMs
- Unclear legislative outlook on whether dealership coalitions can pool resources to challenge incentive programs of all kinds
- Technological advances cut both ways:
  - Dealers can heavily scrutinize some data and results of a program
  - OEMs (and even dealers themselves) can maintain a close up-to-date eye on dealer performance, incentive monies paid, and other key data
  - Ability to take advantage of sophisticated tools, automation abilities (e.g., alerts to underperforming dealers), historical analyses, and customizable views of data

# Emerging Trends

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- Incentive spending continues to increase each year
- Digitalization of incentive programs increases in sophistication
- Increased disputes regarding EV-based incentive programs
  - OEMs want to push EV investment in charging stations, training, and delivery/sales, in part to meet upcoming federal standards
  - Given less-than-expected consumer demand, contentious multi-state challenges by dealers to EV incentive programs
    - § Programs ended + scaling back or reconsidering timeline for EV push
- Exclusivity and brand loyalty standards may face increased pressure as dealers consolidate

# Ongoing Dealer Challenges

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- *Racine Car Dealer v. Hyundai* (W.D. Wisc. 2023): Exclusivity, coercion (How is exclusivity defined and incentivized? “Coercion”?)
  - Dealer argued incentive programs used as “economic lever” to coerce exclusivity
  - Court emphasized need for evidence of “specific, material effect” of coercion
  - Found material dispute over: (1) what agreement meant by “exclusive” and (2) whether termination was voluntary or coerced
- *Star Houston v. Volvo* (Tex. Ct. App. May 2023): Service effectiveness programs (Accurate data? Fair?)
  - Survey-based incentive program violated Dealer Act: Unreliable, unfair for low-volume dealers compared to high-volume

# Ongoing Dealer Challenges

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- *McAllen Jeep v. Subaru* (Tex. DMV Apr. 2023): Termination (Fact-specific justification that will uphold scrutiny?)
  - Reversed good cause finding in termination for service/satisfaction performance, emphasizing risk of injury to public and facilities/personnel over parts
- *Tuscaloosa Hyundai v. Hyundai* (N.D. Ala. Dec. 2023): Variance requests and price discrimination (Motivation? Economic result? Statutory language?)
  - No bad faith in denial of exclusivity variance due to transparent communications by OEM, no risk of “economic death”, voluntary nature, no “right” to program
  - No price discrimination where incentive program changed *net* prices; statute spoke to differences in *actual* prices

# Associational Standing -- Challenges By Dealer Associations

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*New Jersey Coalition of Automotive Retailers, Inc. v. Ford Motor Co.* (N.J. Sup. Ct. 2024)

- NJ CARS challenged Ford's Lincoln Commitment Program under New Jersey FPA as resulting in price differentials between dealers
  - Program incentivized customer amenities via payments on new vehicle sales
- Could Dealer Association challenge OEM Program on behalf of its members? Yes.
  - Associational standing: (1) members would have standing on their own; (2) NJ CARS's interests were germane to its purpose; (3) participation of individual members was not required
  - Statutory standing: Act allowed actions by "franchisee" against "its franchisor"
    - Court focused on "liberal" standing jurisprudence in NJ
    - Expressly declined to invoke canon of statutory interpretation where expression of one thing indicates exclusion of another left unmentioned

Opposite holding: *N.J. Coal. of Auto. Retailers v. Mazda Motor of Am., Inc.* (D.N.J. Ct. Feb. 2023)

# Takeaways

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- Keep programs as simple and consistent as possible with clear guidelines
  - Dealer concerns/complaints about shifting programs → poorer performance, disengagement
- Develop and maintain well-backed methods for determining market areas, dealership locations, and other background realities for programs
- Lean into digitization; use technology to directly link performance and incentive payouts
  - Automate analyses of dealer performance to assess needs for intervention
  - Provide for dynamic access for dealers to see their performance and earnings in real time
  - Refine precise knowledge of dealer performance (i.e., by VIN if possible) and resulting incentive costs:
  - Can it be customer-specific? Customizable on the dealer end?





## CLE: NEW PROCESS

Please scan the QR code and complete the digital attendance verification form to receive CLE credit for this program.

### You will need:

1. **Title:** Bumper to Bumper
2. **Date Viewed:** 7/31/2024
3. **Attendance Verification Code:** SS2398

State-specific CLE credit information can be found in the form.

# Thank you

For more information please contact:

**John Skelton**

[jskelton@seyfarth.com](mailto:jskelton@seyfarth.com)

+1 (617) 946.4847

**Sam Rowley**

[srowley@seyfarth.com](mailto:srowley@seyfarth.com)

+1 (617) 946.4851

**Lisa Haines**

[lhaines@seyfarth.com](mailto:lhaines@seyfarth.com)

+1 (617) 946.8332

**Katherine Moskop**

[kmoskop@seyfarth.com](mailto:kmoskop@seyfarth.com)

+1 (617) 946.4831

**Cathryn Johns**

[cjohns@seyfarth.com](mailto:cjohns@seyfarth.com)

+1 (617) 946.4924