

Implementing Best Practices in 2021 and Beyond: Eric Chase's Legal Audit Checklist for Auto Dealers[©]

Updated every year, this checklist is a suggested guide for all automotive dealers (1) to use in their ongoing efforts to assure their files and operations are current in matters of legal importance; (2) to provide reminders for ongoing and periodic legal requirements; (3) to assist dealers in their regulatory compliance tasks; (4) to have a simple, handy way of auditing their current legal "health;" and (5) to trigger timely and necessary action(s) that might otherwise be overlooked. The checklist does not constitute legal advice.

Annual/Quarterly Internal Legal Audit

Done by: _____

Date: _____

STATUS*

OK Follow-Up N/A

I. FRANCHISE RELATIONSHIP FILES

(Assure security of these important documents. Limit access to those few with a need to know.)

A. Current Sales and Service Agreement, with all amendments and modifications

- i. Keep an up-to-date and complete copy of each Sales and Service Agreement, with standard provisions, all amendments, and related correspondence.
- ii. Advisable to have both hard copy and electronic copy.
- iii. Keep in a nearby, easy-to-access file drawer.
- iv. Alternate Dispute Resolution (ADR) provisions, if any. Be sure to read and know when you have alternatives to the courtroom. (Note: Federal Law prohibits auto franchisors from imposing mandatory binding arbitration for all disputes as part of a dealer agreement. See 15 U.S.C. § 1226.)
- v. Letters of Intent (LOIs)
- vi. "Other" agreements, such as separate facility or performance agreements.

* OK (i.e., no action required)
Follow-Up (should specify *what* you need to do and *when*)
N/A (not applicable to dealer at this time)

B. Factory Bulletins, Announcements, Programs

- i. Watch for “zingers” in otherwise routine correspondence (sometimes references to these show up in termination notices).
- ii. Carefully review any communications that refers to any change(s) in the brand's dealer agreement.
- iii. Keep a complete file on ongoing programs (*e.g.*, GM's "Essential Brand Elements"), and monitor your progress and commitments.
- iv. Keep all communications with the franchisor on recalls.

C. Possible or Actual Disputes or Disagreements: correspondence, memos, notes and other documents regarding actual or potential controversy, or other communications addressing items that are specifically applicable to your dealership. Keep copies of all correspondence that's addressed directly to you on all these subjects:

- | | | | |
|---|--------------------------|--------------------------|--------------------------|
| i. Sales | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ii. Service and CSI | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| iii. Allocations | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| iv. Warranty | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| v. Dealership Audits | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| vi. Facilities | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| vii. Location of Dealership | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| viii. Dualling/Undualling | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ix. New agreements/amendments | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| x. Availability of (desirable) product | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| xi. Incentive Programs and Compliance with Terms/Conditions | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| xii. Factory Programs | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| xiii. Floorplan | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

D. Franchise Termination File (*if applicable*): Threats regarding possible termination/ nonrenewal. On this one, if you are getting threatening or coercive comments – keep a separate file, and *responsibly respond to all such mail* from your franchisor. If a termination threat is even hinted, talk to an experienced lawyer.

 E. “Required” Business Plans

- i. Some, but by no means all, brands require periodic (usually annual) business plans.
- ii. Sometimes, the franchisor will require a business plan from a dealer perceived as underperforming.

- iii. Be careful on these. If you puff your plans, the factory may argue that you made binding promises. If your franchisor has already preprinted your plans or "promises," don't sign on to those that are not fair or realistic. Watch for "zingers" that might set you up for termination (*i.e.*, admissions of current non-compliance with dealer agreement or agreements that require average or above performance at all times in sales and/or CSI).

F. Financial Statements and Related Documents

- | | | | |
|---|--------------------------|--------------------------|--------------------------|
| i. Monthly financial statements: keep at least a full set of monthly financial statements as reported to the franchisor for at least <i>three years</i> . | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ii. Keep end-of-year cumulative factory statements for at least <i>seven years</i> . | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| iii. Keep 13th month statements for at least <i>seven years</i> . | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| iv. Keep copies of all state, federal and local tax filings, and associated correspondence for at least <i>seven years</i> . | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| v. Other financial statements, audits, reviews. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| vi. Related financial correspondence. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| vii. Procedures to protect confidentiality of and limited access to all financial documents | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| viii. Assure backup and redundancy of electronically stored information. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

- G. Document Retention for Litigation:** If you are in litigation, or a formal dispute is imminent, you *must* retain and safeguard everything that may be relevant, including all electronically stored information. This retention requirement is usually referred to as a "litigation hold." The Federal Rules of Civil Procedure (and similar state rules) now incorporate sensible and very *detailed* requirements regarding the preservation for litigation of such electronically stored records. Coordinate with your counsel on this. Make sure all impacted employees are properly instructed. Continue to safeguard and monitor litigation retention requirement. As soon as litigation becomes likely, there should be a clear "litigation hold" letter in effect, and periodically refreshed. Talk to your lawyer about storing everything in this category in appropriate format.

- H. Franchisor Financial Health:** In the aftermath of the GM and Chrysler bankruptcies, keep a file of articles or correspondence that may assist you in monitoring your franchisor's financial wherewithal.

II. LEGAL ADVISOR/STATE LEGAL ISSUES

A. Your Legal Advisor

- i. Every dealer should have one: an attorney you can talk to with confidence.
- ii. Make sure your lawyer has experience in franchise/auto, and work with specialists on matters of importance (*i.e.*, transactional, litigation, *etc.*)
- iii. Don't be shy. If you're looking for a lawyer for any matter of consequence, interview more than one.
- iv. If you are searching for an attorney, a good starting point is the National Association of Dealer Counsel. Its directory identifies experienced auto franchise attorneys throughout the United States.

B. State Legal Questions

- i. Keep mailings from your state or metro association that address legal topics, as well as pending changes and amendments to laws and regulations.
- ii. Call your association with questions.
- iii. Keep a copy of state franchise laws and regulations that affect dealers: *Read them!*

III. BUSINESS STRUCTURE RECORDS; MINUTES

A. Structure: Corporation, LLC, *etc.*

B. Basic Documents: Articles of Incorporation, S-election, LLC.

C. Minutes: Minutes: Be sure to timely update your minutes in compliance with corporate requirements.

D. Licenses: *E.g.*, state operating licenses, environmental, *etc.*

IV. REAL ESTATE

A. Ownership: Deed, mortgage documents, *etc.*

B. Lease

C. Acquisition Documents: *E.g.*, buy-sell.

D. Other Realty Records: Taxes, environmental issues

- E. Site Control Documentation:** If applicable.
- F. Appraisal/Valuation Records**

V. FINANCIAL RECORDS/BUSINESS INSURANCE

- A. Monthly Statements, Submitted to Factory, and All Accounting Tax Files**

B. Tax Related Files

- i. What kind of an entity is your dealership and why?
(*LLC? C-Corp? S-Corp?*)
- ii. LIFO
- iii. Assurance of timely sales tax payments
- iv. Withholding for employees
- v. Disputed Tax Matters
- vi. Copies of all state and federal tax filings
(*keep for at least 7 years*)

- C. File Destruction Policy: Make it Clear, and in Writing.** Assure consistency with legal retention requirements. *Keep* everything related to ongoing or imminent litigation. Insure all employees instructed not to delete electronic information related to dispute. *Do it in writing*, with a proper litigation hold memo.

- D. Insurance**

- i. Periodic audit/update with agent
- ii. Affordable Care Act compliance
- iii. Coverage adequacy
 - (a) check coverage for consumer disputes:
defense and liability coverage
 - (b) business interruption
 - (c) errors and omissions
 - (d) environmental
 - (e) standard omnibus coverage
- iv. Be aware of what constitutes timely notice for a claim or potential claim to insurer for coverage.
- v. Keep records of COBRA compliance when employees leave employment.

VI. LOAN DOCUMENTS/BANK RELATIONSHIPS

- | | | | |
|---|--------------------------|--------------------------|--------------------------|
| A. Mortgages, Credit Lines, Cap Loans – Especially Floor Plan(s) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. Floorplan compliance (<i>out of trust avoidance procedures</i>) | | | |
| B. Bank Account Files and Statements | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| C. Bank/Lender Correspondence | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

VII. CUSTOMER RELATIONS/SALES PRACTICES

- | | | | |
|--|--------------------------|--------------------------|--------------------------|
| A. Complaints From Your Customers | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. Written procedures to follow | | | |
| ii. Follow-up | | | |
| B. Litigation/Arbitration Records | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| C. Required Recordkeeping/Customer Privacy/Identity Theft/Loan Actions and Notices
(<i>Excellent publications available from NADA</i>) | | | |
| i. Security measures/limiting access | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ii. Safeguarding customer information/deal jackets: Written policy and employee confidentiality agreements | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| iii. Consideration in referrals of credit applications of the requirements of the Equal Credit Opportunity Act (ECOA) and the Fair Credit Reporting Act (FCRA): Does dealership policy/practice avoid necessity of sending adverse action notices? | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| iv. Staff/employee trained in privacy/safeguard rules. <i>Keep training records</i> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| D. Assignment of Responsible Employee to: (a) Stay Current on Legal/Regulatory Requirements; (b) Monitor Consumer Relations at the Dealership; and (c) Respond to Inquiries/Complaints | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. Updating all sales personnel on requirements | | | |
| E. Clear and Consistent F&I Practices and Policies | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. Forms in compliance | | | |
| ii. Written standard policies | | | |

- iii. Document fees, *etc.*, in compliance with state law
- iv. Assignment of responsible person to monitor and/or enforce

F. Consistency and Legality of RO Itemization
(Do you have a documentary fee issue?)

G. Arbitration Clause in Consumer Contracts

- i. Must be fair and mutual
- ii. Should bar multiple claimants and class claims
- iii. Should be reviewed in the light of state laws and case decisions:
This is an ongoing issue.

VIII. REGULATORY COMPLIANCE

A. All Dealers Nationwide Need to Assure Compliance with Applicable Federal Laws and Regulations. For an excellent summary of federal requirements, you should have a copy of the NADA and ATD *Federal Compliance Chart*, and the NADA publication, *The Regulatory Maze*. *Be sure to comply with all website requirements, to include compliance with the Americans with Disabilities Act (ADA).*

B. Dealers Should Inquire of Their State Associations For a List of State Regulatory Requirements.

C. Keep Current with Periodic Seminar Participation Available at NADA and Through State Associations.

IX. PROMOTIONS/ADVERTISING

A. Know and Monitor State Laws and Regulations on Advertising

B. Have a “Duty Expert” to Assure Legal and Regulatory Compliance in All Print and Broadcast Advertising.

C. If you Use an Agency, Assurance of Compliance is a Must, Because you May be Liable for Their Mistakes.

D. Compliance with Do-Not-Call Rules and Faxing Regulations

X. WORK FORCE/EMPLOYMENT

- | | | | |
|--|--------------------------|--------------------------|--------------------------|
| A. Posting of All Required State and Federal Notices | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. Equal Opportunity (EEOC) | | | |
| ii. Wages and Hours | | | |
| iii. Family Leave (FMLA) | | | |
| B. Compliance: Affordable Care Act, ADA, FMLA, COBRA, Immigration Law | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| C. Laws Applicable to Military Reservists and National Guard (e.g., Uniform Services Employment and Reemployment Rights Act - USERRA) | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| D. Plans/Policies/Correspondence Regarding Benefits
<i>(e.g., Health, Dental, 401(k), Profit Sharing, Vacation, etc.)</i> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| E. Individual Personnel Folders
<i>(Ensure Privacy!)</i> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| F. Dealership Employee Policy Manual, Including Clear Policies on Sexual Harassment and Discrimination.
<i>(Be sure to make clear that manual is not a contract, and does not change at-will employment status.)</i> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| G. Confidentiality Agreements.
<i>(Especially as to consumer information in deal jackets.)</i> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| H. Training Programs | | | |
| i. In-house: Periodically (not less than once a year and as part of initial indoctrination with <i>all</i> new employees) provide guidance on sales practices, discrimination, sexual harassment, integrity, <i>etc.</i> Keep files on all training. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| ii. Factory: Tech Training | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| I. Unionization Issues: Policies to properly deal with unionization efforts; bargaining in good faith when there is a union. | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| i. When issues arise, bring in counsel as early as possible. | | | |
| ii. This is a fast-moving legal subject. Get regular updates. | | | |
| J. Be Sure to Have an Attorney Knowledgeable in this Specialized Area | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

XI. SUCCESSION

- A. Estate Planning**
(Do you have a will that reflects your current situation and what you want?)
- B. Successor Addendum to Sales and Service Agreement**
(If you haven't done this, you should do it now!)

XII. CO-OWNERSHIP ISSUES (IF APPLICABLE)

- A. Shareholder (or Member) Agreement(s)**
- B. Employment Agreements**
- C. Buyout and Valuation Provisions**
- D. Insurance to Protect Against Financial Consequences of Owner of Death/Disability**

XIII. ENVIRONMENTAL

- A. State Requirements**
- B. Federal Requirements (EPA)**
- C. Any Ongoing Issues**
(e.g., underground storage tanks, spills, hazardous waste disposal, etc.)
- D. Periodic Environmental Audit**

XIV. SAFETY/EMERGENCY PROCEDURES

- A. Compliance with All Applicable Statutes, Regulations and Ordinances**
- B. Posted Procedures for Employees**
- C. Emergency Call List**

D. Fire Drill/Alarm and Sprinkler Inspection

E. Special Circumstances

(e.g., hurricane or earthquake vulnerability)

XV. DOCUMENT RETENTION POLICY

XVI. MISCELLANEOUS LEGAL MATTERS

(This would include all other miscellaneous law-related items not covered by I through XV above, such as, for example, contracts or disputes with vendors or outside service suppliers, spousal issues in divorce of principal, etc.)

XVII. LIBRARY OF MANAGEMENT AND BEST PRACTICES PUBLICATIONS

A. NADA Management Publications

B. Selected Articles and Other References.