

## The Pink Elephant in the Room December 2005

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As chair of the buy-sell section, I have been asked to predict the trends for 2006 in the transactional arena. I am sure there is famous wisdom on why not to make predictions, but I can't remember it. So, here it goes.

There is a pink elephant in the room. Well that might not be accurate, because no one talks about the proverbial pink elephant, while the industry is all abuzz about this one. It is called General Motors. Perhaps albatross is a better description.

GM's problems weigh heavily on the automotive sector and thus on the nature of the legal issues we will see as attorneys. The company's stock recently fell to an 18-year low on concerns about GM's financial problems; a possible bankruptcy filing; and a showdown between the United Auto Workers and management at bankrupt Delphi Corp. Its bonds are rated as junk and they recently decided to close nine plants and layoff 30,000 workers. So, labor lawyers and bankruptcy lawyers be ready. Lawyers representing anyone doing business with GM be ready. Based on its 2004 gross revenue, GM was ranked as the third largest company in the United States. Its failure would be an economic tsunami. Will GM go bankrupt? Right now the "markets" are saying yes, but only time will tell. In the end, GM may have no choice and it might be the "right" thing to do to protect shareholder value.



So what does all the economic talk have to do with buy-sells and lawyers? Well, if GM goes bankrupt, it could seek to reject all or some of its franchise agreements, jettisoning underperforming dealers. If GM downsizes its production, it will have no choice but to reduce its dealer body. There will not be enough supply of vehicles. All GM dealers will be unsecured creditors, standing in line behind all of GM's secured creditors. Holdback, incentive money, credits to the parts account, would all be in jeopardy. The other domestics would most likely have to do some cost cutting of their own to compete with GM (as GM is free to squeeze out costs by discharging all of its unsecured debt). As an aside, you should advise your clients to stay very current with payments from GM.

Now for the good news. Gas prices are declining. Interest rates are steady and unlikely to rise quickly, although they will rise. Inflation will be in check. We will be a car-based society for a long time and the rest of the world will be too (go look up how many cars have been sold in China this year as opposed to last year). Given all of the above, I expect dealership buy-sell activity to be brisk in 2006. Some GM dealers will seek to run for cover by selling, while other dealers may look at this as a buying opportunity. The foreign makes are going to continue to demand high multiples.

On a more finite level, given the extremely tight profit margins of car dealerships, legal compliance can enhance a dealer's bottom line. This is a hard sell, but the dealer who does a little preventive maintenance on legal compliance will spend far less than the dealer who gets sued for poor practices or receives an inquiry from the attorney general. Tell your client what it will cost for you to perform a legal audit and then tell him what a lawsuit will cost. The difference should get his attention.