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## THE NEW POINT: Opportunity and Challenge

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You've likely heard great stories about the dealer (sometimes your competitor) who received a new "point", and how it became a tremendous success. You were envious and wondered when your opportunity would come, when you would finally be the "favorite son" of the factory and not just another standby. Then, it finally happens. You get the call from your zone manager and, more importantly, you receive the all-important Letter of Intent ("LOI"). Your dreams have come true.

Unfortunately, this well-known story can sometimes become a nightmare. The chances of things going awry increase exponentially if you do not address the specific challenges of a new point. Let's explore some of those challenges:

### I. FACILITY REQUIREMENTS.

The most significant requirement in a new point scenario is, of course, the obligation to have the proper facility for the new dealership. This is the proverbial elephant in the room.

Typically, the LOI sets forth the facility locality and guidelines for the new store. It also establishes a specific time-line for the completion of the facility project, and the ultimate date to become fully-operational. The proper negotiation of these requirements is essential for the viability and ultimate success of the project.

The facility requirements must be negotiated in light of the realistic projections for the particular franchise, the rent factor associated with the facility, and land costs. For example, if the franchise is Volkswagen and the projected sales are only 500 units per year (new), a required facility of 40,000 square feet and four acres of land would be absurd.

Sadly, the factory, by and large, does not concern itself with such mundane matters. You must fully evaluate this aspect with the assistance of your financial and legal advisors and approach the investment wisely with both a sound analysis and realistic projections. Don't let the glamour of the deal detract from your good business judgment.

The facility deadlines must also be evaluated with caution. It is not uncommon for the factory time-line to be unpractical – if not completely unrealistic. The typical “stair-steps” include the following:

1. Identification of the site/property;
2. Execution of the Contract of Sale;
3. Governmental approval for construction;
4. Commencement of construction; and
5. Completion of construction, including the deadline to be operational.

In many cases, the LOI will attribute a 2-year period to accomplish this feat. Worse, the LOI will typically establish each stair-step as a “time-of-the-essence” date. Translated from legalese, this means the LOI can be withdrawn by the franchisor if a particular stair-step is not timely met.

A properly-negotiated LOI will establish a realistic timeframe. In most cases, this cannot be less than **3 years**. In some deals the real estate can be scarce or difficult to purchase. Environmental issues can delay the acquisition. Separately, the governmental approval process can drag on for well over a year. Of course, weather can be a serious impediment during construction. All of the factors are beyond a dealer's control and

must be considered in establishing the timeframe. Moreover, the LOI should include a provision which extends the deadlines if one of these factors intervene.

## **II. WORKING CAPITAL AND OTHER REQUIREMENTS.**

The LOI must be carefully scrutinized in order to understand the other requirements of the franchise. Principal among these is the working capital standard. In certain instances, this requirement can be unreasonable, if not illogical. Needless to say, this is another huge outlay. When coupled with the facility costs, the working capital can make the new point an opportunity for disaster. This aspect should be negotiated both in amount and in terms of timing. The same will apply to inventory requirements – particularly motor vehicles.

Additional issues to be evaluated include the following:

1. Floor plan requirements;
2. Performance requirements, including sales and customer satisfaction;[\[1\]](#)
3. Debt-to-equity ratio; and
4. Protest waivers.

Each of these must be carefully considered and negotiated to the largest extent possible.

## **III. PROTEST IMPLICATIONS.**

The establishment of a new point also creates encroachment concerns in many instances. If the point is too close to an existing (competing) dealer of the same line-make, that dealer may have the right to protest or challenge the appointment. State franchise law must be carefully examined in this regard. A protest or challenge can significantly delay the establishment of the point, if not nullify the opportunity completely.

This becomes quite problematic when negotiating the real estate deal. How does a dealer keep the real estate transaction alive while a protest is pending (including possible appeals)? This aspect must be negotiated in the real estate contract so that there is both the ability to extend the contract, and to terminate it in the event the protest delays matters or, worse, prevails.

A LOI typically addresses a protest or challenge. Unfortunately, it only does this in a manner which primarily favors the franchisor. These provisions must be addressed carefully and must be negotiated. At minimum, the

new point dealer must obtain the factory's commitment to defend and pay for the defense of the protest, including the responsibility for both legal and expert fees.

A new point can be a tremendous opportunity. However, it must be approached with caution, competent professional advice, and good business judgment.

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[1] Many will recall the post-bankruptcy LOI's issued by GM which required ridiculous sale levels and lead to threats of, or actual, terminations on that basis.