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Indemnification and Defense of Finance Sources in Consumer Litigation – Potential Pitfalls and Best Practices

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When a consumer files a lemon lawsuit, it is common for the consumer to name as defendants the manufacturer of the car, the dealer who sold the car, and the finance source that provided financing for the car. While plaintiffs' attorneys say that this facilitates settlement of these types of cases, dealer lawyers should be aware that this practice of including the dealers often practically results in increased costs and potential liability for the dealer.

When dealer clients are served with a lemon lawsuit, most are aware that the lawsuit should be tendered to the manufacturer for defense and indemnification pursuant to the sales and service agreement and/or statutory provisions. Unfortunately, although the dealer may be indemnified by the manufacturer, the dealer also may be contractually obligated to defend and indemnify the finance source in the same litigation. Dealer clients often do not understand that the manufacturer

is under no obligation to defend the dealer against contractual claims brought by the finance source. Additional confusion often arises because manufacturers sometimes will indemnify claims brought against their captive finance sources but not against unaffiliated finance sources.

A dealer will typically learn of a demand for indemnification when it receives a demand letter from the finance source. Often, the demand letter will enclose a copy of the plaintiff's complaint and a copy of the dealer agreement between the dealer and the finance source. If a copy of the dealer agreement is not included and it is not in the client's possession, a copy should be requested. The letter will recite the allegedly applicable sections of the dealer agreement and claim that the allegations in the plaintiff's complaint constitute breaches of the dealer's representations and warranties in the dealer agreement.

Most dealer agreements will require the dealer to indemnify the finance source for any damages (including attorney's fees) incurred, because a retail installment sales contract was not entered in full compliance with all applicable laws. A dealer agreement likely will permit the finance source to insist that the dealer buy back the

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contract based upon the alleged breach of contractual representations. In most cases a dealer will not want to buy back the contract and risk a default by the customer. However, if the customer is making payments in accordance with the contract, the financing company will rarely demand a buy back.

Instead, the finance source looks to the dealer for indemnification in the event that the lemon lawsuit results in liability against the dealer. As a practical matter, this will not happen, because the dealer is being indemnified by the manufacturer. The finance source also looks to the dealer to either pay for the defense of the finance company in the lawsuit or to defend the finance company in the lawsuit. In our experience, it is to the dealer's advantage to agree to defend the finance company's interests in the lawsuit. Generally, lemon cases settle without much discovery or motion practice, so the costs of litigation can be minimized. Most finance sources will agree to have the dealer's counsel assume the defense of the finance company in the lawsuit pursuant to a simple indemnification agreement. Dealers should be aware, however, that some finance companies obstinately refuse to allow the dealer to choose the counsel that will defend the finance company and instead assert a contractual right for the finance company to choose its own counsel at the dealer's expense. As ridiculous as this may seem, it may be technically permissible under some dealer agreements.

Until recently, finance sources (and in particular the manufacturer captive finance sources) rarely made a demand for defense and indemnification against a dealer in a lemon lawsuit. Presumably, there was a tacit understanding that the plaintiff was not making any claims of independent wrongdoing against the finance source and that the claims against the finance source were based solely upon holder liability. However, in the last several years, we have noticed: (1) more onerous representations and warranties in dealer agreements with finance sources; and (2) more aggressive actions by finance sources to seek defense and indemnification against dealers in lemon lawsuits. To mitigate expense and risk to the dealer, we recommend the following:

- Counsel your clients to be proactive by forwarding dealer agreements to counsel for review whenever a relationship with a new finance source is being considered or a finance source is proposing an amendment to an existing dealer agreement.
- If the finance source's demand for defense/indemnification is arguably appropriate under the dealer agreement, agree to provide defense and indemnification expeditiously.
- Propose entering into an indemnification agreement that defines the terms of the defense and indemnification and waives any conflict arising out of counsel's representation of the dealer.
- Keep the finance source updated on the progress of the case and send appropriate communications closing out the file once the matter is concluded.

Updated Member Contact Information

Please make sure to notify NADC Staff (info@dealercounsel.com) if your contact information has changed so that your records can be updated accordingly. We will begin to list updated contact information in *The Defender* so all members can be aware of the change.



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Dealer clients are often skeptical when advised to pay their own counsel to defend a finance source in a lemon lawsuit for which the dealer is being provided a defense and indemnification by the manufacturer. Nevertheless, it will be much less expensive for the dealer to agree to provide the defense and manage the costs of litigation by relying upon the expertise of its counsel. Dealer counsel can efficiently manage the defense of the finance source through their knowledge of common characteristics of lemon law cases and through their relationships with plaintiffs' attorneys who often file lemon cases. Failure to timely respond to a legitimate request for defense and indemnification or a refusal of a legitimate request for defense and indemnification is an almost certain path to litigation with the finance source and the dealer may be compelled to pay the finance source's costs and attorneys' fees incurred in enforcing the dealer agreement. Counsel should advise their clients early of these potential pitfalls related to lemon lawsuits and the applicable provisions of dealer agreements should be negotiated to be more favorable/fair to the dealer if possible.

These trends related to finance source indemnification are a timely topic for dealers, and they represent a way for dealer attorneys to provide valuable counsel to their clients. Dealers may have developed a practice of "out of sight, out of mind" when it comes to lemon law cases due to reliance upon manufacturer indemnification programs, but it is even more important now for dealers to understand their potential obligations to indemnify and defend finance sources. ■

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