

Board Meeting Agenda Book



Texas Department *of* Motor Vehicles

HELPING TEXANS GO. HELPING TEXAS GROW.

June 1, 2017

Full Board Meeting, 8:00 a. m.

**AGENDA
BOARD MEETING
TEXAS DEPARTMENT OF MOTOR VEHICLES
4000 JACKSON AVE., BUILDING 1, LONE STAR ROOM
AUSTIN, TEXAS 78731
THURSDAY, JUNE 1, 2017
8:00 A.M.**

All agenda items are subject to possible discussion, questions, consideration, and action by the Board of the Texas Department of Motor Vehicles (Board). Agenda item numbers are assigned for ease of reference only and do not necessarily reflect the order of their consideration by the Board. Presentations may be made by the identified staff or Board member or other staff as needed. The Board reserves the right to discuss any items in executive session where authorized by the Open Meetings Act.

1. **Roll Call and Establishment of Quorum**
2. **Excuse Absences**
3. **Chair's Reports** - Chairman Raymond Palacios
4. **Executive Director's Reports** - Whitney Brewster
Awards, Recognition of Years of Service, and Announcements

BRIEFING AND ACTION ITEMS

5. **Finance and Audit**
 6. A. **TxDMV Fund Update** - Linda M. Flores and Renita Bankhead
(BRIEFING ONLY)
 8. B. **FY 2017 Quarterly Financial Report** - Linda M. Flores and Renita Bankhead
(BRIEFING ONLY)
 19. C. **FY 2018 Preliminary Operating Budget** - Linda M. Flores and Renita Bankhead
(BRIEFING ONLY)
 53. D. **Facilities Update** - Linda M. Flores (BRIEFING ONLY)
 56. E. **Internal Audit Division Status Report** - Sandra Menjivar-Suddeath
(BRIEFING ONLY)
 77. F. **Amendment to the FY 2017 Annual Audit Plan** - Sandra Menjivar-Suddeath
89. 6. **Legislative and Public Affairs** - Caroline Love (BRIEFING ONLY)
 - A. Update on TxDMV Board Recommendations to the 85th Legislature
 - B. General Overview of 85th Legislature Outcomes
98. 7. **Projects and Operations** - Judy Sandberg (BRIEFING ONLY)
Enterprise Projects Update

PAGE

5

6

8

19

53

56

77

89

98

PAGE

- 109 8. **Specialty Plates Designs** - Jeremiah Kuntz
 A. Eastern Star (New Non-Vendor Plate)
 B. University of Texas, Longhorn Tower (Vendor Plate Redesign)
 C. Porsche Club of America (New Vendor Plate)

CONTESTED CASE

- 113 9. **Franchised Dealer's Protested Distributor's Notice of Termination under Occupations Code, §2301.453** - Daniel Avitia and David Richards
 MVD Docket Nos. 14-0010.LIC and 15-0013.LIC;
 SOAH Docket No. 608-14-3211.LIC
Bates Nissan, Inc., Complainant v. Nissan North America, Inc., Respondent

RULES - ADOPTIONS**Title 43, Texas Administrative Code**

- 533 10. **Chapter 206, Management** - David D. Duncan
[Amendments, §206.131, Digital Certificates](#)
 (Proposal Published January 27, 2017 - 42 Tex. Reg. 300)
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and Salvage Vehicle Rebuilders
[Amendments, §§221.16, 221.53, and 221.73](#)
 (Proposal Published January 27, 2017 - 42 Tex. Reg. 301)
- 555 11. **Chapter 209, Finance** - Jeremiah Kuntz and Linda M. Flores
[Amendments, §209.2, Charges for Dishonored Checks](#)
 (Proposal Published March 24, 2017 - 42 Tex. Reg. 1389)
- 562 12. **Chapter 215, Motor Vehicle Distribution** - Bill Harbeson and Daniel Avitia
[Amendments, §215.140, Established and Permanent Place of Business](#)
 (Proposal Published March 24, 2017 - 42 Tex. Reg. 1390)
- 576 13. **Chapter 215, Motor Vehicle Distribution** - Jeremiah Kuntz
[Amendment, §215.155, Buyer's Temporary Tags](#)
 (Proposal Published March 24, 2017 - 42 Tex. Reg. 1392)
- 584 14. **Chapter 217, Vehicle Titles and Registration** - Jimmy Archer
[Amendments, §217.56, Registration Reciprocity Agreements](#)
 (Proposal Published March 24, 2017 - 42 Tex. Reg. 1393)
- 603 15. **Chapter 218, Motor Carriers** - Jimmy Archer and Bill Harbeson
[Amendments, §§218.13, 218.17, 218.56, 218.57, 218.65, and 218.73](#)
[Repeal, §218.74, Settlement Agreements](#)
[New, §218.75, Cost of Preparing Agency Record](#)
 (Proposal Published April 7, 2017 - 42 Tex. Reg. 1876)

Board of the Texas Department of Motor Vehicles
Agenda: June 1, 2017

Page 3

- PAGE 649** **16. Chapter 219, Oversize and Overweight Vehicles and Loads** - Jimmy Archer and Bill Harbeson
[Amendments, §§219.2, 219.3, and 219.124](#)
[Repeal, §219.125, Settlement Agreements](#)
[New, §219.127, Cost of Preparing Agency Record](#)
(Proposal Published April 7, 2017 - 42 Tex. Reg. 1885)

RULE - PROPOSAL

- 678** **Title 43, Texas Administrative Code**
17. Chapter 218, Motor Carriers - Bill Harbeson
[Amendments, §218.61, Claims](#)

EXECUTIVE SESSION

- 18. The Board may enter into closed session under one or more of the following provisions of the Texas Open Meetings Act, Government Code, Chapter 551:**
- **Section 551.071** - Consultation with and advice from legal counsel regarding:
 - pending or contemplated litigation, or a settlement offer;
 - a matter in which the duty of the attorney to the government body under the Texas Disciplinary Rules of Professional Conduct of the State Bar of Texas clearly conflicts with Government Code, Chapter 551; or
 - any item on this agenda.
 - **Section 551.074** - Personnel matters.
 - Discussion relating to the appointment, employment, evaluation, reassignment, duties, discipline, and dismissal of personnel.
 - **Section 551.076** - Security devices or security audits:
 - the deployment, or specific occasions for implementation, of security personnel or devices; or
 - a security audit.

19. ACTION ITEMS FROM EXECUTIVE SESSION

20. Public Comment

21. ADJOURNMENT

The Board will allow an open comment period to receive public comment on any agenda item or other matter that is under the jurisdiction of the Board. No action will be taken on matters that are not part of the agenda for the meeting. For subjects that are not otherwise part of the agenda for the meeting, Board members may respond in accordance with Government Code, Section 551.042 and consider the feasibility of placing the matter on the agenda for a future meeting.

Agenda items may be presented by the named presenters or other TxDMV staff.

Board of the Texas Department of Motor Vehicles
Agenda: June 1, 2017

Page 4

Pursuant to Sections 30.06 and 30.07, Penal Code (trespass by license holder with a concealed or openly carried handgun), a person licensed under Subchapter H, Chapter 411, Government Code (handgun licensing law), may not enter this property with a concealed handgun or a handgun that is carried openly.

Any individual with a disability who plans to attend this meeting and requires auxiliary aids or services should notify the department as far in advance as possible, but no less than two days in advance, so that appropriate arrangements can be made. Contact Stacy Steenken by telephone at (512) 302-2380.

I certify that I have reviewed this document and that it conforms to all applicable Texas Register filing requirements.

CERTIFYING OFFICIAL: David D. Duncan, General Counsel, (512) 465-5665.



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Whitney Brewster, Executive Director
Agenda Item: 4
Subject: Executive Director's Reports – Recognition of Years of Service

RECOMMENDATION

Board Chair and Members offer congratulations to employees reaching a state service milestone.

PURPOSE AND EXECUTIVE SUMMARY

Beginning November 3, 2016, the Executive Director will announce the name of individuals who retired from the agency and will recognize employees who have reached a state service milestone of 20 years and every five-year increment thereafter. Recognition at the June 1, 2017 Board meeting for retirements and state service awards include:

Laura Dennis in the Information Technology Services Division reached 20 years of state service.
Norma Fabian in the Finance & Administrative Services Division reached 20 years of state service.
Linda Martin LeDet in the Vehicle Titles & Registration Division reached 20 years of state service.
Debbie Bates in the Information Technology Services Division reached 20 years of state service.

Idalia Illa-Lopez in the Vehicle Titles & Registration Division reached 25 years of state service.
Andrew Gonzales in the Consumer Relations Division reached 25 years of state service.
Patrick Palmer in the Finance & Administrative Services Division reached 25 years of state service.
Sylvia White in the Consumer Relations Division reached 25 years of state service.
Ellen Blackwell in the Motor Vehicle Division reached 25 years of state service.
Renee Clayton in the Vehicle Titles & Registration Division reached 25 years of state service.

Christine Reding in the Motor Carrier Division reached 25 years of state service.
William Diggs, Jr. in the Vehicle Titles & Registration Division reached 30 years of state service.
Cindy Grisham in the Vehicle Titles & Registration Division reached 30 years of state service.
Lois Johnson in the Motor Carrier Division reached 30 years of state service.

Finally, the following individuals recently retired from the agency:

Stella Rico - Vehicle Titles & Registration Division
Maria Dassing – Consumer Relations Division
Judy Miller - Vehicle Titles & Registration Division
Paula Lancaster - Information Technology Services Division
Susan Price-LaSalla – Motor Carrier Division
Jeffrey Kushaney – Finance & Administrative Services Division



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Linda M. Flores, Chief Financial Officer
Agenda Item: 5. A.
Subject: Presentation of a summary of activities in the TxDMV Fund for month ending April 30, 2017

RECOMMENDATION

This is a briefing of the TxDMV Fund revenue and expenditure activities for April, 2017. No action required.

PURPOSE AND EXECUTIVE SUMMARY

On September 1, 2016, the TxDMV began depositing revenue into the Texas Department of Motor Vehicle Fund (TxDMV Fund or Fund 0010.) The operating budget for Fiscal Year 2017 is primarily funded by revenues collected in the TxDMV Fund. Legislation authorized a one-time \$23 million transfer of funds from General Revenue (Fund 0001) to the TxDMV Fund as start-up resources.

FINANCIAL IMPACT

For the month ending April 2017, collections for the TxDMV Fund totaled \$116.2 million consisting of \$93.2 million in revenue deposits (including collections for payments of fees for credit cards and Texas.gov) plus the \$23 million one-time transfer.

- Revenue collections for the Processing and Handling Fee (P&H) as of April 2017 are within projected levels at \$16.9 million.

Obligations to the TxDMV Fund for the same period includes \$71.5 million in operating expenses, plus \$8.1 million in obligations for fringe benefits and \$4.1 million for convenience and Texas.gov fees. The result is a projected net cash balance of \$32.5 million for the month ending April 2017.

Staff project that collected revenues will continue to cover operating costs.

BACKGROUND AND DISCUSSION

The 83rd Legislature, Regular Session, enacted two bills H.B. 2202 and H.B. 6 that significantly affect TxDMV's revenue disposition for funds collected by the department and its method of finance for the 2014-2015 biennium. The 84th Legislature, Regular Session enacted SB 1512 which ensured that the TxDMV Fund and its revenue dedications were recreated and rededicated revenues for deposit into the TxDMV Fund.

The TxDMV Fund 0010 was created effective September 1, 2016, changing the agency's method of financing from General Revenue (with the exception of the Automobile Burglary and Theft Prevention Authority [ABTPA]) to the TxDMV Fund.

TxDMV Fund Revenue & Expenses

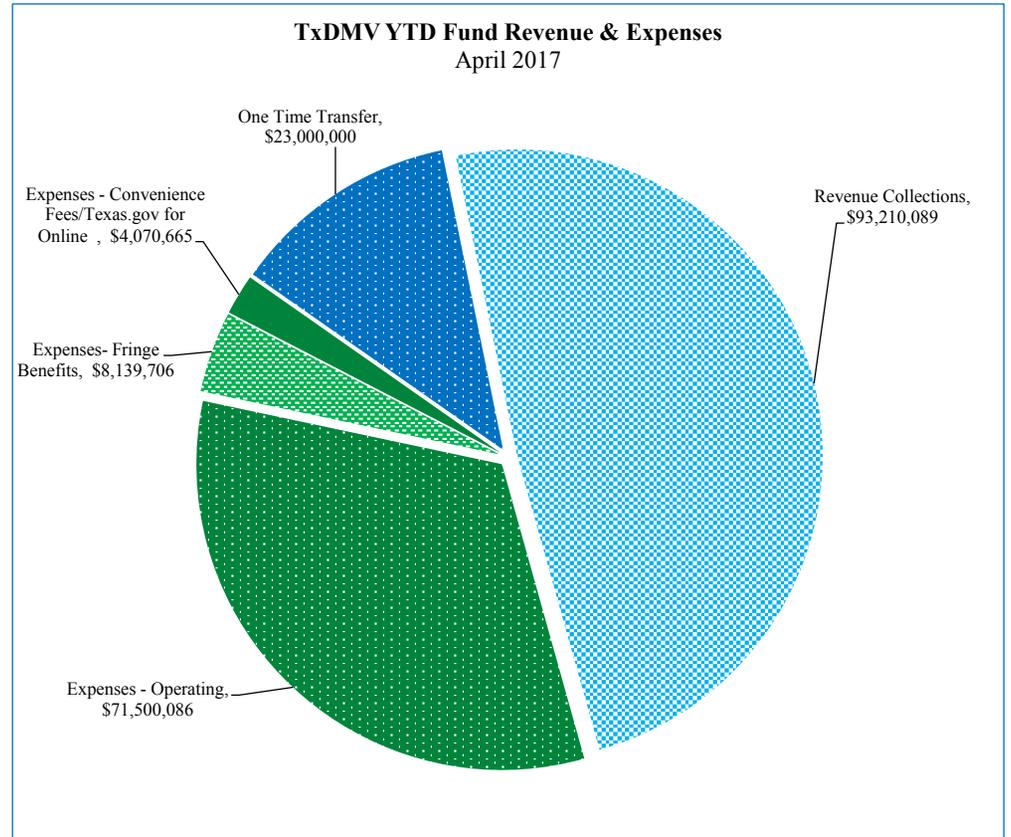
for month ending April 2017

Revenues		
One Time Transfer		\$ 23,000,000
Motor Vehicle Certificates	\$ 25,821,666	
Motor Vehicle Registration Fees	\$ 31,328,084 ⁽¹⁾	
Motor Carrier - Oversize / Overweight	\$ 8,211,822 ⁽²⁾	
Motor Vehicle Business Licenses	\$ 5,225,704	
Miscellaneous Revenue	\$ 1,618,607	
Processing & Handling (P&H) Fees	\$ 16,933,541	
Credit Card Convenience Fees	\$ 2,270,301 ⁽³⁾	
Texas.gov Fees for Online P&H	\$ 1,800,364	

Subtotal Revenue Collections		\$ 93,210,089
Total Revenue		\$ 116,210,089

Expenditures		
Salary Related	\$ 24,981,734	
Benefit Replacement Pay	\$ 85,423	
Other Personnel	\$ 921,291	
Professional Fees	\$ 5,756,759	
Fuels & Lubricants	\$ 28,365	
Consumables	\$ 872,350	
Utilities	\$ 2,353,859	
Travel In-State	\$ 178,794	
Travel Out-of-State	\$ 17,945	
Rent - Building	\$ 455,031	
Rent - Machine and Other	\$ 154,453	
Advertising & Promotion	\$ 8,249	
Purchased Contract Services	\$ 21,243,393 ⁽¹⁾	
Computer Equipment & Software	\$ 1,558,146	
Fees & Other Charges	\$ 881,580	
Freight	\$ 360,466	
Maintenance & Repair	\$ 1,195,757	
Membership & Training	\$ 174,033	
Other Expenses	\$ 66,126	
Postage	\$ 6,886,760	
Reproduction & Printing	\$ 2,774,404	
Services	\$ 539,646	
Other Capital	\$ 5,519	

Subtotal Operating Expenses		\$ 71,500,086
Fringe Benefits	\$ 8,139,706	
Credit Card Convenience Fees	\$ 2,270,301	
Texas.gov Fees for Online P&H	\$ 1,800,364	
Total Expenses		\$ 83,710,456
Net Cash Balance		\$ 32,499,633



Notes:

⁽¹⁾ MyPlates TxDMV Fund revenues for this period total \$2,976,628 with expenses totaling \$2,907,492

⁽²⁾ Motor Carrier - Oversize/Overweight excludes escrow deposits of \$2.6 million.

⁽³⁾ Credit Card Convenience Fees includes fees for Temp Permits, Oversize/Overweight Permits, TxIRP, Motor Carrier Credentialing System (MCCS) and eLICENSING.



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Linda M. Flores, CPA, Chief Financial Officer
Agenda Item: 5.B.
Subject: FY 2017 Quarterly Financial Report

RECOMMENDATION

The attached Financial Summary reflects revenues and expenditures for the TxDMV as of the April 30, 2017. No action required.

PURPOSE AND EXECUTIVE SUMMARY

The Texas Department of Motor Vehicles (TxDMV) Board is briefed quarterly by staff on revenue collections and agency expenditures. The attached Financial Summary includes both second quarter (ending February 28, 2017) and financial information for a portion of the third quarter.

Year-to-Date (YTD) TxDMV Fund 0010 collections of \$112,139,424 exceeded projections, however; collections for all revenues (including Fund 0006 and Fund 0001) were under projection. TxDMV revenue collections were close to projections without any unanticipated fluctuations. Expenses for the same period totaled \$86.8 million with salaries, professional fees, and contract services constituting the majority of the expenditures.

FINANCIAL IMPACT

Beginning in Fiscal Year 2017 the agency is funded from the newly created TxDMV Fund which includes the Processing and Handling Fee (P&H). The exception is the Automobile Burglary and Theft Prevention Authority (ABTPA), which will continue to be funded from General Revenue. The department completed the first eight months without any major cost overruns or unanticipated expenditures.

BACKGROUND AND DISCUSSION

Revenues

Through April of Fiscal Year 2017, TxDMV Fund collections exceeded expectations with overall revenue 1.9% higher than projected. Strong registration and title revenue both finished above projection, offsetting diminished oversize/overweight revenue. Business dealer licenses revenue has exceeded projections with revenue 7.4% higher than anticipated year to date. P&H revenue including the automation portion and temporary permits totaled \$16,933,541 through April 2017.

As of April 30, 2017, revenue collections for the new MyPlates contract totaled approximately \$27 million of which \$13.3 million counts toward the \$15 million General Revenue guarantee. At the current collection rate it is estimated the \$15 million General Revenue guarantee will be met in late summer of calendar year 2017.

Through the first 8 months of Fiscal Year 2017, collections for all revenues ended 4.7% lower or \$55.6 million less than projected. The major drivers for lower than projected revenue collections are a decline in registration revenue and oversize/overweight revenue. Registration revenue is lower than anticipated, as the state has experienced a 1% decrease in the number of registered vehicles compared to the same period last year. Through April, oversize/overweight revenue is 8.7% below projected levels, but revenue in this category trended upward in March and April. The slump in oil prices and the related downturn in the oil patch continue to put pressure on the oversize/overweight category, but the number of permits issued on a monthly basis improved in March and April compared to the same period of Fiscal Year 2016.



Expenditures

Year-to-date expenditures through April 30, 2017 for all funds total \$86,840,910 of which 82% (\$71.5 million) is funded by the TxDMV Fund. In addition to TxDMV Fund expenses of \$71.5 million, obligations to the fund includes \$12.2 million for fringe benefits, credit card convenience fees and payments to Texas.gov results in total TxDMV Fund expenses to over \$83.7 million.

Overall the largest expenditures incurred were in salary related categories, contract services (plate production/registration renewal) and professional fees (Data Center Services and Automation). Included in the year-to-date expenditures is approximately \$2.9 million for contract payments to the MyPlates vendor. Contract payments to the MyPlates vendor are contingent upon revenues collected. As of the end of April, MyPlates revenues totaled \$2,976,628. Also included are capital appropriation expenditures of approximately \$19.3 million, of which half are for Automation projects associated with RTS Refactoring and LACE Replacement/eLicensing.

At the end of the second quarter (February 28, 2017) the staff prepared a Mid-Year review of the operating budget. A total of \$5,346,000 was allocated for postage to mail registration materials (\$4.6 million) and \$375,000 for sticker paper. The department estimates \$2.2 million in lapse (\$1.6 in salaries and \$600,000 in fringe benefits) associated with the Governor's Office hiring freeze effective February 1, 2017. In addition, the department anticipates lapsing approximately \$12 million in the operating budget in set aside payments to Texas.gov for fees related to online processing of the P&H fee. TxDMV does not collect these amounts as revenue, Texas.gov retains \$2.00 fee from each online transaction and remits the states portion to the treasury, and therefore a payment is not processed.



Texas Department *of* Motor Vehicles
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FY 2017 Financial Summary
for the period ending
April 30, 2017

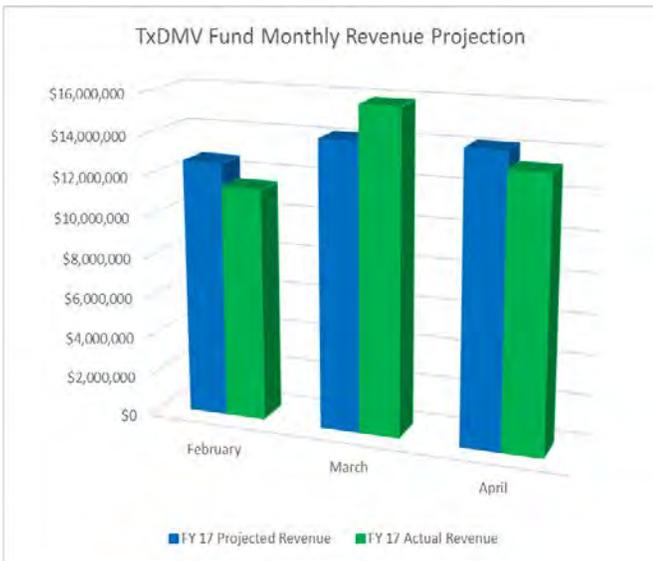
Finance and Administrative Services Division
June 1, 2017

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

TxDMV Fund Overview

<u>Revenues:</u>	FY 2017 YTD Projected Revenue	FY 2017 YTD Actual Revenue
Motor Vehicle Certificates of Title	\$ 24,594,908	\$ 25,821,666
Motor Vehicle Registration Fees	28,909,026	31,328,084
Motor Carrier - Oversize / Overweight	8,757,351	8,211,822
Business Dealer Licenses	4,867,106	5,225,704
Miscellaneous Revenue	1,714,933	1,618,607
TxDMV Fund One-time Transfer	23,000,000	23,000,000
Processing and Handling Fee	18,152,453	16,933,541
Total TxDMV Fund Revenue	\$ 109,995,777	\$ 112,139,424

Overall, TxDMV Fund revenue is 1.9% over projection through the first 8 months of FY 2017. Certificate of Title revenue is 5% higher than projected while registration revenue is 8.4% higher than projected.



Through the first 8 months of FY 2017 Oversize/Overweight deposits to the TxDMV Fund are 6.2% below projections, as fewer permits have been issued YTD in the depressed oil price environment. In the months of March and April the department saw an uptick in the number of permits issued and revenue received. In April FY 2017, the department issued approximately 12% more Oversize/Overweight permits than the same period of FY 2016. After a slow revenue start to the year and recent implementation of eLicensing, Business Dealer Licenses revenue is now 7.4% higher than projected.

The department has been collecting Processing and Handling Fee (P&H) revenue since November and through April has collected nearly \$17 million. After a solid start to the year, P&H revenue slipped slightly in April to finish the reporting period 6.7% under projection. Revenue staff

monitors P&H revenue on a monthly basis. Overall collections remain in line with projections.

Through April FY 2017, the top four TxDMV Fund fees (P&H, Title - \$3 Portion, Buyer's Tag and Automation) accounted for approximately 54% of all TxDMV Fund revenue. The Automation Fee was reduced to \$0.50 in January via P&H rule package and is included below in the Processing and Handling Automation (Portion). Salvage Titles/ Title Histories and MyPlates Renewal Fees round out the top 10 TxDMV Fund fees. The one-time \$23,000,000 transfer is not included below.

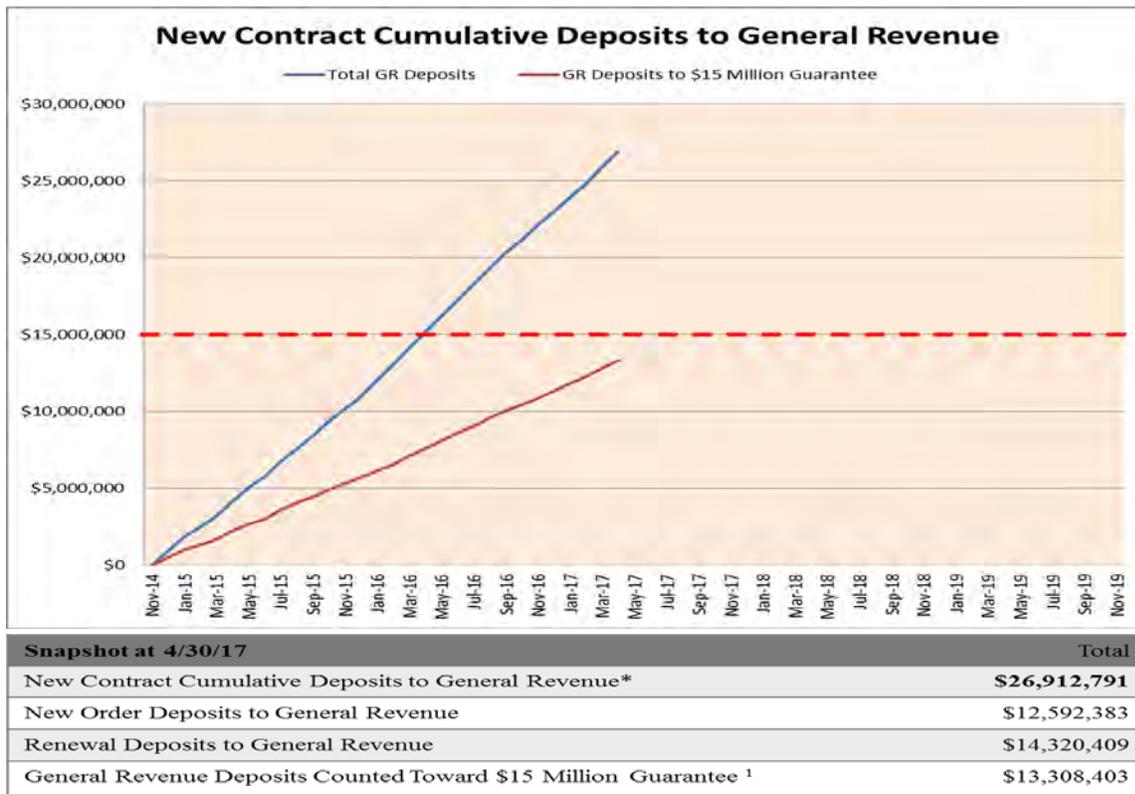
Top 10 TxDMV Fund Fees through April FY 2017 ¹			% of Total
Processing and Handling Fee (P&H)	\$	13,232,899	14.8%
Title Fees (\$3 Portion)		12,684,513	14.2%
Buyer's Tag		11,921,043	13.4%
Automation Fee		10,410,910	11.7%
Oversize/Overweight Permits		6,371,147	7.1%
Business Dealer Licenses		5,224,204	5.9%
Delinquent Title Transfer (Public)		4,908,257	5.5%
Processing and Handling Fee (Automation Portion)		3,700,642	4.2%
Salvage/Title Histories		3,152,778	3.5%
MyPlates Renewal Fees		2,966,681	3.3%
Top 10 TxDMV Fund Fees Deposits	\$	74,573,074	83.7%
Total TxDMV Fund Deposits	\$	89,139,424	100.0%

¹ - Overall collections remain in line with projections.

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

My Plates Contract Revenue and Guarantee Status

Through April of FY 2017, cumulative vendor deposits to GR totaled \$26,912,791. Of these deposits, \$13,308,403 counts toward the contractual guarantee of \$15 million in deposits to GR. At the current rate of growth and using conservative methodology, it is estimated MyPlates will meet the revenue guarantee in the summer of FY 2017.



*Figures exclude refund data and are subject to minimal revision.

¹ – GR revenue from the sale of new plates and 5% of renewal plate revenue shall count toward the guarantee

General Revenue deposits from the sale of vendor specialty plates are determined by plate type and plate term with the state receiving:

- 40% from all plates sales of one year
- 95% of all renewals sales
- 60% of all auction sales
- 60% from all plate sales with a term of greater than one year
- 10% of all ancillary products

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

Overview All Revenues

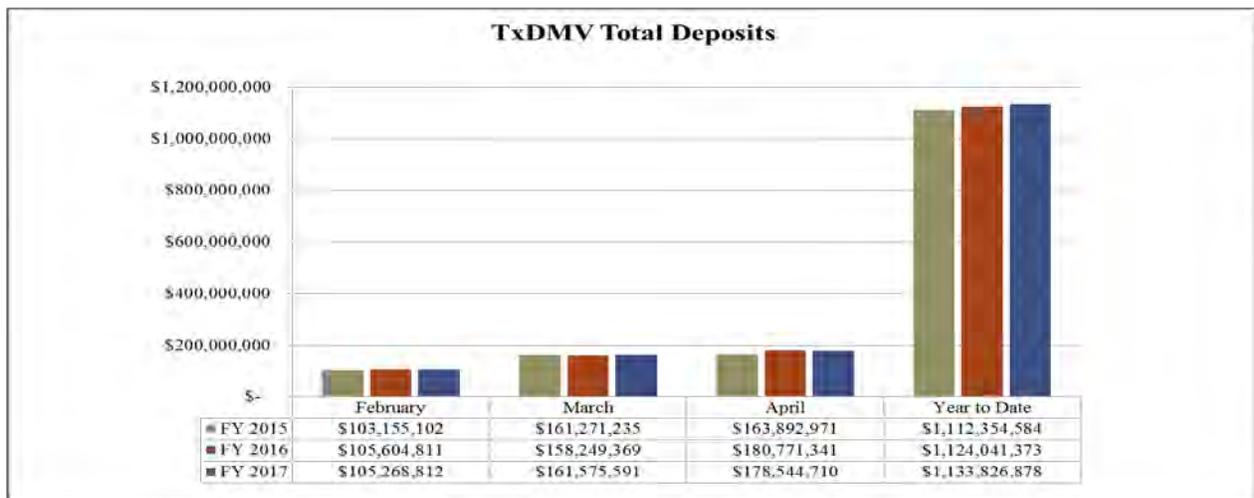
Revenues:	FY 2017 YTD Projected Revenue	FY 2017 YTD Actual Revenue
Motor Vehicle Certificates of Title	\$ 51,697,359	\$ 54,494,582
Motor Vehicle Registration Fees	973,353,471	926,066,622
Motor Carrier - Oversize / Overweight	108,514,804	99,033,599
Commercial Transportation Fees	5,171,809	4,706,476
Business Dealer Licenses	4,867,106	5,225,704
Miscellaneous Revenue	4,644,267	4,366,355
TxDMV Fund One-time Transfer	23,000,000	23,000,000
Processing and Handling Fee	18,152,453	16,933,541
Total DMV Revenue	\$ 1,189,401,268	\$ 1,133,826,878

Overall, revenue is 4.7% under projection through April of FY 2017 for all revenue collections. For the month of April revenue was 1.2% lower compared to April 2016, but total year-to-date revenues are slightly above FY 2016 collections.

Certificate of Title revenue is 5.4% over projection, helped by strong auto sales. In contrast to TxDMV Fund and General Revenue registration revenue, overall registration revenue is unexpectedly below projected levels as the state has experienced a 0.9% decrease in the number of registered vehicles compared to the same period last year. As of April, there were 24,020,803 (excluding exempt vehicles) registered vehicles in Texas. Implementation of the single sticker program and its associated new requirements is the most likely reason for the decrease in State Highway Fund 0006 registration revenue and . Although TxDMV’s registration forecast is more conservative than both the Biennial Revenue Estimate (BRE) and TxDOT Cash Forecast, registration revenue is not expected to meet the FY 2017 projection. Based on the first 8 months of FY 2017, registration deposits to the State Highway Fund are estimated to finish the year approximately \$40 million below staff projections.

Oversize/Overweight revenue is down 8.7% YTD compared to projections, but has seen a revenue rise in the second half of this fiscal year. Oil prices remain depressed, but if recent revenue momentum continues, Oversize/Overweight revenue may meet projections. Commercial Transportation Fees revenue is 9.0% below projections. Business Dealer Licenses revenue is 7.4% higher than projections after a slow start in FY 2017. The Motor Vehicle Division has worked through a backlog of credential applications and recently implemented eLicensing.

TxDMV total deposits YTD through April for the past three fiscal years is shown below. Typically the months of March, April and May are the highest revenue months for the department. The seasonal variation of registration revenue accounts for the large upswing in overall revenue compared to January and February.



FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

April 2017 Budget Status

Expenditures:	2017 Adjusted Budget	1Q Sep - Nov	2Q Dec - Feb	Partial 3Q Mar - Apr	YTD Expenditures	FY 2017 Available Budget	FY 2017 Encumbrances	FY 2017 Available Budget
Salaries and Wages	\$ 41,032,376	\$ 9,391,703	\$ 9,525,759	\$ 6,293,012	\$ 25,210,473	\$ 15,821,903	\$ -	\$ 15,821,903
Benefit Replacement Pay	\$ 113,282	\$ 10,266	\$ 63,400	\$ 11,757	\$ 85,423	\$ 27,859	\$ -	\$ 27,859
Other Personnel Costs	\$ 1,273,315	\$ 293,343	\$ 394,704	\$ 240,848	\$ 928,894	\$ 344,421	\$ -	\$ 344,421
Professional Fees and Services	\$ 43,872,703	\$ 2,530,505	\$ 5,524,176	\$ 7,311,434	\$ 15,366,115	\$ 28,506,588	\$ 8,277,775	\$ 20,228,812
Fuels & Lubricants	\$ 75,650	\$ 8,358	\$ 11,976	\$ 8,030	\$ 28,365	\$ 47,285	\$ 31,406	\$ 15,879
Consumable Supplies	\$ 1,574,710	\$ 268,597	\$ 348,632	\$ 406,565	\$ 1,023,795	\$ 550,915	\$ 397,518	\$ 153,397
Utilities	\$ 4,707,360	\$ 713,743	\$ 815,835	\$ 824,928	\$ 2,354,506	\$ 2,352,854	\$ 233,665	\$ 2,119,189
Travel In-State	\$ 457,609	\$ 76,095	\$ 52,977	\$ 60,044	\$ 189,115	\$ 268,494	\$ -	\$ 268,494
Travel Out-of-State	\$ 78,723	\$ 9,336	\$ 2,300	\$ 5,817	\$ 17,452	\$ 61,271	\$ -	\$ 61,271
Rent - Building	\$ 1,270,380	\$ 184,379	\$ 171,063	\$ 100,451	\$ 455,893	\$ 814,487	\$ 251,058	\$ 563,428
Rent - Machine and Other	\$ 342,728	\$ 25,754	\$ 81,458	\$ 49,347	\$ 156,559	\$ 186,169	\$ 128,135	\$ 58,033
Advertising & Promotion	\$ 650,745	\$ 1,323	\$ 5,631	\$ 2,952	\$ 9,906	\$ 640,839	\$ 32,421	\$ 608,418
Purchased Contract Services	\$ 35,667,378	\$ 5,563,258	\$ 8,343,429	\$ 7,746,303	\$ 21,652,990	\$ 14,014,388	\$ 9,547,701	\$ 4,466,687
Computer Equipment Software	\$ 7,924,365	\$ 145,893	\$ 914,288	\$ 1,103,029	\$ 2,163,209	\$ 5,761,156	\$ 4,326,321	\$ 1,434,835
Fees & Other Charges	\$ 1,458,162	\$ 251,321	\$ 259,263	\$ 373,780	\$ 884,364	\$ 573,799	\$ 347,804	\$ 225,995
Freight	\$ 828,706	\$ 13,098	\$ 235,582	\$ 111,787	\$ 360,466	\$ 468,239	\$ 414,616	\$ 53,623
Maintenance & Repair	\$ 8,139,516	\$ 753,363	\$ 1,003,304	\$ 273,203	\$ 2,029,870	\$ 6,109,646	\$ 3,465,670	\$ 2,643,977
Memberships & Training	\$ 293,129	\$ 91,523	\$ 42,979	\$ 40,556	\$ 175,059	\$ 118,070	\$ 19,293	\$ 98,777
Other Expenses	\$ 13,578,047	\$ 15,583	\$ 26,644	\$ 68,618	\$ 110,845	\$ 13,467,202	\$ 61,925	\$ 13,405,277
Postage	\$ 10,075,274	\$ 4,556,567	\$ 2,187,353	\$ 144,339	\$ 6,888,260	\$ 3,187,014	\$ 2,471,361	\$ 715,653
Reproduction & Printing	\$ 5,833,839	\$ 1,129,177	\$ 1,064,138	\$ 597,146	\$ 2,790,460	\$ 3,043,379	\$ 2,404,129	\$ 639,249
Services	\$ 1,230,493	\$ 127,394	\$ 284,561	\$ 127,827	\$ 539,782	\$ 690,711	\$ 490,308	\$ 200,403
Grants	\$ 13,681,480	\$ -	\$ 1,241,538	\$ 1,856,755	\$ 3,098,294	\$ 10,583,186	\$ 9,458,532	\$ 1,124,654
Other Capital	\$ 1,898,632	\$ 5,519	\$ -	\$ 315,295	\$ 320,814	\$ 1,577,818	\$ 6,050	\$ 1,571,768
	\$ 196,058,601	\$ 26,166,097	\$ 32,600,990	\$ 28,073,823	\$ 86,840,910	\$ 109,217,692	\$ 42,365,691	\$ 66,852,001

Budget Adjustments

Adjusted UB¹ \$ 4,317,815

Total adjustment to original approved budget of \$191.7 million **\$ 4,317,815**

Comparison to Prior Year			
	Adjusted Fiscal Year 2016	Adjusted Fiscal Year 2017	Percent Change
Approved Adjusted Budget	\$ 196,162,934	\$ 196,058,601	-0.05%
Year-to-Date Expenditures	\$ 78,358,757	\$ 86,840,910	10.82%
Available Budget	\$ 117,804,177	\$ 109,217,692	-7.29%
Encumbrances/Remaining Expenses	\$ 60,557,187	\$ 42,365,691	-30.04%
Available Budget	\$ 57,246,990	\$ 66,852,001	16.78%

Notes:

1. Unexpended balance amount adjusted to reflect actual costs in FY 2016 for Automation, County RTS, AMSIT and Physical Security capital budgets.

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

Expenditures:

Year-to-date expenditures through April 30, 2017 for all funds total \$86,840,910. The significant expenditure categories are detailed below:

Salaries and Other Personnel (\$25.2 million) – As of April 30, 2017 there were 711 filled positions and 62 vacancies. Effective February 1, 2017, the Governor's Office implemented a mandatory hiring freeze to be in effect through August 31, 2017. The estimated salary lapse from the hiring freeze is approximately \$1.6 million, the total lapse with benefits will be \$2.2 million.

Purchased Contract Services (\$21.2 million) – This line item includes Huntsville license plate production (\$15.2 million); Special License Plate Fees - Rider 3, (\$2.9 million); and registration renewal and specialty plate mailing (\$3.1 million).

Professional Fees (\$14.9 million) – The majority of these expenses are Data Center Services (DCS) (\$4.6 million) and Automation (\$9.4 million).

Postage (\$6.7 million) – Postage permits for registration renewal mailings.

Reproduction & Printing (\$2.7 million) – Printing and imaging of titles (\$1.3 million), title paper, envelopes, and registration inserts (\$1.4 million).

Utilities (\$2.3 million) – Information Technology data circuit and telephone costs (\$2.1 million); and reimbursement to TxDOT for facility costs (\$225K)

Maintenance and Repair (\$1.9 million) – Annual software maintenance costs (\$994K); RTS Refactoring (\$824K); and County technology support (\$178K)

TxDMV Fund

Year-to-date TxDMV fund operating/capital expenditures totaled \$71,500,086, with the largest expenditures in salary related and contract services. Contract services expenditures includes payments to MyPlates of \$2,907,492 with the majority of the remainder consisting of expenditures for the manufacture of plates. In addition to the \$71.5 million in expenditures there are also obligations to the fund of \$12,177,718 for fringe benefits, credit card convenience fees and payments to Texas.gov bringing total TxDMV fund expenses to \$83,677,804 as of the end of April 2017.

Mid-Year Review:

At the end of the second quarter (February 28, 2017) the staff prepared a Mid-Year review of the budget. The Mid-Year review is an estimate of anticipated year end balances available to be reallocated to address agency needs. Staff works with the divisions to identify anticipated expenditures and needs. In prior years, salary lapse was used to fund one-time items as part of the Mid-Year review; however this year salary lapse was adjusted for the set aside mandated by the Governor's hiring freeze.

Divisions were asked to submit requests for items funded either with lapse identified through the mid-year process or projected balances identified in division budgets. A total of \$7,481,087 was requested and approved: \$2,135,087 in self-funded requests (primarily Information Technology) and \$5,346,000 in reallocated balances. The reallocated balances funded, \$4.6 million for fund postage to mail registration materials, \$375,000 for sticker paper, \$371,000 in merits.

The department anticipates lapsing approximately \$12 million in operating primarily consisting of funding set aside for payments to Texas.gov for fees related to online processing of the P&H fee. In addition to monitoring the expenditure of the approved Mid-Year items, the budget staff will review balances and expenditures at the beginning of the 4th quarter (June 2017) to identify any additional balances that could be available for one time expenditures.

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

Capital Project Status

Technology Replacements and Upgrades - County Support

The FY 2017 budget is \$9.2 million. This includes \$5.5 million in FY 2017 appropriations and \$3.7 million in unexpended balance from FY 2016. Expenditures to date include toner cartridges for county offices, network equipment maintenance, and equipment and services for the County Equipment Refresh Project (CERP). The CERP provides workstation and printer upgrades to the 508 County offices throughout the state. The majority of the encumbrance (\$4.6 million) is allocated for the County Equipment Refresh Project (CERP). The deployment of the workstation and printer upgrades was completed in early April. Staff is in the process of disposing of old equipment and closing the project.

TxDMV Automation System

The TxDMV Automation capital project provides for the continued development of information technology assets to improve customer services and improve access to agency programs for customers and the public.

The majority of the Automation expenditures are associated with the Registration and Titling System (RTS) Refactoring Project, which is estimated to be \$16.2 million at year end. The Point of Sale (POS) component has been implemented in all 254 counties and the migration of RTS off the mainframe onto DCS-based servers was completed in November 2015. The overall schedule for the project has been updated and the new Process and Handling (P&H) fee for RTS was implemented in October 2016. Work continues with the deployment of releases and Workstream 4 tasks, and legislative activity is being evaluated for changes that could impact RTS release schedules.

The LACE Replacement/eLicensing project was successfully launched in March 2017.

The Web Dealer Project continues with dealer implementation and enhancement testing. The modules implemented to date include New Vehicles, Used Vehicles, and Commercial Fleet. The Salvage module was implemented in July 2016. Adjustments have been made for the impact to Web Dealer from the implementation of the TxDMV Fund and the new Process and Handling (P&H) fee. The Centralized Payment module is in the business requirements development phase.

The second phase of Single Sticker was completed in April 2017. The Automation funding for this project was \$1.2 million. The majority of that cost was utilized for the TxDMV International Registration Plan (IRP) system upgrade, which implemented an automated inspection process to replace the manual verification process for commercial fleet services.

The unallocated reserve for Automation was increased in August 2016 by \$1.9 million through a transfer from operating lapse to fund the new WebLien project anticipated to begin in FY 2017. The unallocated reserve amount is currently budgeted at \$3.8 million.

Growth and Enhancement – Agency Operations Support

This budget provides funds to acquire hardware/software to support agency operations. Expenditures and encumbrances to date include costs for miscellaneous computer equipment and laptops.

Commercial Vehicle Information Systems and Networks (CVISN) Grant

The Commercial Vehicle Information Systems and Networks (CVISN) federal grant focuses on safety enforcement on high-risk operators; integrating systems to improve the accuracy, integrity, and verifiability of credentials; improving efficiency through electronic screening and enabling online application and issuance of credentials. The

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

Motor Carrier Division (MCD) works with three other state agencies – Texas Department of Transportation (TxDOT), Texas Department of Public Safety (DPS), and State Comptroller – to implement the grant, with expenditures planned for TxCVIEW maintenance and core augmentation, the ABC Warning Project, and travel. Expenditures of \$222,000 have occurred through April 2017 and \$213,000 is encumbered for the ABC Warning Project.

Data Center Services

The Data Center Services (DCS) program enables state agencies to access data center computing as a managed service. State agencies are billed for the amount of services consumed. Expenditures totaled \$4.6 million through the end of April. The year-to-date total reflects charges for services through the March 2017 billing period. The total DCS budget of \$9.5 million does not include payments to TxDOT for DCS charges, which will be paid from Information Technology (IT) operating funds in FY 2017.

Relocation of Regional Service Centers

This project provides funding in FY 2017 for the relocation of three Regional Service Centers from TxDOT facilities. On Monday, April 3, 2017, the Corpus Christi Regional Service Center began operations in its new location and Vehicles, Titling, and Registration (VTR) stakeholders reported operations went smoothly. The TxDMV Board approved the lease for the new San Antonio RSC at its January 6, 2017 meeting. The new address will be 15150 Nacogdoches Road in Suite 100 and an August 2017 move date is anticipated. A property in the Edinburg area was under consideration for the Pharr Regional Service Center; however, the rental rates were deemed cost prohibitive. In March 2017, TxDMV and the Texas Facilities Commission (TFC) closed the TFC portal request, de-scoped the Pharr relocation from the overall RSC Relocation Project and ended attempts to relocate the Pharr Regional Service Center due to the inability to locate lease space that was suitable for TxDMV's daily operations and/or were cost prohibitive.

Relocation of Bull Creek Campus

Funding in the amount of \$1,400,000 for FY 2017 will be used to address costs related to the relocation of MCD staff from Bull Creek to the 5th Floor of Building 6 at Camp Hubbard. This move is anticipated to occur by January 2018.

Application Migration & Server Infrastructure Transformation (AMSIT)

The Application Migration and Server Infrastructure Transformation project will identify shared assets, applications, and servers to be relocated from their current position to satisfy the goal of establishing a standalone agency environment. Although this project is related to Automation, it is a separate capital project. Primary costs in FY 2016 were for allotted for project management and services provided by NTT Data. The FY 2017 adjusted budget is \$6.5 million, and expenditures total \$581,000 through the end of April 2017, primarily for project management, NTT data project services, and capital equipment.

Physical Security

In June 2016, the TxDMV Board approved transfers from EPMO operating (\$122,040), and Growth and Enhancement, (\$175,000), to create the FY 2016 Physical Security Project budget. FY 2017 funding in the amount of \$354,156 includes \$130,000 in unexpended balance (UB) funding from FY 2016. This amount financed project management costs and other miscellaneous implementation expenses. Expenses to date in FY 2017 are associated with project management, cabling costs, and minor facility costs. This project was closed in April 2017 and equipment has been installed at fifteen Regional Service Centers. The last site remaining is the San Antonio Regional Service Center, which is scheduled to move in August 2017. Physical security cameras and badges will be installed at the new location as part of the Physical Security project and the installation will be managed by IT personnel.

FY 2017 Financial Status Highlights for the Period Ending April 30, 2017

Statement of Capital Project Expenditures through April 30, 2017

Capital Projects	2017 Approved Adjusted Budget	1Q	2Q	3Q	FY 2017 YTD Expenditures	FY 2017 Available Budget	FY 2017 Encumbrances	FY 2017 Available Budget
		Sep - Nov	Dec - Feb	Mar - Apr				
Application Migration & Server Transformation (AMSIT)	6,480,559	37,010	76,181	467,287	580,478	5,900,081	1,156,740	4,743,341
Commerical Vehicle Information Systems & Network (CVISN)	435,000	-	-	221,951	221,951	213,049	-	213,049
Data Center Consolidations	9,574,259	1,486,448	1,866,500	1,291,118	4,644,066	4,930,193	2,992,367	1,937,826
Growth & Enhancements - Agency Operations Support	950,705	66,983	124,672	53,901	245,556	705,149	131,797	573,352
Technology Replacement & Upgrades - County Support	9,199,003	522,752	1,034,547	1,490,979	3,048,278	6,150,725	4,600,951	1,549,774
TXDMV Automation System Project	28,391,882	885,543	3,741,054	5,639,442	10,266,039	18,125,843	5,236,205	12,889,638
Regional Office Relocation	871,500	-	293	62,226	62,519	808,981	80,639	728,342
Bull Creek Relocation	800,000	-	-	-	-	800,000	-	800,000
Physical Security	354,156	48,987	120,384	90,018	259,389	94,767	85,767	9,000
Total	57,057,064	3,047,722	6,963,631	9,316,922	19,328,275	37,728,787	14,284,465	23,444,321

Statement of TxDMV Automation Project Expenditures through April 30, 2017

TxDMV Automation Project Appropriations	FY 2017
Original Estimated Unexpended Balance Carry-Forward from FY 2016	\$ 28,391,882
Total Automation Appropriations	\$ 28,391,882

TxDMV Automation	2017 Approved Adjusted Budget	1Q	2Q	3Q	2017 YTD Expenditures	2017 YTD Encumbrances	2017 YTD Available Budget
		Sep - Nov	Dec - Feb	Mar - Apr			
813010 RTS Refactoring	\$ 16,171,826	\$ 327,249	\$ 2,395,052	\$ 727,843	\$ 3,450,144	\$ 4,312,796	\$ 8,408,886
813015 WebDealer E-Titles	\$ 1,380,817	\$ 117,949	\$ 241,345	\$ 219,383	\$ 578,677	\$ 571,355	\$ 230,785
813020 E-Licensing	\$ 6,380,272	\$ 440,345	\$ 738,347	\$ 4,692,216	\$ 5,870,908	\$ 168,899	\$ 340,465
815028 Single Sticker Phase II	\$ 572,857	\$ -	\$ 366,310	\$ -	\$ 366,310	\$ 183,155	\$ 23,392
84BDGT Unallocated	\$ 3,886,109	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 3,886,109
TxDMV Automation Total	\$ 28,391,882	\$ 885,543	\$ 3,741,054	\$ 5,639,442	\$ 10,266,039	\$ 5,236,205	\$ 12,889,638



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Linda M. Flores, CPA, Chief Financial Officer
Agenda Item: 5.C.
Subject: FY 2018 Preliminary Operating Budget

RECOMMENDATION

A review of the attached FY 2018 Preliminary Operating Budget. No action required.

PURPOSE AND EXECUTIVE SUMMARY

2018 Recommended Operating Budget

The Texas Department of Motor Vehicles (TxDMV) develops annual operating budgets based on approved biennial appropriations. The preliminary Fiscal Year 2018 operating budget implements the first year of tentative appropriations for the 2018-2019 biennium. The attached budget is presented as a briefing item since the 85th Legislature has yet to finalize the appropriations for the Fiscal Year 2018-2018 biennium. This preliminary operating budget allocates \$168.9 million in appropriations recommended by the Senate/House Budget Conference Committee and is structurally balanced to support recurring expenses throughout the agency's organization.

FINANCIAL IMPACT

2018 Recommended Operating Budget

Effective September 1, 2016, TxDMV began depositing revenue into a new agency fund recreated by the 84th Legislature, the TxDMV Fund (0010). The agency's preliminary Fiscal Year 2018 operating budget of \$165.2 million will be primarily supported by TxDMV Fund collections estimated to be \$160 million. In addition to the TxDMV Fund the agency's budget is also funded by a combination of General Revenue appropriations (\$12.8 million), estimates of carryforward of Fiscal Year 2017 Automation balances (\$7.4 million, which includes \$4.6 million from the State Highway Fund) and Federal reimbursements (\$743,750). This preliminary budget document does not include a list of contracts that will be funded as part of the Fiscal Year 2018 budget, those contracts will be presented for approval at the August 2017 Board meeting.

BACKGROUND AND DISCUSSION

2018 Preliminary Operating Budget

Revenues

In Fiscal Year 2017 the department implemented a new Processing and Handling Fee on registration transactions and began collecting revenue in TxDMV Fund 0010 on November 14, 2016. Estimated Fiscal Year 2018 revenue of \$160 million includes collections from the Processing and Handling Fee estimated to be \$58 million with \$74.4 million associated with titles and registration fees and \$13.8 million in fees for Oversize/Overweight permits. Staff is estimating continuation of the upward trend of overall revenue collections, with an increase of approximately 4.4% in Fiscal Year 2018. Increases in the registered vehicle population coupled with natural population growth and healthy auto sales are factors affecting increased revenue collections. The staff estimates that TxDMV will collect approximately \$1.92 billion for the State.



Appropriations

The FY 2018 preliminary operating budget is \$165.2 million and is based on the appropriations recommended the 85th Legislature's Senate/House Conference Committee. The attached budget document includes baseline funding for 763 full time equivalents, online fulfillment of vehicle registrations, license plate production, the Data Center Services (DCS) contract with the Department of Information Resources, vehicle replacements and other projects. The Conference Committee recommendations includes an additional 16 full time equivalents and funding for the following programs:

- Headquarters (HQ) Maintenance
- Special Investigations Unit
- Commercial Vehicle Information System and Networks (CVISN)
- Restoration of Automation, including continuing funding the RTS Refactoring project, eLicensing and new projects such as a kiosk pilot and/or development of mobile applications
- Funding for Cybersecurity initiatives

The Conference Committee recommended two riders related to the use of unexpended balances for the Bull Creek relocation and reporting of TxDMV revenues and expenditures. Finally, the committee recommended \$2,974,356 in biennial reductions to the GR funded ABTPA program.



Texas Department of Motor Vehicles

Table of Contents

Part I: Fiscal Years 2018-19 Legislative Appropriations Request..... 3

 Fiscal Years 2018-19 Legislative Appropriations Request..... 4

 Legislative Conference Committee Recommendations TxDMV..... 5

 Texas Department of Motor Vehicles - Appropriations History..... 6

Part II: Fiscal Year 2018 Revenues 8

 Fiscal Year 2018 Revenue Summary..... 9

 Fiscal Year 2018 TxDMV Revenues vs. Obligations..... 10

 MyPlates Highlights 11

Part III: Fiscal Year 2018 Preliminary Operating Budget..... 13

 Fiscal Year 2018 Preliminary Budget By Appropriation..... 14

 Agency Summary..... 15

 Fiscal Year 2018 Preliminary Operating Budget by Category..... 16

 Fiscal Year 2018 Preliminary Operating Budget by Division 18

 TxDMV Organizational Chart 19

Part IV: Fiscal Year 2018 Preliminary Capital Projects..... 20

 Fiscal Year 2018 Preliminary Capital Budget 21

 Capital Project Details 22

Appendix A: Budget Category Definitions 25

Appendix B: Budget Terms and Definitions 28

Appendix C: Finance and Administrative Services Contacts 31



Texas Department of Motor Vehicles

Part I: Fiscal Years 2018-19 Legislative Appropriations
Request



Texas Department of Motor Vehicles

Fiscal Years 2018-19 Legislative Appropriations Request

The Legislative Appropriations Request (LAR) is the starting point for the agency’s budget. In August 2016, the Texas Department of Motor Vehicles (TxDMV) submitted its appropriations request of \$367.8 million – (\$327.8 million baseline plus \$40.0 million in exceptional items). The current preliminary biennial budget totals \$332.9 million – (\$321.1 million baseline plus \$14.7 million in approved Conference Committee exceptional items, less \$3.0 million in additional reductions), a difference of \$34.9 million less than requested.

	Legislative Appropriations Request (LAR)	Preliminary FY 2018-2019
A. Goal: Optimize Services and Systems		
A.1.1. Strategy: Titles, Registrations, and Plates	\$ 173,328,562	\$ 172,723,262
A.1.2. Strategy: Vehicle Dealer Licensing	\$ 8,294,710	\$ 8,294,710
A.1.3. Strategy: Motor Carrier Permits & Credentials	\$ 18,726,290	\$ 18,726,290
A.1.4. Strategy: Technology Enhancement & Automation	\$ 17,154,836	\$ 12,004,836
A.1.5. Strategy: Customer Contact Center	\$ 4,422,468	\$ 4,422,468
Total, Goal A: Optimize Services and Systems	\$ 221,926,866	\$ 216,171,566
B. Goal: Protect the Public		
B.1.1. Strategy: Enforcement	\$ 12,652,118	\$ 12,627,118
B.2.1. Strategy: Automobile Theft Prevention	\$ 55,151,468	\$ 25,671,702
Total, Goal B: Protect the Public	\$ 67,803,586	\$ 38,298,820
C. Goal: Indirect Administration		
C.1.1. Strategy: Central Administration	\$ 15,804,746	\$ 15,804,746
C.1.2. Strategy: Information Resources	\$ 46,005,443	\$ 46,328,538
C.1.3. Strategy: Other Support Services	\$ 16,257,906	\$ 16,257,906
Total, Goal C: Indirect Administration	\$ 78,068,095	\$ 78,391,189
Grand Total, Department of Motor Vehicles	\$ 367,798,547	\$ 332,861,576
Difference		\$ (34,936,971)

Detail for Adjustments to Fiscal Year 2018-19 LAR Request

A.1.1. Strategy: Titles, Registrations, and Plates	
Baseline reduction - Regional Service Center (RSC) Relocation and New Vehicles	\$ (605,300)
A.1.4. Technology Enhancement & Automation	
Baseline reduction - Automation	\$ (5,950,000)
Automation Restoration	\$ 800,000
B.1.1. Strategy: Enforcement	
Baseline reduction - New Vehicles	\$ (25,000)
B.2.1. Strategy: Automobile Theft Prevention	
Exceptional items not funded - 4% Restoration/Grants	\$ (26,505,410)
Additional Reduction - ABTPA*	\$ (2,974,356)
C.1.2. Strategy: Information Resources	
Baseline reduction - Agency Growth & Enhancement	\$ (76,905)
Cybersecurity Initiative - Capital	\$ 400,000
Total Adjustments to Fiscal Year 2018-19 LAR Request	\$ (34,936,971)

* Includes a \$109,750 biennial reduction related to Article IX, Section 17.10 - Contract Cost Containment.



Texas Department of Motor Vehicles

Legislative Conference Committee Recommendations TxDMV

The Senate/House Conference Committee met on Saturday, May 20, 2017. The Conference Committee’s recommendations must be approved by both chambers by the end of the 85th Legislative Session, May 29, 2017.

Exceptional Items Disposition:

Priority	Exceptional Items	TxDMV Biennial Request		Conference Committee Biennial Recommendations	
		FTE	Amount	FTE	Amount
1	TxDMV Headquarters Maintenance	3.0	\$ 9,828,000	3.0	\$ 9,828,000
2	Special Investigations Unit	13.0	\$ 1,923,131	13.0	\$ 1,923,131
3	CVISN		\$ 1,750,000		\$ 1,750,000
4	Restoration of Automation		\$ 2,500,000		\$ 800,000
	Subtotal TxDMV Fund/Federal	16.0	\$ 16,001,131	16.0	\$ 14,301,131
1	ABTPA 4% Reinstatement		\$ 1,193,586		\$ 0
2	ABTPA Grants		\$ 25,311,824		\$ 0
	Subtotal General Revenue		\$ 26,505,410		\$ 0
	Total TxDMV Request	16.0	\$ 42,506,541	16.0	\$ 14,301,131

Riders

Riders Previously Approved in FY 2016-17 and Requested for FY 2018-19	
MyPlates – This rider provides additional appropriations each year of the biennium for the purpose of making payments to the contract vendor for the marketing and sale of personalized license plates. The rider also allows for unexpended balances to be carried forward into the next fiscal year of the biennium for the same purposes.	Approved
Federal Grants and State Matching Funds – This rider allows the agency to spend unexpended balances of state match funds for federal grants from FY 2017 in FY 2018.	Not Approved
Capital Projects—Unexpended Balance Authority – This rider will allow the agency to spend money appropriated for capital projects each year of the biennium. The agency is requesting that any unexpended funds appropriated for capital projects at the end of FY 2017 be carried forward to the new biennium beginning FY 2018.	Approved

TxDMV Rider Request	
Unexpended Balance Authority within the Biennium – This rider would allow the agency to spend any unexpended balances in appropriations between the fiscal years.	Not Approved

New Riders Added by Conference Committee	
Texas Department of Motor Vehicles Fund Report – This rider requires the agency to submit an annual report on TxDMV Fund 0010 expenditures/revenues to the Legislative Budget Board.	Approved
Unexpended Balance Appropriation Department of Motor Vehicles Austin Bull Creek – This rider allows the agency to carry forward any unexpended funds appropriated for the Bull Creek relocation remaining at the end of FY2017 to the new biennium.	Approved



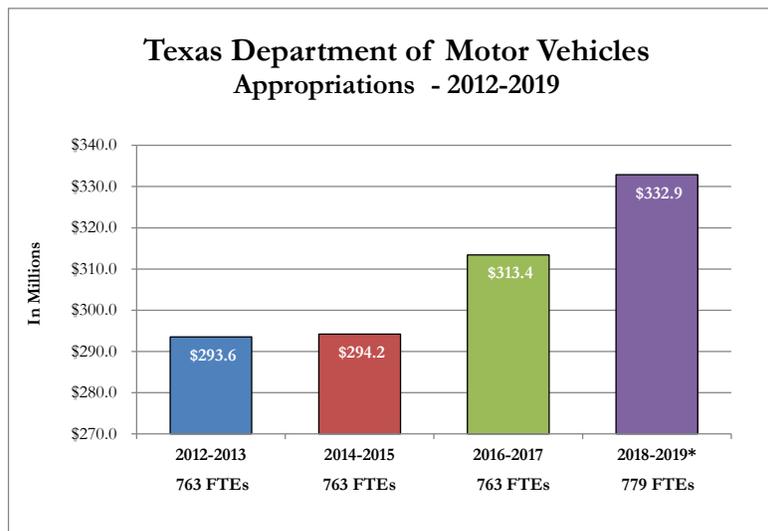
Texas Department of Motor Vehicles - Appropriations History

Since the agency’s inception in Fiscal Year 2010, agency appropriations have more than doubled from the original \$142.9 million. In **Fiscal Years 2012-2013**, the agency’s appropriation increased due to the addition of the Motor Carrier Oversize/Overweight permitting program after passage of S.B. 1420, (82nd Legislature). Appropriations in subsequent years include additional funding for Automation Capital and license plate production. With the passage of H.B. 1692, 83rd Legislature, Regular Session, the agency established the Office of Administrative Hearings to conduct contested case hearings for warranty performance and “Lemon Law” disputes internally, rather than referring such cases to the State Office of Administrative Hearings.

In **Fiscal Years 2016-2017**, the agency’s appropriations increased almost seven percent from **Fiscal Years 2014-2015**. The agency received funds in 2016-2017 to cover higher license plate production and volume costs, relocation of two regional service centers and the Bull Creek campus. In addition, the agency’s ongoing Automation Project (including information technology separation efforts) was fully funded.

The 85th Legislature provides funding for **Fiscal Years 2018-2019** in a preliminary amount of \$332.9 million, a 6% increase over the 2016-2017 biennium. The increase in Fiscal Years 2018-2019 is primarily driven by the approval of funding for TxDMV Headquarters maintenance costs (\$9.8 million).

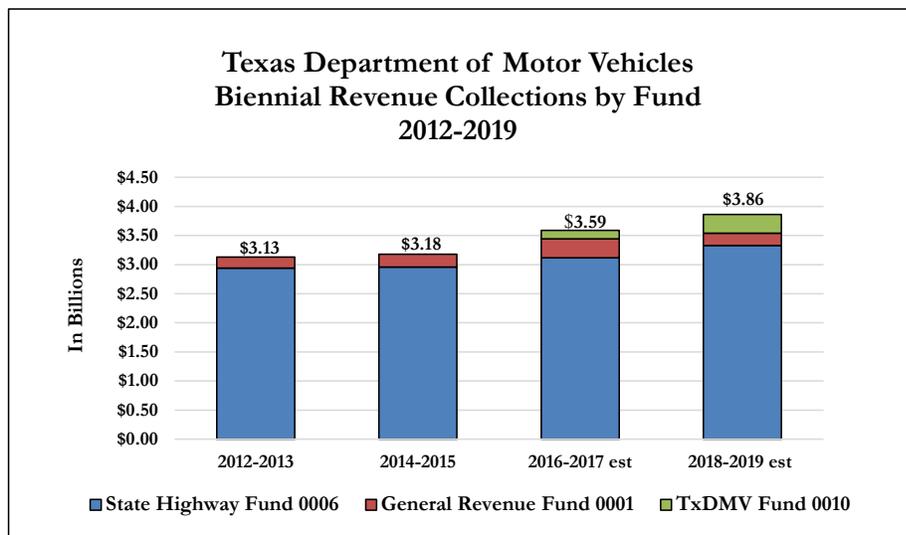
The TxDMV’s method of finance for **Fiscal Years 2018-2019** will be primarily funded by the TxDMV Fund, which was established on September 1, 2017 (with the exception of the Automobile Burglary Theft Prevention Authority [ABTPA] program). The ABTPA program will continue to be funded through General Revenue.



**The 2018-2019 biennial appropriations are subject to final approval of the 85th Legislature.*



Agency revenue collections continue to rise in the current biennium (Fiscal Years 2016-2017) as compared to the previous biennium. In Fiscal Year 2016, the TxDMV collected approximately \$1.75 billion in total revenue for the State of Texas. This includes \$1.53 billion for the State Highway Fund and approximately \$222 million to the General Revenue Fund (GR). In Fiscal Year 2017, the agency estimates an increase of 4.9% in total revenues from Fiscal Year 2016 with State Highway Fund collections estimated at \$1.59 billion, General Revenue Fund collections estimated at \$105.2 million, and TxDMV Fund collections estimated at \$143.7 million. In Fiscal Year 2017, the department implemented a new Processing and Handling Fee on registration transactions and began collecting revenue in the TxDMV Fund on November 14, 2016. The upward revenue trend is expected to continue into the Fiscal Year 2018-2019 biennium, with a revenue increase of approximately 4.4% in Fiscal Year 2018 and 1.3% in Fiscal Year 2019, for a biennial total of approximately \$3.86 billion. Increases in the registered vehicle population coupled with natural population growth and healthy auto sales are factors included in the Comptroller’s 2018-2019 Biennial Revenue Estimate (BRE).





Texas Department of Motor Vehicles

Part II: Fiscal Year 2018 Revenues



Texas Department of Motor Vehicles

Fiscal Year 2018 Revenue Summary

TxDMV collects revenues from registrations, licenses, titles, permits, and credentials for deposit into the State Highway Fund (Fund 0006), the General Revenue (GR) Fund (Fund 0001) and the TxDMV Fund (Fund 0010). Total revenue collections are estimated to be approximately \$1.84 billion in Fiscal Year 2017 in all funds combined. Growth in the revenues is the result of an increase in the number of registered vehicles, natural population growth and healthy economic activity.

Revenue Fund Revenue Descriptions	FY 2016 TxDMV Annual Revenue	FY 2017 TxDMV Estimated Annual Revenue	FY 2018 TxDMV BRE Estimated Annual Revenue ¹	FY 2019 Comptroller Biennial Revenue Estimates
FUND 0001 (General Revenue Fund)				
Certificate of Titles	\$ 74,740,339	\$ 35,360,000	\$ 35,890,000	\$ 36,428,000
Motor Vehicle Registration Fees	\$ 70,206,394	\$ 13,000,000	\$ 12,500,000	\$ 12,500,000
OverSize/OverWeight	\$ 57,095,387	\$ 46,000,000	\$ 47,618,000	\$ 47,618,000
Commercial Transportation Fees*	\$ 13,487,125	\$ 6,471,000	\$ 6,568,000	\$ 6,667,000
Miscellaneous Fees	\$ 6,899,208	\$ 4,394,000	\$ 4,448,000	\$ 4,480,000
Total Estimated Fund 0001 Revenue	\$ 222,428,453	\$ 105,225,000	\$ 107,024,000	\$ 107,693,000
FUND 0006 (State Highway Fund)				
Certificate of Titles	\$ 7,664,800	\$ 6,782,000	\$ 7,500,000	\$ 7,500,000
Motor Vehicle Registration Fees	\$ 1,425,042,883	\$ 1,476,672,000	\$ 1,523,428,000	\$ 1,544,756,000
OverSize/OverWeight	\$ 95,968,514	\$ 105,000,000	\$ 120,766,000	\$ 123,181,000
Total Estimated Fund 0006 Revenue	\$ 1,528,676,197	\$ 1,588,454,000	\$ 1,651,694,000	\$ 1,675,437,000
FUND 0010 (TxDMV Fund)				
Certificate of Titles		\$ 37,817,000	\$ 38,384,000	\$ 38,960,000
Motor Vehicle Registration Fees		\$ 43,245,000	\$ 36,057,000	\$ 36,768,000
OverSize/OverWeight		\$ 13,712,000	\$ 13,849,000	\$ 13,849,000
Commercial Transportation Fees		\$ 7,670,000	\$ 7,747,000	\$ 7,747,000
Processing and Handling Fee ²		\$ 38,635,569	\$ 58,036,235	\$ 58,010,719
Miscellaneous Fees		\$ 2,572,400	\$ 5,888,300	\$ 6,000,300
Total Estimated Fund 0010 Revenue		\$ 143,651,969	\$ 159,961,535	\$ 161,335,019
TOTAL ESTIMATED REVENUE	\$ 1,751,104,650	\$ 1,837,330,969	\$ 1,918,679,535	\$ 1,944,465,019

1 - The Biennial Revenue Estimate (BRE) includes \$3,290,000 in electronic service fees and interest on state deposits.

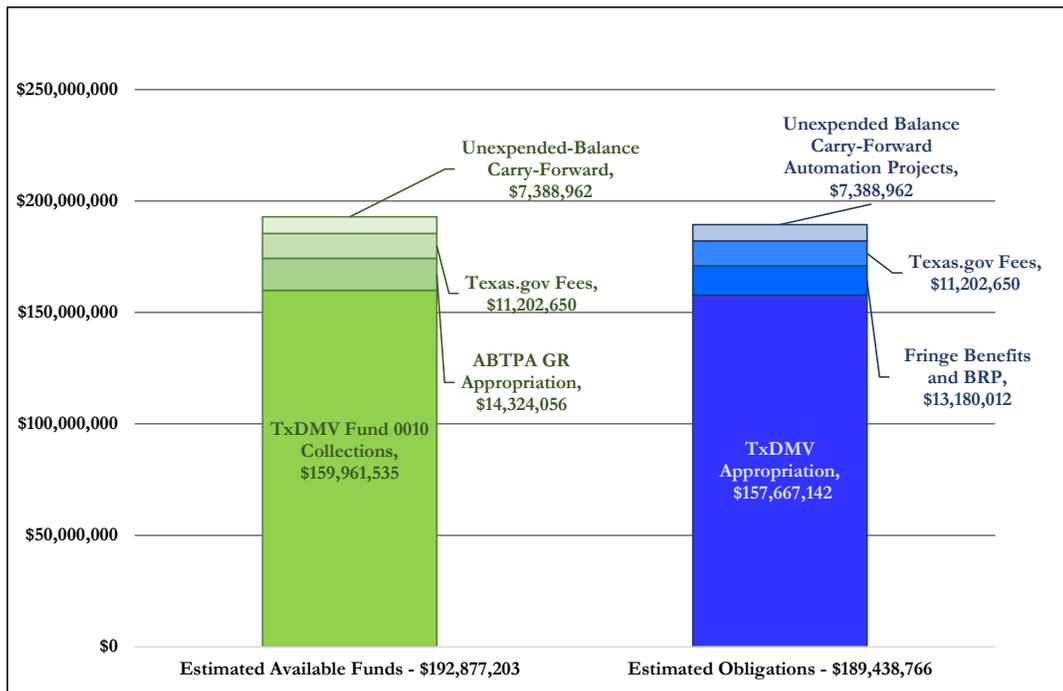
2 - In FY 2017, Processing and Handling (P&H) Fee revenue is 8 months of collections. In FY 2018-2019, P&H Fee revenues do not reflect \$11.2 million in payments to Texas.gov for online transactions since these fees are retained by Texas.gov and not deposited into the TxDMV Fund.

*Source: Texas Comptroller of Public Accounts, Biennial Revenue Estimate, 2018-2019 Biennium, 85th Texas Legislature, January, 2017.



Fiscal Year 2018 TxDMV Revenues vs. Obligations

Total revenues of approximately \$192.9 million primarily consists of \$160 million in estimated TxDMV Fund collections, Texas.gov fees, GR appropriations for ABTPA and estimated carry-forward of Fiscal Year 2017 automation balances. The chart below reflects the estimated available funds are sufficient to cover TxDMV obligations of \$189.4 million for Fiscal Year 2018.



The Fiscal Year 2018 Preliminary Operating Budget treats the \$11.2 million in Texas.gov fees for online registrations renewals as an obligation to the TxDMV Fund and are excluded from the agency's operating budget.



Texas Department of Motor Vehicles

MyPlates Highlights

Contract Term:

The new contract began November 19, 2014, and will run for a term of five years. As of April 30, 2017, total General Revenue (GR) collections from the sale of vendor plates totaled **\$26,912,791**. As laid out under the existing contract provisions, only a portion of this total figure counts toward the \$15 million guarantee. The first contract with MyPlates, Inc. expired on November 18, 2014 with GR collections totaling **\$27,334,768**.



Renewal Contract Provisions

Revenue Guarantee

The revenue guarantee for the renewed MyPlates contract is established at \$15 million to GR from the sale of vendor plates for the five-year renewal period that runs from November 19, 2014 through November 18, 2019. Revenue counted toward meeting the minimum guarantee includes new sales, renewal sales, auction sales and ancillary products. However, the renewal contract is significantly different from the initial contract in that nearly all plate renewal revenue will flow to the state instead of MyPlates. As of April 30, 2017, MyPlates has generated \$13,308,403 in GR deposits that count towards the \$15 million contractual guarantee. The previous contract generated \$27,334,769 in GR deposits.

Revenue Share

New Plate Sales - TxDMV will continue to receive \$8 per plate per year as an administrative fee. The net revenue received for all new license plate sales will be divided with MyPlates receiving 60% and the state (GR) receiving 40%.

Plate Renewals - The net revenue received for all plate renewals will be divided with MyPlates receiving 5% and the state (GR) receiving 95%. This represents a significant change to the compensation structure of the first contract period. During the initial contract period renewal revenue was divided in the same manner as new plate sales.

Multi-Year and Auction Plates

The contract renewal eliminated the option of the 10-year plate. The contract renewal limits plate terms to one, three and five year terms. Revenue for the new multi-year and auction plate sales are divided 60% to the state and 40% to MyPlates.

Plate Inventory Management

New Plate Designs – The TxDMV board maintains sole discretion to approve new plate designs. Once a plate design has been approved by the TxDMV Board, MyPlates is required to provide 200 customer commitments within 180 days before the new design may be sold.



Texas Department of Motor Vehicles

Existing Plate Designs – If a plate design fails to meet a milestone listed below, it will no longer be offered for sale. The previous contract did not place a lower limit on plate sales, but the renewed contract added the 200 plate minimum requirement to clean up inventory and remove slow selling plates.

90 days – 50 plates	180 days – 100 plates
270 days – 150 plates	365 days – 200 plates

Redesign "T" Plate – MyPlates is required, not later than the effective date of the renewal, to redesign the “T” Plate. Existing customers with a “T” Plate will be allowed to maintain their plate until they reach the replacement cycle (seven years). They will also be given the option of replacing the plate immediately at no cost.

Design Specifications

All existing and new plate designs are required to meet the TxDMV standards for content, layout, color and other limitations. TxDMV is required to notify MyPlates as soon as possible of any changes to the design standards, and MyPlates will be granted 180 days to submit redesigned plates to TxDMV.

MyPlates Facts:

Number of Plates in MyPlates Catalog

Of the 173 plate designs approved since 2009, MyPlates has removed 58 designs. Of the removed designs, 55 were permanently discontinued, two were not produced, and one, Texas A&M Helmet, was removed temporarily while it is being redesigned. This leaves 115 vendor plates currently available for the public to order. Two more plates, Colorado School of Mines and Carbon Fiber could be implemented if a 200 prepaid order threshold is met.

Top Ten Plates

The table at right shows top 10 plates ranked by plates ordered (both new and renewals) since November, 2009.

Top 10 Plates		
Rank	Plate Description	Number ordered
1	Lone Star Black	76,094
2	Texas Black 1845	24,845
3	T for Texas - Black	17,137
4	Small Star Black	15,679
5	Classic Black	11,440
6	Texas Vintage Black	7,510
7	Texas White	7,190
8	Lone Star Pink	6,301
9	Small Star Silver	5,774
10	Come And Take It Flag	5,019

Highest All Time Plate Sold

MyPlates has auctioned 182 personalized patterns to date. These patterns generated an average of \$175 a year in revenue to GR. The record for the highest price fetched at a Texas plate auction is still \$115,000, for 12THMAN (\$79,590 to GR).

General Revenue Collections

At the end of the five-year vendor contract (from 2009-2014), 38% of the gross revenue generated was distributed to GR and 50% to the vendor. Two and a half years into the amended, renewed five-year vendor contract (from 2014 to 2019), the distribution of revenue is 63% to GR, and 26% to the vendor. (Under the renewed contract, GR receives 95% of the renewal revenue.)

Renewal of One, Three and Five-Year Term Plates

The GR Fund currently derives most of its renewal revenue from vendor plates with one-year terms (87%). Plates with five-year terms account for 12% and plates with three-year terms account for 1% of the renewal revenue to GR.



Texas Department of Motor Vehicles

Part III: Fiscal Year 2018 Preliminary Operating Budget



Texas Department of Motor Vehicles

Fiscal Year 2018 Preliminary Budget By Appropriation

The General Appropriation Act (GAA) has preliminarily appropriated \$168.9 million for Fiscal Year 2018. This amount funds agency Fiscal Year 2018 operations (\$157.5 million) and Texas.gov fees (\$11.2 million for Processing and Handling (P&H) Fee transactions). The GAA also includes additional appropriations for certain unexpended balances and other allowable costs. The following chart depicts the TxDMV Fiscal Year 2018 budget by Program Goal and Strategy. This preliminary budget includes adjustments between strategies for position transfers and increases to appropriations for Benefit Replacement Pay (BRP) and estimated carry-forward of Fiscal Year 2017 unexpended balances in Automation.

Not included are fringe benefits and appropriated payments to Texas.gov, which are listed as obligations to the TxDMV Fund on page 18.

These amounts reflect the actions of the Conference Committee.

A. Goal: Optimize Services and Systems	2018 Preliminary Budget *
A.1.1. Strategy: Titles, Registrations, and Plates	73,826,655
A.1.2. Strategy: Vehicle Dealer Licensing	4,147,355
A.1.3. Strategy: Motor Carrier Permits & Credentials	9,255,352
A.1.4. Strategy: Technology Enhancement & Automation	9,285,457
A.1.5. Strategy: Customer Contact Center	2,377,427
Total, Goal A: Optimize Services and Systems	98,892,246
B. Goal: Protect the Public	
B.1.1. Strategy: Enforcement	6,462,452
B.2.1. Strategy: Automobile Theft Prevention	12,835,851
Total, Goal B: Protect the Public	19,298,303
C. Goal: Indirect Administration	
C.1.1. Strategy: Central Administration	7,902,373
C.1.2. Strategy: Information Resources	23,364,517
C.1.3. Strategy: Other Support Services	8,209,703
Total, Goal C: Indirect Administration	39,476,593
Total TxDMV Appropriation Budget	157,667,142
Other Adjustments	
Estimated Increase for Benefit Replacement Pay	113,012
Projected Unexpended Balance Carry-Forward	
Capital - Tx Automation Systems Article VII Rider 5	7,388,962
Subtotal, Other Adjustments	7,501,974
Total TxDMV Operating Budget	165,169,116
Method of Finance	
General Revenue Fund (includes estimated Automation UB)	15,525,366
State Highway Fund (estimated Automation UB)	4,644,639
TxDmv Fund	144,255,361
Federal Reimbursements	743,750
Total, Method of Finance	165,169,116

** Fiscal Year 2018 Strategy Appropriations are adjusted for transfers between strategies that were implemented in Fiscal Year 2017 after the submission of the LAR. Article IX of General Appropriations Act allows transfers up to 20% of the approved appropriation amount of each strategy. Transfers between strategies for Fiscal Year 2017 were to accommodate the reallocation of FTEs between divisions. The Fiscal Year 2018 Preliminary Operating Budget treats the \$11.2 million in Texas.gov fees for online registrations renewals as an obligation to the TxDMV Fund and are excluded from the agency's operating budget.*

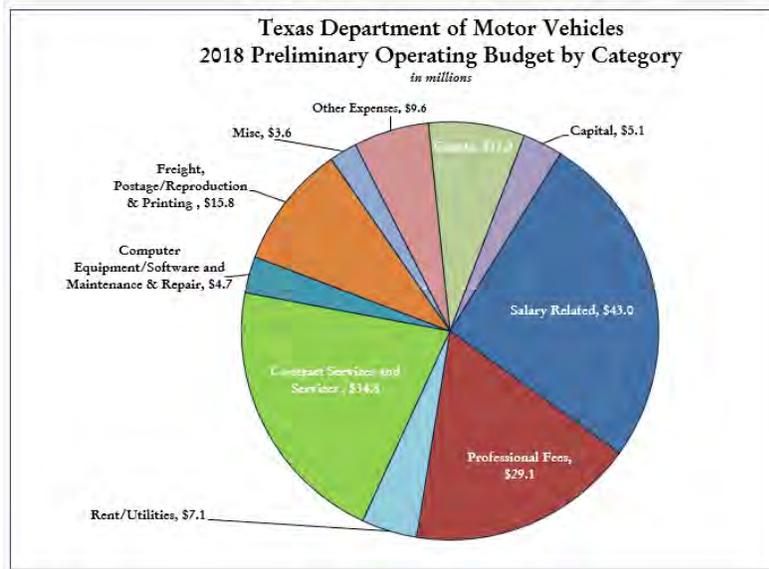


Texas Department of Motor Vehicles

Agency Summary

TxDMV is governed by a nine member board appointed by the Governor, with the advice and consent of the Senate, to serve six-year overlapping terms. The agency’s mission is “to serve, protect and advance the citizens and industries in the state with quality motor vehicle related services.”

The Executive Director, Whitney Brewster, and Deputy Executive Director, Shelly Mellott, oversee the agency’s day-to-day operations. The Executive Director reports to the agency board and directs staff to enact operational changes as a result of enacted legislation and implement policies and rules approved by the board. The pie chart below reflects the Fiscal Year 2018 operating budget by category.



The agency’s Fiscal Year 2018 operating budget of approximately \$165 million is a decrease of \$27 million over the Fiscal Year 2017 original approved budget of \$192 million. The decrease is primarily due to the completion in 2017 of major capital projects for LACE Replacement and AMSIT, and a reduction in the Fiscal Year 2018 budget for Automation funding. Approximately one-third of the budget consists of Professional Fees (associated with Automation projects). The majority of the remaining budget is related to the production of registration materials, titles and plates (services, freight, postage, reproduction, printing, and other expenses) and salary expenses.

Miscellaneous Expense totaling \$3.6 million is comprised of the following items: \$1.5 million in Advertising, Fees and Other Charges; \$1.2 million in Fuels, Lubricants and Consumables; In-State and Out-of-State Travel of \$600,000; and Memberships & Training of \$300,000.

Detail Contract Services & Services	Amount
Huntsville Plate Production	\$ 20,452,057
Registration stickers, motor vehicle and speciality plates mailing	\$ 5,185,345
MyPlates contract payments	\$ 6,836,637
Facility Support (Headquarters/RSC)	\$ 1,586,323
Contracts for online training, subscriptions & Interagency agreements	\$ 708,426
Total	\$ 34,768,788

Detail for Professional Fees	Amount
Data Center Contract - DIR	\$ 9,076,261
UB for Capital Projects (primarily contractors)	\$ 7,388,962
Deloitte for RTS Refactoring	\$ 5,766,078
Info Technology (IT) Operating for eLicensing	\$ 1,000,000
CVISN Grant and CVIEW (Commercial Vehicle Information Exchange Window)	\$ 1,175,000
TxDOT DCS	\$ 1,200,000
Cybersecurity and Automation Initiatives	\$ 1,200,000
Contractors and Miscellaneous Contracts	\$ 1,974,329
TxPROS (Texas Permitting & Routing Optimization System)	\$ 333,780
Total	\$ 29,114,410

Detail for Other Expenses	Amount
Agency Wide - Contingency	\$ 4,741,603
Agency Wide - Specialized Programs - Credit	\$ 3,267,440
Card Fees (TxPROS, Temp Permits, MCCS, etc)	\$ 960,470
Contingency Facility Operations	\$ 249,498
Capital - Growth & Enhancement	\$ 155,045
SIU - Onboarding Expenses	\$ 261,834
Other Expenses	\$ 261,834
Total	\$ 9,635,890



Fiscal Year 2018 Preliminary Operating Budget by Category

The table below outlines the Fiscal Year 2018 operating budgets by TxDMV budget categories. The allocations represent estimates of anticipated costs based on prior year expenditures and planned obligations.

Budget Category	FY 2018 Preliminary Budget
Salaries and Wages	\$ 41,728,206
Benefit Replacement Pay	\$ 113,012
Other Personnel Costs	\$ 1,241,310
Professional Fees and Services	\$ 29,114,410
Fuels & Lubricants	\$ 81,000
Consumable Supplies	\$ 1,153,561
Utilities	\$ 5,545,221
Travel In-State	\$ 474,002
Travel Out-of-State	\$ 86,135
Rent - Building	\$ 1,268,550
Rent - Machine and Other	\$ 320,573
Purchased Contract Services	\$ 33,643,862
Advertising & Promotion	\$ 95,050
Computer Equipment Software	\$ 898,974
Fees & Other Charges	\$ 1,355,486
Freight	\$ 828,290
Maintenance & Repair	\$ 3,758,227
Memberships & Training	\$ 300,795
Other Expenses	\$ 9,635,890
Postage	\$ 9,178,744
Reproduction & Printing	\$ 5,827,275
Services	\$ 1,124,926
Grants	\$ 12,303,182
Other Capital	\$ 5,092,435
Total	\$ 165,169,116

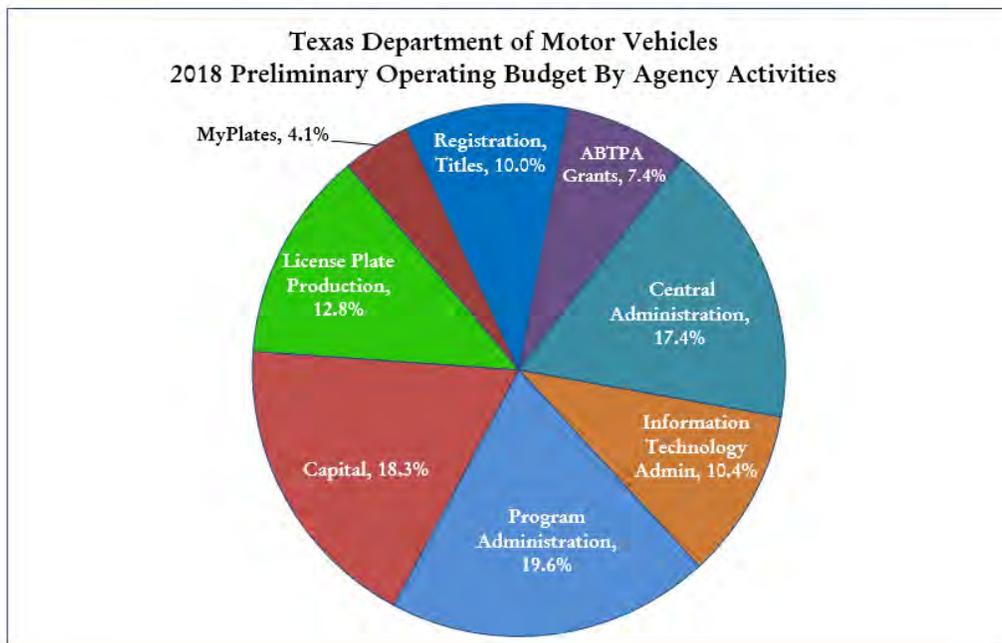
A description of the budget categories are in [Appendix A](#).



Texas Department of Motor Vehicles

The TxDMV budget is primarily allocated to registration, titling, license plates, and upgrading agency technology. The pie chart below shows that a total of 22.8% of the agency budget is dedicated to the production of plates (12.8%) and registration and title materials (10.0%). In addition, 10.4% of the budget is allocated to technology administration while Capital expenditures account for 18.3% of the total budget. The chart below details the various spending levels by program.

Program Administration (19.6%) includes budgets for administration of agency programs including ABTPA, Motor Vehicle, Motor Carrier programs (Oversize/Overweight and Texas International Registration Plan [IRP]), Inspections and Enforcement, Lemon Law (including management and administrative hearings), and Registration and Titling activities. The remainder of the budget includes funding for Central Administration/Support Services (17.4%), grants for ABTPA (7.4%) and the MyPlates contract (4.1%). Central Administrative costs represent a larger share of costs than in prior years due to the funding for Headquarters (HQ) maintenance costs.



Program Administration

ABTPA, Consumer Relations, Enforcement, Motor Carrier, Motor Vehicle, Office of Administrative Hearings, Vehicle Titles and Registration

Central Administration

Executive Office (including Civil Rights), Board Support Office, Finance and Administrative Services (excluding license plate production), Office of General Counsel, Government and Strategic Communications, Office of Innovation and Strategy, Internal Audit

Information Technology:

Enterprise Project Management
Information Technology Division



Texas Department of Motor Vehicles

Fiscal Year 2018 Preliminary Operating Budget by Division

The General Appropriations Act provides the agency with its total appropriation amount by goal and strategy. In comparison, the purpose of the operating budget is to establish a specific operating budget allocation by division and capital project.

The table below outlines TxDMV’s Fiscal Year 2018 operating budget and the number of FTE by division/office.

Division/Office	FY 2018 Preliminary Budget	FTE Allocation
Automobile Burglary and Theft Prevention Authority	\$ 12,836,878	5.0
Board Support Office	\$ 139,177	1.0
Consumer Relations Division	\$ 2,361,347	48.0
Enforcement Division	\$ 6,004,081	90.0 ¹
Enterprise Project Management Office	\$ 1,572,954	17.0
Executive Office*	\$ 553,486	4.0
Finance and Administrative Services Division	\$ 37,544,560	74.0 ²
Office of General Counsel	\$ 1,026,965	11.0
Government and Strategic Communications Division	\$ 1,140,338	10.0
Human Resources Division	\$ 1,035,489	9.0
Information Technology Services Division	\$ 15,557,367	92.0
Office of Innovation & Strategy	\$ 128,150	1.0
Internal Audit Office	\$ 293,500	3.0
Motor Carrier Division	\$ 7,998,294	116.0
Motor Vehicle Division	\$ 2,434,221	38.0
Office of Administrative Hearings	\$ 413,685	5.0
Vehicle Titles and Registration Division	\$ 35,814,747	255.0 ³
Agency Wide	\$ 8,009,043	0.0
Subtotal	\$ 134,864,282	779.0
Capital Projects		
TxDMV Automation System Project (includes estimated UB from 2017)	\$ 13,955,040	
Data Center Consolidation	\$ 9,076,261	
Technology Replacement & Upgrades - County Support	\$ 5,000,000	
Growth & Enhancements - Agency Operations Support	\$ 808,998	
PC Replacement	\$ 124,395	
Cybersecurity Initiative	\$ 400,000	
Vehicle Replacement (includes new vehicles for Special Investigation Unit - SIU)	\$ 600,000	
Capital Equipment (HQ Maintenance & SIU)	\$ 340,140	
Subtotal	\$ 30,304,834	
Agency Total	\$ 165,169,116	
Method of Finance		
General Revenue Fund (includes Automation UB)	\$ 15,525,366	
State Highway Fund (estimated Automation UB)	\$ 4,644,639	
TxDMV Fund	\$ 144,255,361	
Federal Reimbursements	\$ 743,750	
Method of Finance Total	\$ 165,169,116	
TxDMV Fund Obligations not included in operating budget		
- Fringe Benefits	\$ 13,067,000	
- Payments to Texas.gov for online transaction fees ³	\$ 11,202,650	
Subtotal	\$ 24,269,650	
Grand Total TxDMV FY 2018 Preliminary Obligations	\$ 189,438,766	

*Executive Office includes \$21,405 for Civil Rights Office.

1 - FTE allocation for Enforcement is increased by 8 FTE and VTR by 5 FTE for Special Investigations Unit

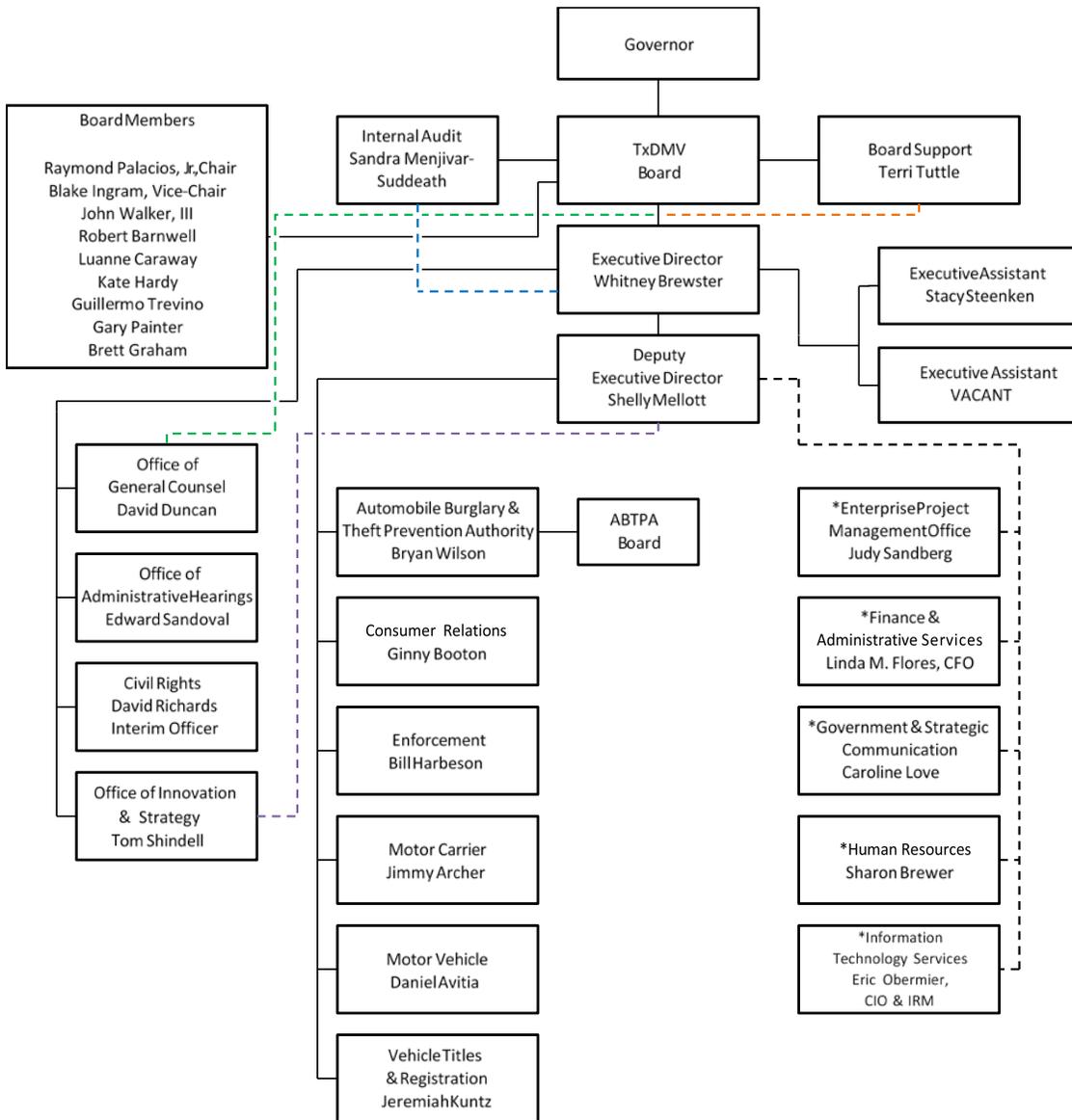
2 - FTE allocation for Finance and Administrative Services is increased by 3 FTE for HQ Maintenance Exceptional Item

3 - The Fiscal Year 2018 Preliminary Operating Budget treats the \$11.2 million in Texas.gov fees for online registrations renewals as an obligation to the TxDMV Fund and are excluded from the agency’s operating budget.



Texas Department of Motor Vehicles

TxDMV Organizational Chart



**Note: Although these positions report directly to the ED, rank is equivalent to the Motoring Services Division Directors. The DED assumes the responsibilities of the ED in absentia.*



Texas Department of Motor Vehicles

Part IV: Fiscal Year 2018 Preliminary Capital Projects



Texas Department of Motor Vehicles

Fiscal Year 2018 Preliminary Capital Budget

TxDMV Capital Project Appropriations	FY 2018
Fiscal Year 2018 Appropriation	\$ 22,951,012
Estimated Unexpended Balance Carry-Forward	\$ 7,388,962
Total Capital Appropriations	\$ 30,339,974

TxDMV Automation System ¹	2018 Preliminary Budget
RTS Refactoring	\$ 5,016,078
eLicensing/LACE	\$ 750,000
Automation Initiatives <i>(includes a kiosk pilot program and mobile applications)</i>	\$ 800,000
Web Lien*	\$ 2,514,732
Cybersecurity*	\$ 775,000
CVIEW*	\$ 600,000
Call Center Upgrades*	\$ 500,000
Fraud Data Dashboard*	\$ 500,000
External Website Renovation*	\$ 500,000
E-Renewals/E-Reminder*	\$ 500,000
Online Certified Records*	\$ 500,000
Enterprise Reporting*	\$ 500,000
Unallocated*	\$ 499,230
TxDmv Automation System Subtotal	\$ 13,955,040
Other Technology Projects	
Growth and Enhancements - Agency Operations Support	\$ 808,998
Technology Replacement & Upgrades - County Support	\$ 5,000,000
PC Replacement <i>(includes Special Investigation Unit-SIU)</i>	\$ 124,395
Data Center Consolidation	\$ 9,076,261
Cybersecurity Initiative	\$ 400,000
Other Technology Projects Subtotal	\$ 15,409,654
Other Capital Projects	
Vehicle Replacement <i>(includes new vehicles for SIU)</i>	\$ 635,140
Capital Equipment <i>(HQ Maintenance & SIU)</i>	\$ 340,140
Other Capital Projects Subtotal	\$ 975,280
TxDmv Total Capital Budget	\$ 30,339,974

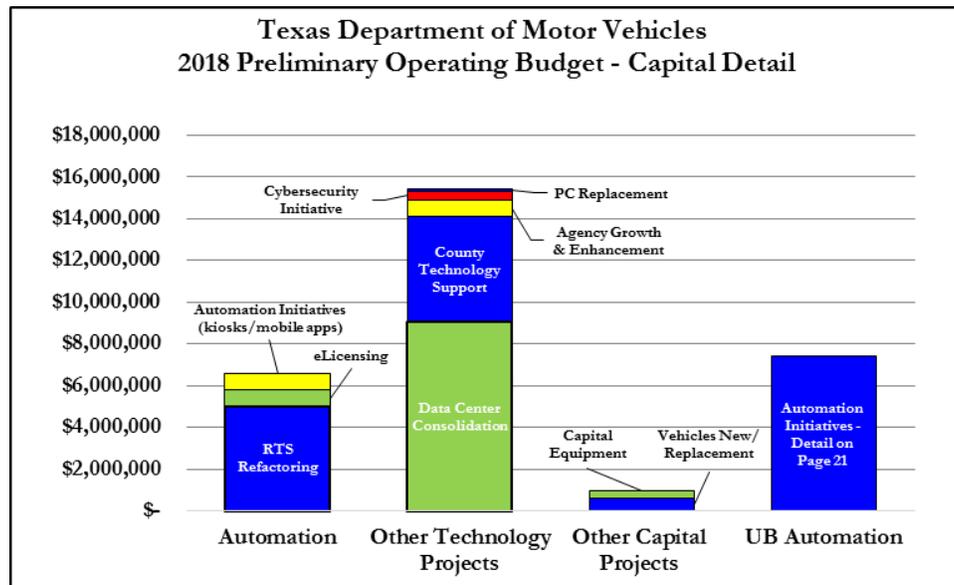
1. The TxDMV Automation project includes project funds for Fiscal Year 2018 which will be funded from budget balances remaining at year end of Fiscal Year 2017.

* - Project funded through Unexpended Balance (UB) carry-forward from Fiscal Year 2017



Texas Department of Motor Vehicles

Capital Project Details



TxDMV Automation Systems Project (\$6.5 million + estimated \$7.4 million carry-forward)

TxDMV is developing information technology assets to improve customer services and access to agency programs for the public through the TxDMV Automation System Project. This project encompasses entire agency operations in order to take advantage of operational efficiencies. This project also allows data sharing between agency functions to improve customer service. There are multiple initiatives in Fiscal Year 2018 that will be addressed through the TxDMV Automation Systems Project. Major projects include:

Capital Appropriations:

RTS Refactoring Project – In June, 2013, TxDMV entered into a contract with Deloitte Consulting LLP to refactor the former Registration and Titling System (RTS) by converting the code from a mainframe program to a JAVA web-based system. The system holds nearly 100 million current and archived vehicle registration and titling records. The contract consisted of multiple work streams that will continue through 2018.

The RTS Refactoring project, which began implementation in May, 2015, is currently fully deployed to TxDMV headquarters staff, the Regional Service Centers and all 254 counties. The team is currently working on work streams four and five which include Maintenance and Operations (M&O) and Knowledge Transfer activities, respectively. Additionally, work stream four includes quarterly enhancement releases.



Texas Department of Motor Vehicles

eLicensing – The new eLicensing system, launched in March, 2017, allows current dealer and salvage licensees and those seeking licenses for the first time to renew and/or apply online. The funding for the upcoming biennium will increase self-service capabilities.

Automation Initiatives– These planned projects, such as a kiosk pilot and mobile applications are to provide customers with the ability to electronically access TxDMV services more conveniently.

Unexpended Balance:

webDEALER Project – The webDEALER project involves the development of a web-based computer system that will allow motor vehicle dealers to submit vehicle title and registration applications electronically. This project includes multiple phases; the system is now available for new car sales, used car sales, document management, and commercial fleet buyers. Remaining phases to be implemented in Fiscal Year 2018 are eTags, Centralized Payments, and eTitles.

Cybersecurity – Provide increased levels of encryption and authentication.

Commercial Vehicle Information Exchange Window (CVIEW) – Upgrade the data sharing capabilities and data quality of this information database used by various state agencies to ensure commercial carrier compliance.

Call Center Upgrades – Upgrade agency telephone equipment allowing TxDMV’s call centers to incorporate new functionality.

Fraud Data Dashboard – Utilize a Cognos (a specialized software tool) reporting cube to create a dashboard to analyze patterns and trends in transactions in order to identify possible fraud using predetermined thresholds to set possible fraud alerts.

External Website Renovation – Update and refresh the agency’s public website in an effort to improve customer usability.

E-Renewals/E-Reminder – Reduce paper registration renewal notices by replacing them with an option to receive an electronic registration renewal notice. This results in savings to the agency as well as reducing the agency’s reliance on paper based transactions and aligns with customers’ increased reliance on digital communication.

Online Certified Records – Provide the ability for consumers to obtain certified vehicle records online, 24/7.

Enterprise Reporting – Agency initiative to continue enhancements to existing reports and to create new reports to monitor and improve the performance of the agency.

Technology Replacement & Upgrades for Counties (\$5.0 million)

This appropriation provides funding to maintain printers, computers, monitors, laptops, cash drawers, etc. deployed at county tax assessor-collector offices throughout the state. Additionally, it provides funding to support point-to-point connectivity to the agency’s Registration and Titling System for all 254 counties and their 508 primary and substation locations.



Texas Department of Motor Vehicles

Data Center Consolidation (\$9.1 million)

This appropriation supports information technology infrastructure assets and functions through statutorily required participation in the State Data Center maintained by the Department of Information Resources (DIR). Also included are costs for printing and mailing of registration processed online. This allows TxDMV to fund data center services from resulting continued efforts to build an IT infrastructure, the implementation of the RTS Refactoring project, and the ongoing impact of separating from Texas Department of Transportation (TxDOT) networks.

Agency Growth and Enhancement (\$0.8 million)

Agency operations support includes information resources activities that enhance or expand existing information resources services in TxDMV's individual program areas. This project includes replacement of desktop computers, desktop printers, laptops, and peripheral devices; telephone system replacements and upgrades; replacement and upgrades of network equipment; the development of a VOIP (Voice over Internet Protocol) infrastructure; and the software licenses for enterprise applications. Additionally, the project includes division-level imaging and document management in the development of workgroup applications.

PC Replacement (\$0.1 million)

The PC Replacement project was situated in Growth & Enhancement in previous years. It has now been separated into its own project.

Cybersecurity Initiative (\$0.4 million)

This is a new project providing funding to agencies for initiatives to improve security for statewide information technology systems.

Other Capital Projects (\$0.9 million)

This category consists of two new projects for TxDMV. Vehicles, funding for 33 replacement and 4 new vehicles for Enforcement's Special Investigations Unit (SIU); and Equipment which includes funding for headquarters security/badging equipment.



Texas Department of Motor Vehicles

Appendix A: Budget Category Definitions



Texas Department of Motor Vehicles

Budget Category Definitions

In Alphabetical Order

Advertising and Promotion – Includes radio/media ads, posters, signage, brochures, flyer production, and other promotional items.

Benefit Replacement Pay – Benefit Replacement Pay (BRP) is compensation authorized by the Texas Legislature to offset the loss of state-paid Social Security contributions.

Capital – Includes items established as “Capital Items” by the agency, or greater than \$5,000, which have capital authority as outlined in Rider 2 of the General Appropriations Act, 85th Legislature, such as Acquisition of Information Resource Technology, land and buildings, relocation of facilities, and aggregate furniture purchases in excess of \$100,000.

Computer Equipment – The purchase and replacement of personal information technology equipment and peripherals such as workstations, monitors, keyboards, and laptops.

Consumables – Standard consumable costs required to run the day-to-day operations of the agency such as paper, pens, pencils, media discs and USB drives, paper clips and staples.

Contract Services – General jobs outsourced to third party companies and organizations for the benefit of the agency such as MyPlates and Standard Register.

Fees and Other Charges – Credit card processing fees, employee health insurance fees, State Office of Risk Management insurance charges, and court filing fees.

Freight – Costs to transport license plates to county tax offices.

Fuels and Lubricants – Fleet maintenance and operation costs related to oil changes and refueling fleet vehicles.

Grants – Pass through funds designated for use by city, county, and other state agencies for a specific, contractual requirement.

Maintenance and Repair – Expenditures related to the upkeep of agency facilities, equipment, and software used on agency systems for annual application support such as e-Tags and International Registration Plan (IRP).

Memberships and Training – Fees for training courses and conference registrations for agency staff. Also included are expenditures for memberships for agency personnel such as Texas Association of Public Purchasers, American Association of Motor Vehicle Administrators (AAMVA) and the National Board of Motor Vehicle Boards and Commissions.

Other Expenses – Includes office furniture and equipment, and miscellaneous non-categorized costs such as employee awards, publication purchases, parts, promotional items, and non-capitalized tools. Also included in this category is a portion of the funding for TxDMV Automation and Growth and Enhancement.

Postage – Includes costs of metered mailing for license plates, registration renewal notices, and titles; and includes the cost of the rental of agency post office boxes.



Texas Department of Motor Vehicles

Professional Fees – Work, requiring specific expertise, provided by third party professionals holding specific certifications and qualifications.

Rent – Building/Rent – Machine, Other – Costs associated with procurement of project facilities such as office rental, off-site training rooms; and costs associated with the rental of office equipment such as postage meters and copy machines.

Reproduction and Printing – Includes all agency printed materials primarily used in registration renewal notices and titles such as notification inserts, envelopes, and title paper.

Salary – Includes salaried workers and interns, longevity pay, health insurance contributions, and retirement contributions. Does not include contract workers who are not a part of the organization's normal payroll.

Services – Includes costs associated with services provided to TxDMV through subscription such as National Motor Vehicle Information System (NMVTIS) and LexisNexis.

Travel (In-State/Out-of-State) – Planned travel costs provided to participant. Includes transportation, meals and accommodations, and travel per-diems.

Utilities – Costs associated with providing services at facilities such as electricity, telephone, water, and natural gas.



Texas Department of Motor Vehicles

Appendix B: Budget Terms and Definitions



Texas Department of Motor Vehicles

Budget Terms and Definitions

Appropriated – Refers to the dollars or associated full-time equivalent (FTE) positions authorized for specific fiscal years and to the provisions for spending authority.

Appropriation Year (AY) – Refers to the specific fiscal year for which an appropriation is made. The appropriation year dictates the year to which the expenditure is authorized/charged.

Annual Operating Budget – An agency's approved Annual Operating Budget represents a one-year financial plan supporting the agency's business operations and addresses base operating requirements and adjustments. The budget covers funding for each division and reflects the most appropriate method of finance and strategy for core activities and continuing programs. The TxDMV Preliminary Annual Operating Budget reflects Fiscal Year 2018 appropriations as identified in the 85th Legislature, Regular Session, GAA. The agency's preliminary Annual Operating Budget covers a one-year period from September 1 through August 31.

Base Request – The base request represents the basis for the agency's biennial budget. The base request cannot exceed the appropriated amount established by the legislature through the prior biennial GAA, adjusted for Article IX appropriation reductions.

Benefit Replacement Pay – Benefit Replacement Pay (BRP) is compensation authorized by the Texas Legislature to offset the loss of state-paid Social Security contributions. S.B.102, 74th Legislature eliminated the state-paid Social Security payment, effective December 31, 1995. After this date, eligible employees began receiving a supplement known as Benefit Replacement Pay (BRP) in place of the state-paid Social Security payment. Eligible employees include those that were employed by the state and subject to FICA taxes on August 31, 1995, and have been continuously employed by the state since that date; employees that left the state but returned within 30 consecutive calendar days and those that retired before June 1, 2005, and returned to work with the state before September 30, 2005.

Biennium – Two-year funding cycle for legislative appropriations.

Capital Budget – The portion of an agency's appropriation that is restricted to expenditures for designated capital construction projects or capital acquisitions.

Centralized Accounting and Payroll/Personnel System (CAPPS) – CAPPS is the official name of the statewide Enterprise Resource Planning (ERP) system created by the Comptroller's of Public Accounts (CPA) office ProjectONE team. CAPPS will replace legacy systems with a single software solution for financial and Human Resources (HR)/Payroll Administration for Texas state agencies. The modules for TxDMV's CAPPS include: Asset Management; General Ledger/Commitment Control (Budget); Payables; Purchasing/eProcurement; HR and Payroll Administration.

Expended – Refers to the actual dollars or positions utilized by an agency or institution during a completed fiscal year; a goal or strategy; an object of expense; or an amount from a particular method of finance.

General Appropriations Act (GAA) – The law that appropriates biennial funding to state agencies for specific fiscal years and sets provisions for spending authority.

General Revenue (GR) Fund – The fund (Fund 0001) that receives state tax revenues and fees considered available for general spending purposes and certified as such by the Comptroller of Public Accounts.



Texas Department of Motor Vehicles

Federal Funds/Grants – Funds received from the United States government by state agencies and institutions that are appropriated to those agencies for the purposes for which the federal grant, allocation, payment or reimbursement was made.

Full-Time Equivalents (FTEs) – Units of measure that represent the monthly average number of state personnel working 40 hours per week.

Fiscal Year (FY) – September 1 through August 31 and specified by the calendar year in which the fiscal year end, e.g. Fiscal Year 2018 runs from September 1, 2017 through August 31, 2018.

Lapsed Funds – The unobligated balance in an item of appropriation that has not been encumbered at the end of a fiscal year or at the end of the biennium. Appropriations expire if they are not 1) obligated by August 31 of the appropriation year in which they were made or 2) expended within two years following the last day of the annual year.

Line-item – An element of spending authority granted to an agency or institution in an appropriations bill. It is literally, a line in the General Appropriations Act specifying an agency's appropriations for a specific designated use. In Texas, the governor may veto a line-item.

Method of Finance – This term usually appears as a heading for a table that lists the sources and amounts authorized for financing certain expenditures or appropriations made in the General Appropriations Act (GAA). A source is either a "fund" or "account" established by the comptroller or a category of revenues or receipts (e.g. federal funds).

Processing and Handling Fee – In accordance with H.B. 2202, 83rd Legislature, Regular Session, in June 2016, effective January 1, 2017, a new processing and handling (P&H) fee for registration activities has been adopted. The new P&H fee is set at an amount sufficient to cover the costs of registration services.

Salary Budget – Fiscal Year 2018 salaries include projected annual costs based on Fiscal Year 2017 actual salaries with adjustments for vacancies, merits and Fiscal Year 2018 longevity costs.

State Highway Fund (Fund 0006) – Constitutionally created fund that dedicates net revenues from motor vehicle registration fees and taxes on motor fuels and lubricants. Revenue in the State Highway Fund is used for highway construction and maintenance, acquisition of rights-of-way and law enforcement on public roads.

TxDMV Fund (Fund 0010) – S.B. 1512, 84th Legislature, Regular Session, re-created the TxDMV Fund outside of the GR Fund and directed the agency to change its deposit schedule beginning in Fiscal Year 2017. S.B. 1512 also redirected the revenues previously identified in H.B. 2202, 83rd Legislature, Regular Session associated with certain TxDMV fees to be deposited to the credit of the newly established TxDMV Fund. ABTPA, however, continues to be self-funded through the collection of a \$2 fee on insurance policy renewals and its fees are deposited to the credit of the General Revenue.

Unexpended Balance (UB) or Carry-Forward – The amount left in an item of appropriation at the end of an appropriation period and includes only that part of the appropriation, if any, which has not had an obligation or commitment made by the agency in charge of spending the appropriation. The term also refers to the amount of an appropriation, a fund or a category of revenue which is brought forward (appropriated) to the succeeding fiscal year. Agencies must have legislative authority to move funds from one year to the next and/or from one biennium to the next biennium.



Texas Department of Motor Vehicles

Appendix C: Finance and Administrative Services Contacts



Texas Department of Motor Vehicles

Finance and Administrative Services Contacts

Linda Flores, Chief Financial Officer
512-465-4125

Renita Bankhead, Assistant Chief Financial Officer
512-465-1216

David Chambers, Purchasing Director
512-465-1257

Sergio Rey, Accounting Operations, Director
512-465-4203

Ann Pierce, Deputy Division Director, Administrative Services
512-465-4100

Budget Analysts

John Ralston, Budget Team Lead
512-465-4182

Jack Starnes, Sr. Budget Analyst
512-465-4178

Delores Hubbard, Budget Analyst
512-465-4195

Sheila Bledsoe, Budget Analyst
512-465-5831

Revenue Forecasting

Theo Kosub, Revenue Forecasting Team Lead
512-465-1448

Brian Kline, Financial Analyst
512-465-4194

Laura Fowler, Financial Analyst
512-465-5851

Planning

Lisa Conley, Planner
512-465-4186



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Linda M. Flores, Chief Financial Officer
Agenda Item: 5. D.
Subject: Facilities Update

RECOMMENDATION

For information purposes only.

PURPOSE AND EXECUTIVE SUMMARY

TxDMV Facilities Services presents updates regarding agency relocation projects:

- Bull Creek/Motor Carrier Division (Austin, Texas)
- Corpus Christi Regional Service Center (Corpus Christi, Texas)
- San Antonio Regional Service Center (San Antonio, Texas)
- Pharr Regional Service Center (Pharr/Edinburg, Texas)

FINANCIAL IMPACT

- \$1.49 million was initially appropriated for the Motor Carrier Division (MCD) Relocation
- \$1.4 million was appropriate for the relocation of Regional Service Center Relocations

BACKGROUND AND DISCUSSION

Motor Carrier Division located on Bull Creek will relocate to Camp Hubbard, Building 6, 5th floor. Physical move is scheduled to occur January 2018.

Corpus Christi Regional Service Center moved to its new location on 602 North Staples in the Corpus Christi Regional Transit Authority building and commenced normal business hours on Monday, April 3, 2017.

San Antonio Regional Service Center will move to its new location, 15150 Nacogdoches Road, Suite 100, in August 2018. The TxDMV is collaborating with Texas Facilities Commission and the Landlord to ensure agency specifications are met.

The Pharr Regional Service Center initiative has been de-scoped from relocating at this time. The agency was unable to locate affordable real estate which met the agency's operational needs.

The enclosed *Facilities Update Report* provides further detail.



FACILITIES UPDATE

JUNE, 2017

Agency Property Relocation Projects (PRP)

2016-2017 Agency Moves

★★★★★

The agency received funding during the 84th Legislative Session to relocate Motor Carrier Division (MCD) staff from the Bull Creek Property and selected Regional Service Centers. An internal TxDMV workgroup was established that determined San Antonio (SA), Pharr (PH) and Corpus Christi (CC) are best candidates for relocation during the biennium. TxDMV and Texas Facilities Commission (TFC) gathered space requirements to determine appropriate square footage and develop property specifications.

>Bull Creek/Motor Carrier Division (Austin, Texas)

Current Status:

- MCD is scheduled to relocate to the 5th floor at Camp Hubbard, Building 6 in January 2018. Texas Department of Transportation (TxDOT) is coordinating renovations to the area and has begun the de-construction phase that included asbestos mitigation. TxDMV conducted a walk through with Texas Correctional Industries (TCI) in January 2017, to assist in modular office configuration layout. Final plans and cost estimates are expected to be received in May 2017.
- Modular installation, cabling and electrical work is anticipated to begin November 2017 with a projected move date in January 2018 and final surplus removal from the Bull Creek location by or before February 2018.

>Corpus Christi Regional Service Center (Corpus Christi, Texas)

Current Status:

- The regional service center office moved to its new location, 602 North Staples on March 31, 2017. The move occurred after work hours to minimize disruptions to customers.
- Surplus items were transported to Austin on Saturday, April 1st. TxDMV staff processed the surplus items for reuse within the agency and/or auction.
- A check in with Vehicle Title and Registration Division (VTR) stakeholders on Monday, April 3, 2017, indicated that the first day of business at the new location went smoothly. Estimates indicate that the project was completed on time and under budget.

❖ **Agency Property Relocation Projects (PRP)**

- 2016-2017 Agency Moves >\$1.49 million
Appropriated for Motor Carrier Division Relocation >\$1.4 million
Appropriated for Regional Service Center Relocations

❖ **Property Updates**

- Bull Creek
- Corpus Christi
- San Antonio
- Pharr

>San Antonio Regional Service Center (San Antonio, Texas)**Current Status:**

- Board approval for the San Antonio proposal was received January 2017. San Antonio's new address will be 15150 Nacogdoches Road in Suite 100 and an anticipated move date in early to mid-August.
- Facilities Services began outreach to the landlord's project manager for project plans and schedules. A final architectural drawing was completed in February 2017.
- In March, staff relayed mechanical, electrical and plumbing (MEP) related needs to the landlord's project manager. The landlord's architects and engineers are developing a final drawing of these "MEP" plans. The plans should be completed in May 2017 and routine weekly project meetings will be scheduled to monitor progress.

>Pharr Regional Service Center (Pharr, Texas)**Current Status:**

- In March 2017, TxDMV determined that rental rates for space suitable for TxDMV operations were cost prohibitive in Pharr Texas. Consequently, the TxDMV regional service center will remain on TxDOT property.



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Sandra Menjivar-Suddeath, Director, Internal Audit
Agenda Item: 5. E
Subject: Internal Audit Division Status

RECOMMENDATION

None.

PURPOSE AND EXECUTIVE SUMMARY

The status update provides information on current Internal Audit Division (IAD) activities. This status update includes information on audit and advisory service engagements and external coordination and reviews.

FINANCIAL IMPACT

None.

BACKGROUND AND DISCUSSION

Internal Projects

The IAD has finalized or is currently working on six internal projects:

- Registration and Title System (RTS) Refactoring and Single Sticker Post-Implementation Review Audit
- Information Technology Services (ITS) Division Application Services Section Organizational Review Advisory Service
- Continuous Monitoring of Vehicle Registration and Title Transactions Advisory Service
- Internal Audit Recommendation Follow-Up Engagement
- Fiscal Year 2018 Annual Audit Plan
- Annual Quality Assurance review

Of those six internal projects, two projects have been finalized: 1) Registration and Title System (RTS) Refactoring and Single Sticker Post-Implementation Review Audit (Cognos Audit) and 2) Information Technology Service (ITS) Division Application Services Organization Review Advisory Service Report (ITS Organization Review).

The Cognos Audit had an overall maturity rating of “3” and had two recommendations based on one audit result. The audit identified that TxDMV end user staff should have training on the Cognos application and how it works in the department. To address the results, the ITS Division will work with Finance & Administrative Services (FAS) and Vehicle Titles & Registration (VTR) to develop end user training and review the current reports.

The ITS Organization Review identified that the resources in the Application Service Section have the appropriate skill set to do their work. Resources, however, have been over allocated due to insufficient project capacity planning and cross-training.

External Coordination

The State Auditor’s Office had finished their audit and the report has been released.



Internal Audit Division (IAD) June Status Update

Status of the Fiscal Year 2017 Internal Audit Plan

Current Internal Audit Division Projects			
Project	Description	Current Status	Expected Report Release/Presentation Date
Continuous Monitoring of Vehicle Registration and Title Transactions Advisory Service	Advisory Service for Vehicle Titles & Registration (VTR) where the division will identify reports that could be used to continuously monitor potentially fraudulent transaction.	Fieldwork	This audit report is expected to be released in July 2017.
Internal Audit Recommendation Follow-Up Engagement	This engagement is verifying the implementation status of the internal audit recommendations that had a completion date prior to December 2016.	Fieldwork	The audit report is expected to be presented in the August 2017 Board Meeting.
Fiscal Year 2018 Internal Audit Plan	Identify high risk areas that may warrant an audit or advisory service in Fiscal Year 2018.	Fieldwork	The audit plan will be presented during the August 2017 Board Meeting.
Annual Quality Assurance Review	To assess if the Internal Audit Division is meeting both the Generally Accepted Government Auditing Standards and International Standards for the Professional Practice of Internal Auditing.	Planning	The letter is expected to be will be presented during the August 2017 Board Meeting.
Registration and Title System (RTS) Refactoring and Single Sticker Post-Implementation Review Audit	Audit on the data reliability of Refactored RTS – Cognos reports	Completed	See Attachment 1
Management/Board Request - IT Organizational Review Advisory Service	Advisory Service for the Information Technology Service (ITS). The IAD team will be conducting an organizational review of one section in ITS.	Completed	See Attachment 2

External Audits

1. SAO Compliant Process Audit - The report was released in May 2017.

Attachments

1. Registration and Titling System (RTS) Refactoring & Single Sticker Post-Implementation Review Audit Report
2. Information Technology Service (ITS) Division Application Services Section Organization Review Advisory Service Report



Texas Department *of* Motor Vehicles

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Registration and Titling System (RTS) Refactoring and Single Sticker Post- Implementation Review Audit Report 17-2

Internal Audit Division
April 2017

Table of Contents

Overall Conclusion and Executive Management Response	1
Maturity Assessment.....	1
Strengths.....	1
Improvements	1
Background.....	2
Audit Results.....	3
The Cognos Reporting Application is Functioning Correctly Despite Lack of User Exposure into how Reports are Produced.....	3
Appendix 1: Objectives, Scope, Methodology, Maturity Assessment.....	5
Objectives	5
Scope and Methodology.....	5
Maturity Assessment Rating Definition	6



Registration and Titling System (RTS) Refactoring and Single Sticker Post-Implementation Review, 17-2

Executive Summary

WHY AND WHAT WAS REVIEWED

In April 2015, the Registration and Titling System (RTS) legacy report tool was replaced with the Cognos enterprise reporting application. The Cognos application provided a modern platform to better analyze the RTS data and also provided the agency with the ability to conduct ad-hoc reporting. The RTS data is used by key divisions, specifically the Vehicle Titles and Registration and Finance & Administrative Services divisions, to make strategic and operational decisions.

The audit objective was to determine whether Cognos reports provide management and staff with complete and accurate information from RTS.

WHAT WE RECOMMENDED

The Information Technology Services (ITS), Finance & Administrative Services (FAS), and Vehicle Titles & Registration (VTR) work together to develop and provide training for internal agency Cognos users on the application's method of data processing and the reporting limitations it inherently creates.

The Department should perform a detailed review of Cognos reports structure to understand the exact mechanics of the reports.

WHAT WE DETERMINED

The Cognos application is pulling data accurately according to its design. However, users were skeptical of Cognos data reliability and completeness, leading them to spend additional time and effort verifying Cognos report output to RTS source data to ensure reports' accuracy.

User training did not cover the differences in data processing between the RTS reporting tool and the Cognos reporting application. The training provided consisted of tutorials on the mechanics of the user interface for application navigation and generating reports and exposure to Cognos reporting cubes during the User Acceptance Testing (UAT) phase.

The UAT exposure did not allow the user to see how the Cognos reporting application would be used once it was implemented. Further, the testing did not allow for validation of Cognos output with the underlying source data since the testing consisted of comparing the developed Cognos reports and the RTS reports to ensure the calculated results matched.

MANAGEMENT RESPONSE

Management agrees that training and report review will provide additional insight into how the system operates.

The Information and Technology Services Division will create and conduct a training curriculum and work with the Vehicle Title and Registration and Financial and Administrative Services divisions to review Cognos report structures by fiscal year end 2018.

Overall Conclusion

Maturity Assessment

3: Defined Process Level - The process has been standardized, documented, communicated, and is being followed. The process, however, may not detect any deviation due to the process not being sufficiently evaluated to address risks.

Other possible ratings and definitions can be found in Appendix 1, under Maturity Assessment Rating Definition.

Strengths

The Texas Department of Motor Vehicles' (TxDMV) development and implementation of Cognos included business requirement and design input from the intended end users. The Cognos reports and cube functionality was built according to the business requirements and design.

Improvements

The TxDMV needs to identify and communicate to Cognos users the Cognos application's data processing methods and the resulting considerations that users must make when interpreting Cognos report output.

Below are the audit results that further expand on these areas. The detailed audit results can be found under the Audit Results section of this report.

Audit Result #1: The Cognos Reporting Application Functioning Correctly Despite Lack of User Exposure into how Reports are Produced

Background

The Texas Department of Motor Vehicles implemented the Cognos enterprise reporting application in April 2015. The application replaces the Department's Registration and Titling System (RTS) reports throughout the Department, notably the Vehicle Registration and Title Division and the Financial and Administrative Services Division, rely upon the Cognos reporting application for business intelligence. The application allows Department users to generate ad-hoc reports on motor vehicle transaction and financial information. The Department uses Cognos to provide information to the public, oversight agencies, and its Board of Directors.

However, the reliability of the Cognos reporting application has been questioned by the Department as it continues to experience multiple, repeated instances of reported actual transactions not matching projections or other expected correlated data.

The Cognos application development consolidated approximately 900 RTS reports into 49 pre-built reports and 7 report cubes. The report cubes are capable of querying and filtering by multiple attributes of motor vehicle transactions simultaneously. The cubes provide a snapshot of motor vehicle transaction data available at the time a query is run. Cognos analysis report cubes and 10 pre-built reports pull from data stored in data marts. These data marts consist of copied and aggregated motor vehicle transaction information from the RTS and the RTS Point-of-Sale application. The aggregated information includes vehicle attributes (make, model, year, color, county, etc.) but loses transactional detail (transaction ID number, document number, etc.). The data marts copy RTS and Point-of-Sale data weekly.

This audit was included in the Fiscal Year 2017 Audit Plan. We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards and in conformance with the Internal Standards for the Professional Practice of Internal Auditing. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The audit was performed by Derrick Miller (Senior Auditor) and Sandra Menjivar-Suddeath (Internal Audit Director).

In accordance with the Texas Internal Auditing Act, this report is distributed to the Board of the Texas Department of Motor Vehicles, Governor's Office of Budget, Planning, and Policy, Legislative Budget Board, State Auditor's Office, and the Sunset Advisory Commission.

Audit Results

The Cognos Reporting Application is Functioning Correctly Despite Lack of User Exposure into how Reports are Produced.

Condition

Department users were skeptical of Cognos data reliability and completeness, leading them to spend additional time and effort verifying Cognos report output to RTS source data to ensure reports' accuracy. However, the Cognos application is pulling data accurately according to its design.

Cause

The Vehicle Titles and Registration (VTR) Division has identified and experienced multiple instances of data reliability issues stemming from Cognos performance issues such as failure to populate report fields and errors in data loading that prevented transactions from getting into the vehicle titles reporting source tables.¹

The Cognos user training did not cover the differences in data processing between the RTS reporting tool and the Cognos reporting application. For example:

- Source data in the data marts may not account for all days in a month when a monthly reporting period ends during the work week. Data marts are batch updated every Friday. The data set may be missing some days from the reporting period, or include additional days outside of the reporting period.
- Cubes and reports using snapshot data are inherently incapable of producing historical information. Cognos reports and cubes operate using either transactional data or snapshot data. Transactional data is based on a count of the number of record creations, edits, and deletions that have occurred in a given period. However, snapshot data provides only the number of transactions contained within the system at the time of the query.

The training provided to users consisted of tutorials on the mechanics of the user interface for application navigation and generating reports and exposure to Cognos reporting cubes during the User Acceptance Testing (UAT) phase.

The UAT exposure did not allow the user to see how the Cognos reporting application would be used once it was implemented because the testing environment did not allow testing of cumulative transaction sets and instead used a separate transaction set for each specific testing element. Further, the testing did not allow for validation of Cognos output with the underlying source data since the testing consisted of comparing the developed Cognos reports and the RTS reports to ensure the calculated results matched.

Effect

Department staff spends additional time and effort, after creating reports, verifying Cognos output with RTS data attempting to ensure information is accurate and valid on a case-by-case basis.

¹ Cognos performance issues were not included within this audit's scope of work. The Department had a concurrent task force of Department staff, multiple vendors' staff, and Department of Information Resources staff analyzing re-emergent RTS issues, their root cause, and the methods taken to correct them.

Criteria

Best practice for the System Development Life Cycle should include a user training plan that accounts for the technical skills and knowledge end users will need to minimize productivity losses. The Department of Information Resources' project delivery framework also recommends testing of data contained within the system and data used by the system. Testing of data ensures that the item under test accepts or delivers all and only the data intended for that item, in the form, format, and frequency that is correct for that item.

Recommendations

The Internal Audit Division recommends:

- 1.1 The Information Technology Services (ITS), Finance & Administrative Services (FAS), and Vehicle Titles & Registration (VTR) work together to develop and provide training for internal agency Cognos users on the application's method of data processing and the reporting limitations it inherently creates.
- 1.2 The Department should perform a detailed review of Cognos reports structure to understand the exact mechanics of the reports.

Management's Response and Action Plan

The Vehicle Title and Registration (VTR) and Financial and Administrative Services (FAS) divisions agree that there should be training on the application method of data processing and the reporting limitations. Additional training on the functionality of cubes within the COGNOS application and a detailed review of Cognos report structures would be useful. Both VTR and FAS staff would participate in any future agency training. Furthermore, FAS staff who worked with legacy RTS data will consult with new COGNOS users to ensure the system's strengths and limitations are known.

The Information Technology Services (ITS) division will develop and present Cognos training for internal Department users. ITS will also work with VTR and FAS to conduct a detailed review of the Cognos reports to identify and communicate the reporting functionality to compare with business needs. The VTR or FAS divisions can assist in reviewing the documentation provided by the ITS to determine if the system and reports are performing as expected.

However, the VTR and FAS divisions do not have the technical expertise regarding how or when the information is being loaded into the system or the queries the system is using to create the reports, and therefore would not be able to assist in the development of the training curriculum.

Given the Department's priorities with multiple ongoing capital I.T. projects and the current legislative session, ITS expects to complete the Cognos training program by the end of 2nd quarter fiscal year 2018 (2/28/2018) and the Cognos report review by fiscal year end 2018 (8/31/2018).

Management Action Plan Owner: Eric Obermier, Chief Information Officer

Anticipated Completion Date:

Recommendation 1.1	2/28/2018
Recommendation 2.2	8/31/2018

Appendix 1: Objectives, Scope, Methodology, Maturity Assessment

Objectives

The objective of this audit was to determine whether Cognos reports provide management and staff with complete and accurate information from the Registration and Titling System.

Scope and Methodology

The scope of this audit included the Cognos report business requirement, development, and testing documentation prior to implementation of the Cognos application in April 2015, and Cognos related training materials provided prior to and upon implementation in April 2015.

We reviewed Cognos report structures and the data tables and data definitions queried by the reports to determine if the reports were pulling information accurately according to their design. We were unable to directly verify the report output against the RTS source data due to 1) data aggregation into data marts making one-to-one transaction verification impossible, 2) the snapshot nature of some report information made it impossible to reliably recreate reports based on a specific data set.

We reviewed Cognos application development documentation and user acceptance testing results to determine whether the Department approved adequate report design to produce the desired information. We also reviewed user training materials and presentations to assess whether crucial information in using Cognos reports was communicated to end users.

We did not perform root cause analysis for performance or data reliability issues, as these items were deemed out of scope. The Department had a concurrent task force analyzing re-emergent RTS issues, their root cause, and the methods taken to correct them.

Information and documents that we reviewed included the following:

- *Report 9522 Registrations by Class Description*
- *Current Vehicle Registration Report*
- *Registration by Class Code query*
- *Data definitions for query tables*
- *Workstream 3 (Cognos) requirements gathering sessions*
- *Design session attendance log*
- *Deloitte Enterprise Reporting Capability Transition Phase Software Specifications Report*
- *Cognos User Acceptance Testing results*
- *AVNet Academy Student Roster*
- *Registration and Titling System (RTS) Refactoring Project Workstream 3 Cognos Training presentation*
- *RTS Project Working with Cognos Reports and Cubes webinar presentation*
- *TxDMV RTS Training Guide for Working with Cognos Reports*
- *Cognos data architecture approach*
- *Interviews with Department division directors, staff-level report users, and development testing staff.*
- *Interview with Deloitte Cognos development personnel*

Maturity Assessment Rating Definition

The maturity assessment rating and information were derived from the Control Objectives of Information and Related Technologies (COBIT) 5 IT Governance Framework and Maturity Model and the Enterprise Risk Management (ERM) Maturity Model. The model was adapted for TxDMV assurance audit purposes and does not provide a guarantee against reporting misstatement and reliability, non-compliance, or operational impacts. Below are the definitions for each rating level.

- 0 - A rating level of 0, also known as a non-existent process level, is defined as no process has been defined or used.
- 1 - A rating level of 1, also known as an initial and ad-hoc process level, is defined as a standardized process has not been developed and an ad hoc approach is being used when issues arise.
- 2 - A rating level of a 2, also known as repeatable but intuitive process level, is defined as having developed standardized process to where similar procedures are being followed by several people.
- 3 - A rating level of a 3, also known as a defined process level, is defined as having a standardized, documented, communicated, and followed process. The process, however, may not detect any deviation due to the process not being sufficiently evaluated to address risks.
- 4 - A rating level of a 4, also known as a managed and measurable process level, is defined as having a standardized, documented, communicated, and followed process. Management monitors and measures compliance with process. Process is under constant improvement and provides good practice.
- 5 - A rating level of a 5, also known as refined level, is defined as having a good process (e.g., standardized, documented, communicated, and followed process) based on the results of continuous improvement and the use of technology. Information technology is used in an integrated way to automate workflow, providing tools to improve quality, and effectiveness.



**Texas Department
of Motor Vehicles**

HELPING TEXANS GO. HELPING TEXAS GROW.

**Information Technology Services (ITS)
Division Application Services Section
Organizational Review Advisory Service
Report
17-3**

**Internal Audit Division
May 2017**

Table of Contents

Overall Conclusion	1
Strengths	1
Improvements	1
Background	2
Advisory Service Results	3
ITS Division Application Services Section Capacity	3
Appendix 1: Objectives, Scope, Methodology, Maturity Assessment	6
Objectives	6
Scope and Methodology	6
Appendix 2: ITS Application Services Organization Review – Advisory Service Deliverables	7



ITS Division Application Services Section Organizational Review, 17-3 Executive Summary

WHY AND WHAT WAS REVIEWED

The Information Technology Services (ITS) Division - Application Services Section is responsible for the development, maintenance, and oversight of Texas Department of Motor Vehicles (TxDMV) applications used both internally and externally.

In the Fiscal Year (FY) 2017 Operational Plan, the ITS Division recognized that the TxDMV has an increased number of projects since its 2009 creation and a division-wide operational assessment was warranted. The ITS Division is planning a top to bottom organizational assessment to ensure the ITS Division is positioned to help TxDMV achieve its goals of 1) being Customer Centric, 2) Optimizing Services and Innovation, and 3) being Performance Driven. As part of the organizational review, the ITS Division requested the Internal Audit Division perform an advisory service to ensure resource capacity and skill level was sufficient to meet the project demands and subsequent operational support responsibilities.

The advisory service determined the following:

- 1) whether planned IT resource time allocation aligned with actual time expended;
- 2) whether employee responsibilities align with employee skills; and,
- 3) whether time allocation within Centralized Accounting and Payroll/Personnel System (CAPPS) is sufficient for the ITS Application Services Section to fulfill operational and project responsibilities.

WHAT WE RECOMMENDED

The Internal Audit Division made three recommendations to improve the communication and cross-training of the ITS Division Application Services Section.

WHAT WE DETERMINED

The Internal Audit Division determined that an over allocation of ITS Division resources has occurred due to project capacity planning and limited cross-training. ITS Division resources, however, have a sufficient skill set and knowledge for their assigned duties.

The ITS Division is reliant on specific, limited resources with the knowledge and skills to service on-going and upcoming department application development and maintenance projects. The ITS Division has identified the need for resources' development and cross-training, however, current resource schedules do not allow for development and cross-training.

Eight ITS resources have compensatory leave balances greater than 200 hours. The eight ITS resources have an average of 354 hours of compensatory leave. On average, ITS Division Application Services Section resources had approximately 90 hours of compensatory leave.

MANAGEMENT RESPONSE

Management agrees with the three recommendations and has begun working on implementing their action plans. The action plans include cross-training staff, knowledge transfer, communicating with project managers on project assignment status, and communicating resource allocation adjustments. One action plan has already been completed at the time of the audit report issuance.

Overall Conclusion

Strengths

The ITS Division works cooperatively with the Enterprise Management Office (EPMO) to implement TxDMV enterprise projects and together are focused on achieving the department's mission and operational goals. The ITS Division also focuses on improving their Division to better serve the current and future needs of the department, which is why their resources have the sufficient skill set and knowledge to support the department's applications.

Improvements

The TxDMV ITS Division needs to cross-train resources and communicate resource allocation to project managers.

Result #1: ITS Division Application Services Section Capacity (see page 3 for more information).

Background

The Information Technology Services (ITS) Division is responsible for department-wide information technology needs and the maintenance and support of the department's major systems and technologies. The ITS Division includes several sections: Application Services; Support Services; Infrastructure Services; and Information Security. The Application Services Section is responsible for the development, maintenance, and oversight of TxDMV applications used both internally and externally. The ITS Application Services Section works closely with the Enterprise Project Management Office (EPMO) to plan and execute projects that have been identified as priorities for the department. Additionally, ITS Division and EPMO share ITS Division resources for application project implementation.

In the Fiscal Year (FY) 2017 Operational Plan, the ITS Division recognized that the TxDMV has experienced an increased number of projects since its 2009 creation and a divisional operational assessment is warranted. The ITS Division is planning a top to bottom organizational review to help ensure the ITS Division is positioned to help the department meet current and future priorities and achieve its department strategic goals. As part of the organizational review, the ITS Division requested the Internal Audit Division (IAD) perform an advisory service.

This advisory service was included in the FY2017 Audit Plan. IAD conducted this advisory service in accordance to the International Standards for the Professional Practice of Internal Auditing.

The advisory service was performed by Jason Gonzalez (Senior Auditor) and Sandra Menjivar-Suddeath (Internal Audit Director).

In accordance with the Texas Internal Auditing Act, this report is distributed to the Board of the Texas Department of Motor Vehicles, Governor's Office of Budget, Planning, and Policy, Legislative Budget Board, the State Auditor's Office, and the Sunset Advisory Commission.

Advisory Service Results

ITS Division Application Services Section Capacity

Conditions

The following conditions were identified during the course of the advisory service:

- Capacity planning does not take into account the maintenance and operations of Information Technology applications and the resources that will be conducting the maintenance and operations.
- EPMO project managers can have difficulty monitoring project time allocations for ITS Application Services resources as the resources leave project implementation assignments to address application maintenance and operations.
- Capacity and resource allocation planning for the development of enterprise technology projects is not sufficiently communicated.

Causes

- The ITS Division has limited resources with the knowledge and skills to service on-going and upcoming department application development and maintenance. The ITS Division has identified the need for resources' development and cross-training, however, current project schedules do not allow for development and cross-training. For example, the design and maintenance of all TxDMV finance applications are assigned to a single ITS Division resource. The ITS Division resources have not spent adequate time with their backups to ensure duties can be sufficiently performed if the primary is unavailable. Furthermore, five ITS Division resources have primary design and maintenance responsibilities for over nine applications. An additional six ITS Division resources have primary and backup responsibilities for over nine applications.
- EPMO monitors and track hours of assigned ITS resources on a monthly basis and are not always made aware when ITS resources have been reallocated for maintenance and operational items.

Effect

Both enterprise projects and resources are impacted by the conditions observed. Enterprise projects were impacted as project deadlines and scopes were changed because of resource constraints. Even with the project scope and timeline changes, eight ITS resources have compensatory leave balances greater than 200 hours. These eight ITS resources have an average of 354 hours of compensatory leave. In addition, during the first quarter of Fiscal Year 2017, multiple ITS resources recorded hours over capacity:

- 11 ITS resources averaged 12 hours over capacity (September FY 2017);
- 17 ITS resources averaged 23 hours over capacity (October FY 2017); and,
- 14 ITS resources averaged 7 hours over capacity (November 2017).

Criteria

At the team level, IT project management best practices include clearly defining and communicating the focus and goals of the project, recognizing what each individual brings to the team, and properly planning and documenting all processes. The project manager is responsible for asking the right questions at the outset of a project in order to establish the appropriate scope, budget, and timeline. Open and ongoing communication is a critical aspect of IT project management. Communication should include resource availability throughout the course of the project. The IT project manager must also set up a framework for evaluating and controlling risk factors throughout the course of the project, and maintain a detailed record of progress, problems, resolutions and accomplishments.

Recommendations

The Internal Audit Division recommends the following:

- 1.1 Formally schedule cross-training and adjust resource allocation according to expanded resource skill sets.
- 1.2 Develop a process for communicating when a project resource will be unavailable to finish project assignments or may be significantly delayed.
- 1.3 Communication of resource allocation adjustment or reassignment should be formally communicated to all parties timely, including hours and task progress.

Management's Response and Action Plan:

Management Response & Action Plan 1.1

Management agrees with this recommendation. While backups have been identified for sub-components of the applications, they have their own primary areas of support responsibility. Project and release schedules have not afforded ample opportunity for many backup personnel to take the lead on programming assignments other than those they are primarily responsible for. Management will develop a plan to begin utilizing backup support personnel to take lead on those areas of development to balance between that and their primary support areas. With knowledge transfer sessions underway for the RTS Refactoring Project, which includes a large number of ITS Division staff, taking lead roles in future development for non-primary areas of support will have limited progress through August 31, 2018. These efforts will have a direct impact on application release capacity and project schedules due to additional time spent by support staff performing non-development efforts while cross-training occurs. Project time allocations will be adjusted as necessary by resource to support these activities which may require project Executive Steering Committee (ESC) or Governance Team (GT) approval if project schedules are impacted. That said, primaries as well as backups are both attending the knowledge transfer sessions. When time allows, the backups already help with or shadow support activities. Due to the size of the staff, most resources have more than one area of primary or backup responsibility. This puts a larger time strain on this process.

Management Action Plan Owner(s): Laura Dennis, Ray Rowehl, Dave Childers

Anticipated Completion Date: On-going

Management Response & Action Plan 1.2

Management agrees with this recommendation. Staff have already begun attending meetings coordinated by EPMO project managers where sharing of information occurs on the status of assignments, risks to their completion, etc. In addition, IT resources have been directed to notify their manager at least weekly if they are unable to fulfill their assigned time allocation and tasks for associated projects.

Management Action Plan Owner(s): Laura Dennis, Ray Rowehl, Dave Childers

Anticipated Completion Date: Completed

Management Response & Action Plan 1.3

Management agrees with this recommendation. The ITS Division will work with EPMO to ensure all project staff resources receive formal communication of their time allocations and associated responsibilities within the project upon approval of project schedules. IT Resource Managers will also send formal communications to project managers when competing priorities prevent project resources from fulfilling their time commitments to a project on at least a weekly basis. In addition, progress on project resource task assignments will be reported at least weekly in either regularly scheduled project team meetings where the project manager is present, or via email. Resources are responsible for updating their hours in the JIRA tool, which tracks the programming assignments, for monitoring by Project and Resource Managers. Should any information presented via the communications described above require ESC or GT communication or action, existing Governance Team policies and procedures will apply.

Management Action Plan Owner(s): Laura Dennis, Ray Rowehl, Dave Childers

Anticipated Completion Date: August 31, 2017

Appendix 1: Objectives, Scope, Methodology, Maturity Assessment

Objectives

The objectives of this advisory service were to determine:

- whether planned IT resource time allocation aligned with actual time expended;
- whether employee responsibilities align with employee skills; and,
- whether time allocation within the system is sufficient.

Scope and Methodology

The scope of this advisory service included the ITS Division resource allocation management and employee time reporting for the Application Services Section.

The IAD reviewed the Centralized Accounting and Payroll/Personnel System (CAPPS) to determine resource allocation. The IAD also reviewed 3rd party contractor ITS Division employee allocation reporting and staffing recommendations. Finally, the EPMO ITS Division employee allocation analysis was reviewed, and IAD performed an analysis of resource allocation.

Information and documents that we reviewed included the following:

- *CAPPS Reported Hours/Overtime Hours*
- *Deloitte Resource Allocation Reporting and Staffing Recommendations*
- *FY 2017 IT Usage Charts*
- *ITSD Organizational Assessment Initiative Overview*
- *Application Services Areas of Responsibility*
- *TxDMV ITS Operational Plan*
- *Interviews with ITS Application Management*
- *Interviews with EPMO Management*
- *Interviews with ITS Application Services Section resources*
- *Interviews with EPMO Project Managers*

Appendix 2: ITS Application Services Organization Review – Advisory Service Deliverables

Scope Area	Conclusion
<p>Panned IT resource time allocation and actual time expended.</p>	<p>Planned project time allocations do not always align with the actual time spent by resources. ITS Division Application Services Section resources have recorded hours over management expectations.</p> <p>During the first quarter of FY 2017 multiple ITS Division Application Services Section resources recorded hours over capacity:</p> <ul style="list-style-type: none"> • 11 ITS resources averaged 12 hours over capacity (September FY 2017); • 17 ITS resources averaged 23 hours over capacity (October FY 2017); and, • 14 ITS resources averaged 7 hours over capacity (November 2017). <p>Eight ITS Division Application Services resources have over 200 hours of compensatory leave, with an average compensatory leave of 354 hours. Two Application Services resources have over 500 hours of compensatory leave. On average, ITS Division Application Services Section resources had approximately 90 hours of compensatory leave.</p>
<p>Employee responsibilities and skill sets.</p>	<p>The majority of projects are assigned to a few ITS Division Application Services Section resources. Currently, five resources have the primary design and maintenance responsibilities for over nine applications while another six ITS Division resources have primary and backup responsibilities for nine other applications. The primary resources have sufficient knowledge and skill set to support their assignments and duties.</p> <p>ITS Division Application Services Section resources have not been fully cross-trained although ITS Division management has identified the need for cross-training.</p>
<p>Sufficiency of Cognos time allocation.</p>	<p>Deloitte recommended an additional six resources for Cognos application maintenance. Internal Audit believes six resources may be initially needed due to current enterprise report requests and the unfamiliarity of the application by the department users. However, six resources may not be needed as the department matures in the understanding of the Cognos application and enterprise requests lessen.</p>



DATE: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Sandra Menjivar-Suddeath, Director, Internal Audit
Agenda Item: 5. F.
Subject: Recommendation to amend the Fiscal Year 2017 Internal Audit Plan

RECOMMENDATION

Recommendation to amend the Fiscal Year (FY) 2017 Internal Audit Plan by removing the TxDMV Fund tables and Process & Handling Fees (TxDMV Fund) audit from the plan and adding the PCI Compliance with Credit Card audit.

PURPOSE AND EXECUTIVE SUMMARY

The Internal Audit Division (IAD) is requesting that the FY 2017 Internal Audit Plan be amended by removing the TxDMV Fund tables and Process & Handling Fees (TxDMV Fund) audit from the plan and adding the PCI Compliance with Credit Card audit.

The Texas Internal Auditing Act (Govt Code 2102.008) requires that the agency's governing board approve the annual audit plan. The TxDMV Board approved the FY 2017 Internal Audit Plan on September 1, 2016. Since the plan was approved, the Internal Audit Division (IAD) has identified an additional risk that requires a modification to the approved audit plan. Modifications to the audit plan require Board approval.

FINANCIAL IMPACT

None.

BACKGROUND AND DISCUSSION

The TxDMV Board approved the FY 2017 Internal Audit Plan on September 1, 2016. Since the plan was approved, the Internal Audit Division (IAD) has identified an additional risk that requires a modification to the approved audit plan. Specifically, the IAD identified a risk related to the department's PCI Compliance.

The TxDMV accepts customers' credit cards for Motor Carrier, Motor Vehicle, and some Vehicle Titles and Registration transactions. To be able to accept credit cards, the agency has to attest to the Payment Card Industry (PCI) Security Standards Council that the credit card information obtained from transactions are being safeguarded. Specifically, the agency has to attest in several annual Self-Assessment Questionnaire (SAQ) documents that credit card information is not being stored electronically as well as other requirements (e.g., access controls, maintaining a security policy). The SAQ documents provide assurance to the PCI Security Standards Council that the department is in compliance with PCI standards and the applicable PCI compliance levels. Since some credit card transactions are handled and processed by TxDMV employees, it is important that appropriate controls exist to ensure the department is meeting its PCI compliance requirements.

Based on information received from the Finance & Administrative Services Division, the TxDMV revenue projections for the TxDMV fund and the Process & Handling Fee are aligned with actual revenue received since September 1, 2016. For this reason, the IAD believes that the TxDMV Fund audit can be removed from the FY2017 Internal Audit Plan and be replaced with the PCI Compliance with Credit Card audit.



TxDMV Internal Audit Plan for Fiscal Year 2017 – Revised

Internal Audit Division

June 1, 2017

TxDMV Revised Internal Audit Plan for Fiscal Year 2017

Texas Department of Motor Vehicles Fiscal Year 2017 Internal Audit Plan		
Topic	Division	Background and Preliminary Objectives
Required Reports under the Texas Internal Auditing Act		
1. Fiscal Year 2016 Annual Internal Audit Report 35 hours	Agency-wide	<u>Background:</u> A summary of internal audit activities, including the status of the FY 2016 audit plan, non-audit services provided, and external audit services procured; and the FY 2017 audit plan. This report must be submitted before November 1 of each year to the Governor, the Legislative Budget Board, the State Auditor’s Office, the Sunset Advisory Commission, and the TxDMV Board and be posted on the agency’s website (Government Code, Section 2102.009).
2. Fiscal Year 2018 Internal Audit Plan 100 hours	Agency-wide	<u>Background:</u> The annual audit plan is prepared using risk assessment techniques to identify individual audits to be conducted during the year. The TxDMV Board must review and approve the annual audit plan (Government Code, Section 2102.005).
Audits and Advisory Services		
1. Oversize/Overweight Permitting 250 hours <i>Carry-over from Fiscal Year 2016 Internal Audit Plan</i>	Motor Carrier	<u>Background:</u> The TxDMV regulates oversize vehicles and loads on highways and bridges. In fiscal year 2014, the Oversize/Overweight Permits Section issued over 836,000 permits; responded to over 198,000 permit-related calls from customers, and collected more than \$178 million in fees. The agency uses the Texas Permitting and Routing Optimization System (TxPROS), an online permitting & mapping system, to allow customers to apply for and self-issue many permits. <u>Tentative Objectives:</u> (1) Determine whether the TxDMV issues Oversize/Overweight permits and collects the appropriate fees in accordance with laws and regulations (2) Determine whether the TxDMV validates, updates, and communicates route restriction information on a timely basis to ensure routes are safe for permitted Oversize/Overweight loads

Texas Department of Motor Vehicles Fiscal Year 2017 Internal Audit Plan		
Topic	Division	Background and Preliminary Objectives
<p>2. RTS Refactoring and Single Sticker Post-implementation Review 1400 hours</p> <p><i>Carry-over from Fiscal Year 2016 Internal Audit Plan</i></p>	Agency-wide	<p><u>Background:</u> Refactored RTS included COGNOS reports that replaced standard reports from legacy RTS and included updated ad hoc reporting capabilities. Staff and management use information from COGNOS reports to make strategic and operational decisions.</p> <p><u>Tentative Objectives:</u></p> <p>(1) Determine whether COGNOS reports provide management and staff with complete and accurate information from RTS</p> <p>(2) Determine whether COGNOS reports provide <i>at least</i> the same level of information or service as reports from the legacy RTS</p>
<p>3. TxDMV Fund tables and Process & Handling Fees 1150 hours</p>	FAS, ITS, VTR	<p><u>Background:</u> SB 1512 (84th Texas Legislature) re-created and re-directs revenue sources for the TxDMV fund starting September 1, 2016. HB 6 exempts the fund and its revenues from consolidation. The intent of the bill is to separate the fund from the General Revenue and State Highway funds, allowing the TxDMV to fund its operations.</p> <p>The TxDMV Board of Directors used its authority to adopt a P&H fee structure to fund agency operations during its June board meeting. The P&H fees are effective for motor vehicle registrations starting January 2017.</p> <p><u>Tentative Objectives:</u></p> <p>(1) Determine whether appropriate revenues, including registration fees, are deposited to the TxDMV fund appropriately</p> <p>(2) Determine whether appropriate amounts are transferred to counties per agency rule</p>
<p>3. PCI Compliance with Credit Card</p>	ITS	<p><u>Background:</u> The TxDMV accepts customers' credit cards for Motor Carrier, Motor Vehicle, and some Vehicle Titles and</p>

Texas Department of Motor Vehicles Fiscal Year 2017 Internal Audit Plan		
Topic	Division	Background and Preliminary Objectives
<p><u>Information Storage</u> 1150 hours</p>		<p><u>Registration transactions. To be able to accept credit cards, the agency has to attest to the Payment Card Industry (PCI) Security Standards Council that the credit card information obtained from transactions are being safeguarded. Specifically, the agency has to attest in several annual Self-Assessment Questionnaire (SAQ) documents that credit card information is not being stored electronically as well as other requirements (e.g., access controls, maintaining a security policy) to ensure compliance with PCI standards and the applicable PCI compliance level.</u></p> <p><u>Tentative Objective:</u> <u>To determine if credit card information is being stored electronically.</u></p>
<p>4. Continuous Monitoring of Vehicle Registration and Title Transactions 1000 hours <i>Advisory Project</i></p>	<p>VTR/ITS</p>	<p><u>Background:</u> Fiscal year 2016 had a number of suspicious and fraudulent registration and title transaction activities within the agency and through Tax-Assessor Collectors, including high visibility arrests related to alleged fraud. The agency employs 1 investigator to investigate suspected title fraud. Auditors would analyze registration and title transactions from the RTS on a scheduled basis to identify suspicious and possibly fraudulent transactions processed by the agency or Tax-Assessor Collectors. Refer suspicious and possible fraudulent transactions to VTR to investigate.</p>
<p>5. Management or Board Request 350 hours</p>	<p>TBD</p>	<p>Time has been allotted to management and commission for a special request or to review a new and emerging risk for the agency. If no request is received, one of the audits from the other possible project list will be conducted.</p>
Other Internal Audit Division Duties		

Texas Department of Motor Vehicles Fiscal Year 2017 Internal Audit Plan		
Topic	Division	Background and Preliminary Objectives
		<ul style="list-style-type: none"> • Coordinating with external auditors and reviewers (25 hours) • Investigating allegations of fraud, waste, and abuse that Internal Audit receives or that the State Auditor’s Office refers from its fraud hotline and advising on the Anti-Fraud, Waste, and Abuse Workgroup (300 hours) • Conducting an annual Quality Assurance and Improvement Program as required by auditing standards (75 hours) • Tracking and monitoring the status of prior-year audit recommendations (100 hours) • Advising the agency’s Governance Team and Executive Steering Committees (425 hours)
Total Budgeted Hours on Required Reports, Audits ,and Advisory Service:		4,285
Total Budgeted Hours on Other Internal Audit Division Duties:		925
Total Budgeted Hours:		5,210

Methodology

Scope

The Internal Audit Plan for Fiscal Year 2017 covers the period of September 1, 2016 to August 31, 2017.

Risk Assessment

The audit plan was developed using a risk-based methodology including input from Board members and senior management. Internal Audit also analyzed agency information to rank potential audit topics by risk, including contracting risk.

The State Auditor's Office (SAO) guidelines for the Internal Audit Plan for Fiscal Year 2016, request that internal audit indicate which projects in the audit plan address expenditure transfers, capital budget controls, contract management, and information technology risks. The proposed audits that address these topics are the following:

- ~~TxDMV Fund tables and Process & Handling Fees and~~ RTS Refactoring and Single Sticker Post-implementation Review will address information technology risks
- ~~TxDMV Fund tables and Process & Handling Fees will address expenditure transfers and capital budget controls~~
- ~~TxDMV Fund tables and Process & Handling Fees and My Plates Contract—if resources are available—will address contract management~~

Hour Analysis

Hours were calculated using historical data and auditor's judgement. Hours are an estimate and could be adjusted during the fiscal year.



TxDMV Internal Audit Plan for Fiscal Year 2017 – Revised

Internal Audit Division

June 1, 2017

TxDMV Revised Internal Audit Plan for Fiscal Year 2017

Texas Department of Motor Vehicles Fiscal Year 2017 Internal Audit Plan		
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2. Fiscal Year 2018 Internal Audit Plan 100 hours	Agency-wide	<u>Background:</u> The annual audit plan is prepared using risk assessment techniques to identify individual audits to be conducted during the year. The TxDMV Board must review and approve the annual audit plan (Government Code, Section 2102.005).
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<p>3. PCI Compliance with Credit Card Information Storage 1150 hours</p>	ITS	<p><u>Background:</u> The TxDMV accepts customers' credit cards for Motor Carrier, Motor Vehicle, and some Vehicle Titles and Registration transactions. To be able to accept credit cards, the agency has to attest to the Payment Card Industry (PCI) Security Standards Council that the credit card information obtained from transactions are being safeguarded. Specifically, the agency has to attest in several annual Self-Assessment Questionnaire (SAQ) documents that credit card information is not being stored electronically as well as other requirements (e.g., access controls, maintaining a security policy) to ensure compliance with PCI standards and the applicable PCI compliance level.</p> <p><u>Tentative Objective:</u></p> <p>To determine if credit card information is being stored electronically.</p>

Texas Department of Motor Vehicles Fiscal Year 2017 Internal Audit Plan		
Topic	Division	Background and Preliminary Objectives
<p>4. Continuous Monitoring of Vehicle Registration and Title Transactions 1000 hours <i>Advisory Project</i></p>	VTR/ITS	<p><u>Background:</u> Fiscal year 2016 had a number of suspicious and fraudulent registration and title transaction activities within the agency and through Tax-Assessor Collectors, including high visibility arrests related to alleged fraud. The agency employs 1 investigator to investigate suspected title fraud. Auditors would analyze registration and title transactions from the RTS on a scheduled basis to identify suspicious and possibly fraudulent transactions processed by the agency or Tax-Assessor Collectors. Refer suspicious and possible fraudulent transactions to VTR to investigate.</p>
<p>5. Management or Board Request 350 hours</p>	TBD	<p>Time has been allotted to management and commission for a special request or to review a new and emerging risk for the agency. If no request is received, one of the audits from the other possible project list will be conducted.</p>
Other Internal Audit Division Duties		
<ul style="list-style-type: none"> • Coordinating with external auditors and reviewers (25 hours) • Investigating allegations of fraud, waste, and abuse that Internal Audit receives or that the State Auditor’s Office refers from its fraud hotline and advising on the Anti-Fraud, Waste, and Abuse Workgroup (300 hours) • Conducting an annual Quality Assurance and Improvement Program as required by auditing standards (75 hours) • Tracking and monitoring the status of prior-year audit recommendations (100 hours) • Advising the agency’s Governance Team and Executive Steering Committees (425 hours) 		
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Methodology

Scope

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The audit plan was developed using a risk-based methodology including input from Board members and senior management. Internal Audit also analyzed agency information to rank potential audit topics by risk, including contracting risk.

The State Auditor's Office (SAO) guidelines for the Internal Audit Plan for Fiscal Year 2016, request that internal audit indicate which projects in the audit plan address expenditure transfers, capital budget controls, contract management, and information technology risks. The proposed audits that address these topics are the following:

- RTS Refactoring and Single Sticker Post-implementation Review will address information technology risks

Hour Analysis

Hours were calculated using historical data and auditor's judgement. Hours are an estimate and could be adjusted during the fiscal year.



DATE: June 1, 2016

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Caroline Love, Government & Strategic Communications Division Director
Agenda Item: 6
Subject: 85th Legislative Session Update

PURPOSE AND EXECUTIVE SUMMARY

Provide the Board an update on bills of interest being considered by the 85th Legislature. Provide a status of the legislation being considered related to the Texas Department of Motor Vehicles Board Recommendations to the 85th Legislature as adopted in November 2016.

BACKGROUND AND DISCUSSION

The briefing includes the status legislation impacting the department. Key dates for the legislative session are included as well. The Government and Strategic Communications Division will continue to provide updates on implementation efforts as well.



Texas Department *of* Motor Vehicles

HELPING TEXANS GO. HELPING TEXAS GROW.

85th Legislative Session Update

**Agenda Item 6.A. Update on TxDMV Board Recommendations to the
85th Legislature**

and

Agenda Item 6.B. General Overview of the 85th Legislature Outcomes

June 1, 2017

85th Legislative Session Update

The 85th Texas State Legislative Session began on January 10, 2017 which started the 140 day process for elected officials to consider changes to state statutes. While they adjourned Sine Die on May 29, 2017; the session does not truly conclude until 20 days later, during which time the Governor has the opportunity to sign legislation, allow legislation to become law without signature, or veto legislation. At the time this report was submitted, the session had not yet concluded and verbal remarks will include updates.

As outlined in previous meetings, the Texas Department of Motor Vehicles (TxDMV) Board is charged with considering opportunities to improve the operations of the department and recommending statutory changes to the Texas Legislature under Texas Transportation Code, Section 1001.025. TxDMV's Government and Strategic Communications Division worked with all the department's divisions and offices to identify statutory changes the board could recommend. Those changes were also evaluated by stakeholders.

The TxDMV Board adopted a set of legislative recommendations in November 2016. These recommendations were then presented to the Office of the Governor, Lt. Governor, and Speaker; as well as the chairs of the Senate and House Transportation Committees for further consideration during the session. An update on those recommendations is included in this report, as well as a listing of legislation passing with an impact on department operations and activities.

A. Update on TxDMV Board Recommendations to the 85th Legislature

In relation to the TxDMV Board recommendations, the following legislation was filed with status noted:

- I. **Registration Code Changes: SB 2075 by Rodriguez/HB 2461 by Pickett**
 - Status: SB 2075 Recommended for House Local and Consent Calendar
 - Summary: SB 2075 was passed by the Senate on April 26, and subsequently passed by the House Transportation Committee with a recommendation for

consideration on the Local and Consent Calendar. The legislation includes several clean up items, as well as further defining when a county tax assessor-collector office's transactions can be performed by a different county to allow for continuity of services for customers. This recommendation also includes language allowing for printed receipts from online vehicle registration renewal transactions to serve as proof of registration for 30 days (to allow the actual sticker time to be received through the mail). There are also changes resulting from an internal audit recommendation associated with when counties remit registration fees to the state to align the statute with when fees are processed by the system currently and adjust the time frames accordingly.

II. Permanent Token Trailer Registration: HB 2433 by Pickett

- Status: Placed on General State Calendar 5/10/17, never considered
- Summary: This legislation was voted favorably from the House Transportation Committee on April 28 and subsequently placed on the House General State Calendar May 10 but was not brought up before the May 11 deadline for further consideration on the House Floor. This recommendation was also made to the 84th Legislature and would have allowed for a permanent token trailer license plate option with a change to the associated registration fee. The current annual registration option remained available to customers under this legislation.

III. Motor Carrier Registration & Enforcement Changes: HB 3254 by Phillips (Senate Sponsor: Nichols)

- Status: Voted favorably from the Senate Transportation Committee on May 17 and recommended for the Senate Local and Uncontested Calendar
- Summary: This legislation passed out of the House May 9 on the Local and Consent Calendar and continued to work its way favorably through the Senate process. The legislation includes many of the recommendations from the 84th Legislative Session to promote greater efficiency and safety of the motoring public in TxDMV operations as it relates to the motor carrier industry and regulation of the industry. The language covers enforcement of chameleon carriers (i.e., a carrier who changes names or operates under various aliases to continue operations without remedying previous penalties or sanctions, often related to

safety), provisions related to renewals and re-application of registration for motor carriers; a requirement for household goods movers to file all tariffs (i.e., what the mover charges a consumer) with the TxDMV rather than just the current requirement of only tariffs for moves between municipalities; and other clarifications.

IV. Title Act Changes: SB 2076 by Sen. Rodriguez/HB 2462 by Pickett

- Status: SB 2076 Placed on the House General State Calendar 5/19/17
- Summary: SB 2076 was voted out of the Senate on April 27, then voted favorably from the House Transportation Committee May 11. The legislation changes statute to allow the “Certified Copy of Original Title” (CCO) to serve as the only valid proof of ownership and other various clarifications in statute. This also includes a new recommendations changing statute to reference and conform to the appropriate Code of Federal Regulations regarding odometer disclosure statement requirements.

V. Lemon Law: HB 2070 by Smithee (Senate Sponsor: Watson)

- Status: Voted from Senate Business & Commerce 5/19/17 to the Local & Uncontested Calendar
- Summary: HB 2070 passed out of the House May 4 and was voted favorably from the Senate Business & Commerce Committee May 19 with a recommendation to be placed on the Local & Uncontested Calendar. The legislation provides some statutory clarifications; as well and simplify a vehicle’s qualifications for Lemon Law status. HB 2070 will help Texas statutes reflect practices adopted in other states.

VI. Seized Disabled Parking Placard Process/HB 1790 by Pickett (Senate Sponsor: Rodriguez)

- Status: Sent to the Governor 5/8/17
- Summary: HB 1790 was voted from the House April 27, then subsequently from the Senate on May 12. The bill clarifies TxDMV’s role when disabled parking placards are seized by law enforcement and removes outdated practices.

VII. Vehicle Size & Weight Administrative Changes: HB 3255 by Phillips

- Status: Voted favorably from House Transportation 4/28/17

- Summary: While HB 3255 was voted favorably from the House Transportation Committee on April 28, it was never placed on a House Calendar for further consideration. The legislation pursued several recommendations from the 84th Legislative Session clarifying the responsibilities of shippers and that the department can deny an oversize/overweight (OS/OW) permit if the carrier is “out-of-service” for safety reasons with the Federal Motor Carrier Administration.
 - The recommendation also included language to streamline the OS/OW permitting process and provide revenues to cover the costs associated with the operation of the program through depositing 10% each OS/OW permit fee to the TxDMV Fund. This provision would have applied only to those OS/OW permits established by the 86th Legislature or after as it was voted out of the House Transportation Committee; or if the Legislature designates otherwise.

VIII. Size & Weight Vehicle Specific Changes/HB 1789 by Pickett

- Status: Placed on General State Calendar 5/10/17, never considered
- Summary: HB 1789 was voted favorably from the House Transportation Committee on April 20; then placed on the House General State Calendar for May 10 but was not heard before the May 11 deadline. This legislation would have conformed Texas statutes with federal laws after passage of the recent Fixing America’s Surface Transportation (FAST) Act as it relates to several motor vehicle size and weight limitations.

IX. Notification to Demolish Vehicle Process Changes/HB 3131 by Martinez (Senate Sponsor: Rodriguez)

- Status: Voted from Senate Business & Commerce 5/19/17 to the Local & Uncontested Calendar
- Summary: HB 3131 was voted out of the House May 6, then subsequently voted from the Senate Business & Commerce Committee May 19 with a recommendation it be placed on the Local & Uncontested Calendar. This legislation removes a redundant requirement that the department must send notice to an applicant who has been identified as the owner of a vehicle. The

recommendation and legislation was based upon feedback from the industry and stakeholders.

X. TxDMV Own/Control Real Property: SB 1349 by Watson/HB 3689 by Pickett

- Status: SB 1349 Passed the House 5/19/17
- Summary: SB 1349 was voted out of the Senate April 20, then subsequently voted favorably from the House Transportation Committee May 11 and recommended for the House Local & Consent Calendar May 19. The department continued to work closely with the Office of the Governor and the Texas Department of Transportation (TxDOT) to identify a solution for housing TxDMV headquarters operations. The legislation allows TxDMV to accept property from TxDOT, and for TxDMV to maintain, improve and have control over such property. The transfer from TxDOT would apply only to the Camp Hubbard location in Austin, where TxDMV headquarters is currently housed.

B. General Overview of the 85th Legislature Outcomes

Several other pieces of legislation passed by the 85th Legislature will have an impact on TxDMV operations. (NOTE: At the time of submission, the session had not concluded and some of this legislation may not have passed both chambers.) These include, but are not limited to:

- HB 561 by Murphy allows for the use of small utility vehicles by delivery and logistics companies in residential communities to provide for more efficient package delivery services. This bill amends current law relating to the operation of certain vehicles used for package delivery and authorizes a \$25 license plate fee for such small utility vehicles.
- HB 1247 by Pickett seeks to address notification requirements applicable to a vehicle storage facility in possession of an impounded vehicle registered in another state. This bill requires a vehicle storage facility operator to send the notice to an address obtained from the applicable governmental or private entity that has access to the relevant vehicle information and by providing for the circumstances under which the operator may provide notice by publication.

- HB 1693 by Dean would allow for vehicle title transfer documentation to be processed either electronically or by paper. The legislation also references the appropriate federal regulations regarding odometer disclosure statements, which is also reflected in SB 2076 by Rodriguez, a TxDMV Board recommended item.
- HB 1959 by Thompson requires the department to conduct a study that identifies and assesses alternative procedures for commercial vehicle registration, licensing, and permitting. In addition it authorizes TxDMV to collaborate with another state agency or a research division of an institution of higher education in Texas to conduct the study.
- HB 2663 by Pickett allows for counties to issue a replacement vehicle registration sticker without a fee if it is determined by the county that the renewed sticker was not received by the customer in the mail, either through an online or mail-in renewal transaction.
- HB 4102 by Neave provides an opportunity for individuals to voluntarily contribute to a grant program at the time of vehicle registration to help fund the testing of evidence collected in relation to sexual assaults or other sex offenses and authorizes voluntary contributions by the Texas Department of Public Safety.
- SB 1251 by West provides an opportunity for individuals to voluntarily contribute to the Ending Homelessness Fund at the time of vehicle registration.
- SB 1524 by Nichols provides for overweight shipment of sealed containers from production facilities proximate to the ports of entry. The legislation creates a permit authorizing the movement of a sealed intermodal shipping container moving in international transportation not more than 30 miles from an applicable port of entry. The \$6,000 permit fee is distributed to the State Highway Fund and local entities to compensate for road damage, including 4% (\$240) of every permit being deposited to the TxDMV Fund to cover the costs of issuing the program.
- SB 1001 by Larry Taylor allows for trailers up to 7,500 lbs gross vehicle weight rating to be exempt from state safety inspection requirements. This is an increase from 4,500 lbs gross vehicle weight rating and will require programming updates.
- SB 2205 by Hancock seeks to ensure safe operation of automated motor vehicles and automated driving systems on Texas roads. The bill implements minimum

safety requirements for the operation of these vehicles and systems without any additional regulatory structures at the state or local levels.

In addition, 11 pieces of legislation are poised to be passed by the 85th Legislature at the time of submission of this report that would create 44 new specialty license plates. Of those, seven bills relate to special military plates creating 40 such new plates. The remaining four plates relate to new “Back the Blue”, State of Texas Award recipients, Blessed are the Peacemakers, and justices of the peace specialty license plates.

85th Legislature Key Dates

Some key dates occurring during the 85th Legislative Session include:

- Tuesday, Jan. 10, 2017: 1st Day of the 85th Legislative Session
- Friday, Mar. 10, 2017: 60th Day, last day to file general bills
- Monday, May 29, 2017: 140th day, the last day of session
- Sunday, Jun. 18, 2017: 20th day following final adjournment, the last day the Governor can sign, allow a bill to go into law without signature, or veto bills
- Monday, Aug. 28, 2017: 91st day following final adjournment and the date in which bills without specific effective dates become law

The Government and Strategic Communications Division will continue to provide regular updates on legislative implementation efforts.



DATE: June 1, 2017

Action Requested: Briefing

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Judy Sandberg, Enterprise Project Management Office Director
Agenda Item: 7
Subject: Enterprise Projects Update

RECOMMENDATION

This is a briefing only and no decisions or actions are requested.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of this briefing is to provide an update on enterprise projects. The report includes:

- A portfolio trend dashboard to show the combined health of all projects (the portfolio)
- A dashboard for each active project
- A list of closed projects
- Timeline for planning portfolio for fiscal years (FY) 18/19
- Glossary
- Definitions for dashboard indicator colors.

FINANCIAL IMPACT

As shown on the Portfolio Trend dashboard, all active projects are within budget and are on target to end within budget.

BACKGROUND AND DISCUSSION

Since January 2016, the following projects were completed and closed by the executive Governance Team:

1. Centralized Accounting and Payroll/Personnel System (CAPPS) Human Resources (HR) Project
2. Consolidated Call Center Project
3. County Equipment Refresh Project
4. FileNet Project
5. Licensing, Administration, Consumer Affairs, and Enforcement (LACE) Replacement (eLICENSING) Project
6. Physical Security Project
7. Registration & Title System (RTS) Name Parsing Project
8. Regional Office Telecommunications Project
9. Single Sticker Phase II Project.

The following projects are on schedule and within budget:

1. Application Migration Server Infrastructure Transformation (AMSIT) to end by 8/31/2017
2. webDealer to end by 04/30/2018
3. Refactored RTS to end by 12/31/2018.

Planning for new projects for fiscal years (FY) 2018/2019 is in progress. The FY18/19 Portfolio Schedule is scheduled for decision at the June 26, 2017 Governance Team meeting.

Enterprise Projects Update

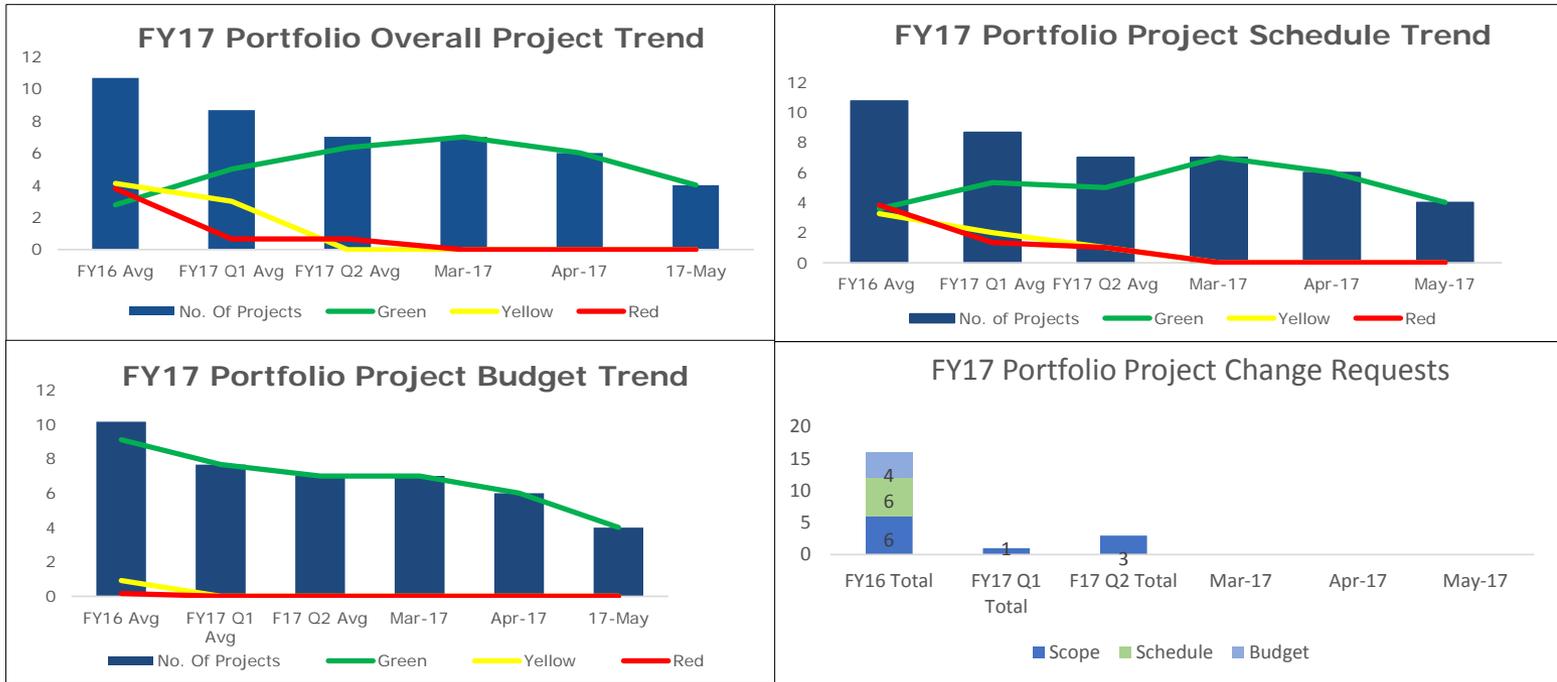
June 1, 2017

Board Meeting Presentation





TXDMV Portfolio Trend



Project Dashboards





RTS Refactoring	Benefits to Public	Benefits to Agency
<p>RTS Refactoring will refresh the RTS technology by modernizing the core RTS system and provide business intelligence reporting capabilities.</p> <p>Project Manager – T. Beckley Business Owner – J. Kuntz Executive Sponsor– W. Brewster</p>	<ul style="list-style-type: none"> Improved customer service (system modernization provides opportunities for increased efficiency when implementing improvements). 	<ul style="list-style-type: none"> Modernization of the RTS system. Business intelligence reporting capabilities. Transitions RTS from TxDOT to the TxDMV infrastructure.

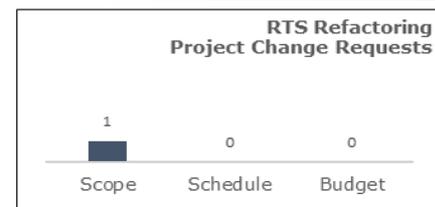
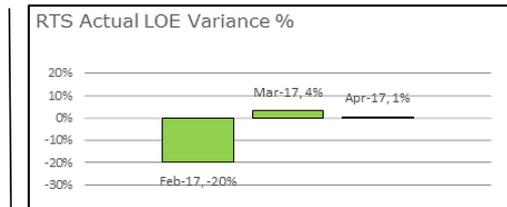
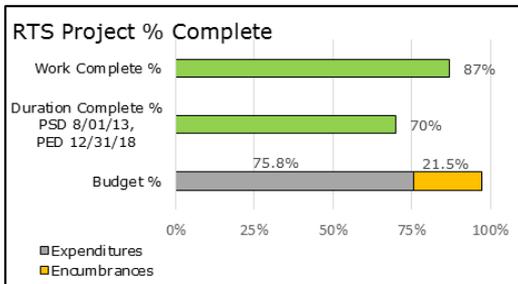
RTS Refactoring Budget
<p>Source: Automation</p> <p>Total External Budget: \$62,020,840</p> <p>Expenditures: \$46,981,037</p> <p>Encumbrances: \$13,148,952</p> <p>Budget Remaining: \$1,890,851</p>

May 2017 Status

Overall	Schedule	Budget	Scope	Risk
G	G	G	G	Y

December 2016 to April 2017 Trend Line

	WS2+	WS4- 8.9.0	WS4- 8.10.0	WS4- 9.0
Req	✓	✓	✓	G
Design	✓	✓	✓	
Devel	✓	✓	Y	
Test	✓	✓		
Deploy	✓	✓		



Accomplishments – Last 30 Days
<ul style="list-style-type: none"> Deployed release 8.9 on 4/23/2017. Continuing development on release 8.10. Requirements gathering has commenced on release 9.0.
Milestones – Next 30 Days
<ul style="list-style-type: none"> Continue development for release 8.10. Continue requirements gathering for Release 9.0.

Risk/Issues	Mitigation/Corrective Action
<p>I₁ - Middle Tier Migration (MTM) Virtual Private Network (VPN) tunnel was not available on 5/1/17 impacting the 8.10 release schedule.</p> <p>R₁ - Legislative mandates requiring a September 1, 2017 or January 1, 2018 implementation date may impact the planned RTS release schedule, which will also impact the webDEALER schedule.</p>	<p>I₁ - Working with Texas.gov and DCS to come up with a plan to get the VPN tunnel in place.</p> <p>R₁ - Monitor legislative activities and communicate any changes impacting project schedule to other projects and coordinate changes appropriately.</p>

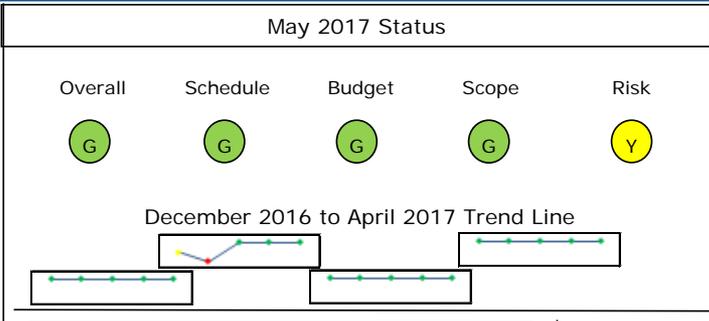
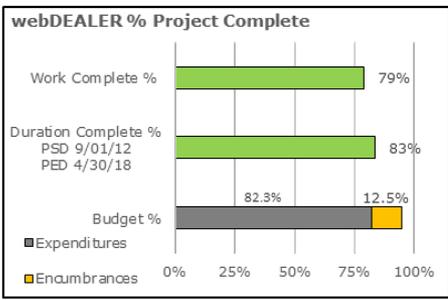
WS4 Release Schedule



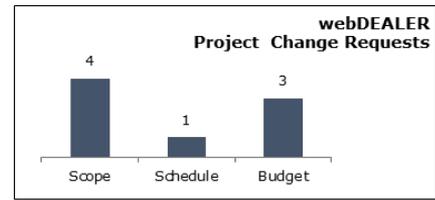
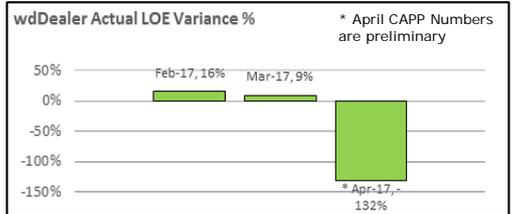
webDEALER	Benefits to Public	Benefits to Agency
webDEALER allows a vehicle title to be created, stored and transferred in electronic form, improving the accuracy of the titling process. Project Manager – G. Wessels Business Owner – T. Thompson Executive Sponsor – J. Kuntz	<ul style="list-style-type: none"> Reduced costs for titling and registration services from motor vehicle sales. Improved titling and registration time by reducing manual processes. 	<ul style="list-style-type: none"> Reduced costs for the county tax office and TxDMV to title and register vehicles. Improved system to track and manage registration and title services from Motor Vehicle Sales. Eliminates RSPS-DTA Processes.

webDEALER Budget

Source: Automation
 Total External Budget: \$6,257,079
 Expenditures: \$5,146,922
 Encumbrances: \$781,867
 Budget Remaining: \$328,290



	New Car Used Car	CFB Adopt Sal	WD DMV Fund	WD P&H Fee	eTags	CP	eTitles
Req	✓	✓	✓	✓	✓	✓	✓
Design	✓	✓	✓	✓	✓	G	G
Devel	✓	✓	✓	✓	✓		
Test	✓	✓	✓	✓			
Deploy	✓	✓	✓	✓			



Accomplishments – Last 30 Days

- Completed Server Architecture Design and Placed Request For Service (RFS)
- Completed eTAG Development.

Milestones– Last 30 Days

- Design and begin procurement process.
- Started Centralized Payment (CP) Design.
- Continue CP and eTAG RTS Release 9.0 coordination.

webDealer Release Schedule

Risk/Issues

R₁ – WD, AMSIT and RTS Project Schedules, Resource Sharing and Operational needs may impact the SDLC Milestone Project Schedule.

R₂ – eTag release may cause an issue with the DB2 server due to the additional load, which may delay the Nov 2017 Release.

R₃ – Legislative mandates requiring a September 1, 2017 or January 1, 2018 implementation date may impact the webDEALER Release Schedules.

Mitigation/Corrective Action

R₁ – eTAG/C/P Release – Closely manage critical resource plan allocations vs. actual detailed efforts to the WBS between AMSIT and WD Projects.
 eTitles Release – Starting early review of high level design requirements. Compare WBS/LOE to previous estimate and reconcile as appropriate.

R₂ –Conduct DB2 Architectural Design Review. Perform LAST on DB2 prior to Nov 2017 Release.

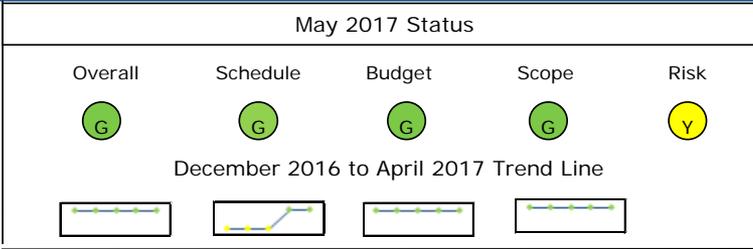
R₃ – Monitor legislative activities and communicate any changes impacting webDEALER Release Schedules to webDEALER ESC.



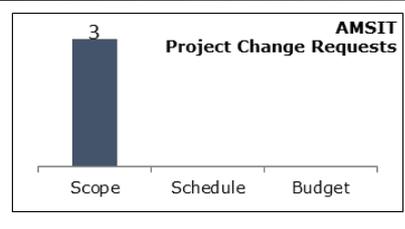
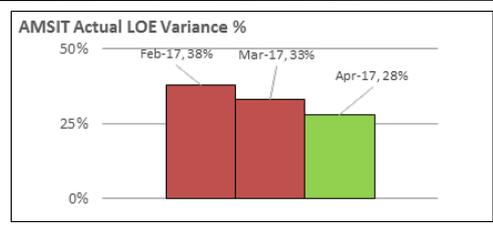
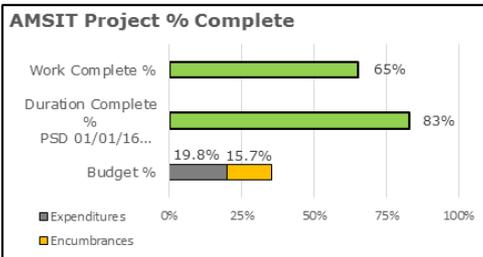
AMSIT	Benefits to Public	Benefits to Agency
<p>AMSIT plans and implements the separation of TxDMV applications and related IT infrastructure components from TxDOT.</p> <p>Project Manager – R. Abdeladim Business Owner – T. Benavides Executive Sponsor – E. Obermier</p>	<ul style="list-style-type: none"> Improved agility to meet customers' needs with system autonomy. Improved service quality with stabilized environment. 	<ul style="list-style-type: none"> Streamlined support processes and enhanced automation. Improved information security. Compliance with state mandates related to Data Center transformation.

AMSIT Budget

Source: Capital
Total External Budget: \$7,353,955
Expenditures: \$1,453,873
Encumbrances: \$1,156,740
Budget Remaining: \$4,743,342



Initiating	✓
Planning	✓
Executing	G
Closing	



- Accomplishments – Last 30 Day**
- Completed NSOC circuit configuration.
 - Completed NSOC call center discovery.
 - Completed strategy for 11 WebSub counties.
 - Communications executed for WebSub & WebDealer for ForgeRock.

- Milestones – Next 30 Days**
- Complete WebSub go Live 6-12-17.
 - Complete WebDealer UAT.
 - Complete delta copies at Austin Data Center.
 - FTP to SFTP resource onboard.
 - Complete move of call center.

- Risk/Issues**
- R₁ – Overall project schedule at risk for completion by 8/31/17 due to multiple threads of activity occurring in parallel and the remaining effort to be completed.
- R₂ – Overall project schedule is at risk for completion by 08/31/17 due to contention for resources for the ForgeRock effort.
- R₃ – Novell to Windows, there is the risk that unknown items will continue to be identified.
- R₄ – NTT resource for FTP to SFTP has resigned placing script update and migration activity at risk as well as the schedule for completion.

- Mitigation/Corrective Action**
- R₁ Risk level is lowered based on vendor activity. Continue to monitor closely.
- R₂ – Risk is being closely monitored on an daily basis.
- R₃ – Impacted business users will be notified of files/data that cannot be migrated. Files on the shared drive are non-mission critical. The Leadership and ESC will be notified.
- R₄ – NTT is actively seeking a replacement resource.



FY 2017 Closed Projects

- Governance Team Meeting October 20, 2016
 - FileNet Project
- Governance Team Meeting December 21, 2016
 - CAPPs HR Project
- Governance Team Meeting March 27, 2017
 - LACE Replacement Project (effective 03/31/17)
- Governance Team Meeting April 24, 2017
 - Single Sticker Phase II
 - Facility Physical Security
- Governance Team Meeting May 22, 2017
 - County Equipment Refresh Project



Timeline for FY18/19 Portfolio of Projects

Date	Status	Action
5.1.2017	Done	Portfolio governance process shared with Executive Team.
5.16.2017	Done	TxDMV executive project champions provide project "idea" forms to EPMO.
5.29.2017	Done	Sine Die – Texas legislative session ends. <i>(Indicates which project "ideas" got funded.)</i>
6.16.2017	On Target	EPMO uses project "idea" information to draft portfolio schedule for Governance Team (GT) consideration.
6.18.2017		Last day Governor can sign or veto bills. <i>(Confirms which project "ideas" got funded.)</i>
6.26.2017		GT members are asked to adopt, amend, or reject the proposed Portfolio Schedule for FY18/19.
9.1.2017		Start date for FY18/19 portfolio. Begin reporting to TxDMV Board.
8.31.2019		End date for FY18/19 Portfolio.



Glossary

API – Application Programming Interface
 AMSIT – Application Migration Server Infrastructure Transformation
 BA – Business Analyst
 BAFO – Best and Final Offer
 BRD - Business Requirements Document
 C³ – Consolidated Call Center
 CA - Corrective Action
 CCB - Courtesy Callback
 DCS – Data Center Services
 CAPPs - Centralized Accounting and Payroll/Personnel System
 CERP – County Equipment Refresh Program
 CIO - Chief Information Officer
 CPO - Chief Projects Officer
 CPA - Comptroller of Public Accounts
 CPU – Central Processing Unit
 CRD – Consumer Relations Division
 DB2 – IBM Database Server Products
 DCS – Data Center Services
 DEV Development
 DIR - Department of Information Resources
 DPS - Department of Public Safety
 DTA – Dealer Title Application
 ENF - Enforcement
 EPMO - Enterprise Project Management Office
 ERQ – Enterprise Reporting Quarter
 ESC – Executive Steering Committee
 FAQ – Frequently Asked Questions
 FTE – Full Time Equivalent
 G – Green (Status)
 GT – Governance Team
 HB – House Bill
 HEB - Howard E Butt Grocery Stores
 HR – Human Resources
 I – issue
 IAM – Identity and Access Management
 IT – Information Technology
 ITSD – Information Technology Services Division
 Jama - Product management software developed By Jama S/W Co.
 JIRA – Issue Tracking Software developed By Atlassian
 LACE - Licensing, Administration, Consumer Affairs, and Enforcement
 LAST - Load and Stress Testing
 LPAR – Logical Partition

M – Migration
 M - Mitigation
 MCD – Motor Carrier Division
 M/CA – Migration/Corrective Action
 MS - Mitigation Strategy
 NIM – Nice Information Management
 NSOC - Network Security Operations Center
 MVD – Motor Carrier Division
 OAG - Office of Attorney General
 OOS – Out of State
 P&H – Process and Handling
 PCR – Project Change Request
 PED – Project End Date
 PM - Project Manager
 PMLC - Project Management Life Cycle
 PMP - Project Management Professional
 PO – Purchase Order
 POCN - Purchase Order Change Notice
 RQAT - Quality Assurance Team
 PSD – Project Start Date
 R – Red (Status)
 R – Risk
 R/I – Risk/Issue
 R/T - Registration and Title
 RFO – Request For Offer
 RO – Regional Office
 RSPS – Remote Sticker Printing System
 RRTS - Refactored RTS
 RSC – Regional Service Center
 RTS - Registration & Title System
 QAT – Quality Assurance Team
 QTR – Quarter
 SIT – System Integration Test
 SAT - System Acceptance Testing
 SCC – Salvage Common Checkout
 SDLC - Systems Development Life Cycle
 SDLC – Software Development Life Cycle
 SMS – Security Management System
 SOP – Standard Operating Procedures

SOW – Statement of Work
 SS PII - Single Sticker Phase II
 TAC – Tax Assessor Collector
 TCEQ - Texas Commission on Environmental Quality
 TPDF - Texas Project Delivery Framework
 TS - Registration and Titling System
 TxIRP – Texas International Registration Plan
 TxDOT – Texas Department of Transportation
 UAT - User Acceptance Testing
 VTR – Vehicle Title and Registration Division
 WD - webDEALER
 WFM – Work Force Management
 WS – Work Stream
 WS2+ – Work Stream 2+
 WS4 – Work Stream 4
 Y – Yellow (Status)



Project Category Dashboard Indicators

Category	Blue (Closed Projects) 	Green 	Yellow 	Red 
Budget	Cost Variance (Budget to Spend ratio) is 0% or less, i.e. does not exceed authorized budget	Cost variance is trending to 0% or less.	Cost variance is trending to exceed authorized budget by 1 to 14% by project end date	Cost variance is trending to exceed authorized budget by 15% or more by project end date
Schedule	Duration variance is 0% or less and project finished by/before project end date	Project is on schedule to end by approved end date (Schedule Variance is 0% or less)	Project Schedule is behind by 1-2 weeks and/or risk to project end date is low to medium.	Project Schedule is behind by 2 weeks or more and/or risk to project end date is high.
Scope	Chartered scope is delivered, no more, no less unless project change management was applied through governance	Project is on target to deliver chartered scope, no more, no less or project change management was applied through governance	Chartered scope is at medium risk of not being fully delivered by end date or unmanaged scope creep is evident	Chartered scope is at high risk of not being fully delivered by end date or unmanaged scope creep is causing overruns on cost, schedule, and/or LOE
Resources	Actual Level of Effort (LOE) variance is +/-10% of planned LOE.	Actual Level of Effort (LOE) variance is =/< 14.9% of planned LOE.	Actual Level of Effort (LOE) variance is >15% but < 19.9 % of planned LOE.	Actual Level of Effort (LOE) variance is > 20% of planned LOE
<i>Negative LOE can mean resources are not available as planned</i>				
Risks / Issues (Severity = Probability x Impact)	All Risks/Issues are Mitigated/Addressed or transferred to new owner in closeout report	All risks/issues are severity level low and have mitigation strategies/corrective action plans and owners.	1 or more Risks/Issues related to cost, schedule, or scope has a medium severity level	1 or more Risks/Issues related to cost, schedule, or scope has a high severity level
Overall	All other categories are blue	Budget, Scope and Schedule are green	Budget or Schedule or Scope is yellow	Budget or Schedule or Scope are red



DATE: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Jeremiah Kuntz, Vehicle Titles and Registration Division
Agenda Item: 8. A., B., and C.
Subject: Specialty Plate Design

RECOMMENDATION

The Vehicle Titles and Registration Division seeks board approval or denial of the proposed vendor and non-vendor plate designs submitted for consideration.

PURPOSE AND EXECUTIVE SUMMARY

Statutory authority for the board to approve non-vendor specialty plates is in Transportation Code, Section 504.801. Statutory authority for the board to approve vendor specialty license plates and invite the public’s comment on proposed vendor plate designs is in Texas Transportation Code, Section(s) 504.851 (g) and (g-1) (1). The board’s approval criteria is clarified in Administrative Code(s), §217.45, *Specialty License Plates, Symbols, Tabs, and Other Devices*, and §217.52, *Marketing of Specialty License Plates through a Private Vendor*.

The renewed vendor contract specifies (paragraph #11, *Inventory Management Controls*) that following the board’s contingent approval of a plate, the vendor must get at least 200 commitments within six months of the approval in order for the plate to be produced. (Equally, existing plates must maintain 200 registered in order to stay in the program.) My Plates’ procedure is to first offer a plate to the public to register their interest. Following the board’s contingent approval, My Plates then offers a plate online for prepaid orders. My Plates confirms when 200 prepaid orders are achieved. (Since the contract with My Plates was renewed in March 2014, the board has contingently approved 17 vendor plates. Of the 17, six did not achieve the required 200 commitments and were not produced.)

TxDMV’s procedure is to invite comments on all proposed plates ahead of the board’s review. The department’s intent is to determine if any unforeseen public concerns about a plate’s design exist. The department publishes a 10-day “like/dislike/comment-by-email” survey, called an eView, on its website. Although the survey counts the public’s “likes” and “dislikes,” it is unscientific and not used as an indicator of a plate’s popularity. The vendor’s OU plate received thousands of eView “dislikes” in 2010 (presumably because of college football rivalry) and has since sold over 1,000 plates.

Three eViews, each with one plate, were presented to the public. The public’s comments are summarized below.

FEBRUARY 2017 eView

Eastern Star:
 No negative comments were received; 690 people liked this design, and 158 did not.



APRIL 2017 eView

Redesigned – University of Texas Longhorn Tower:
 Six negative comments were received; 303 people liked this design, and 242 did not.



MAY 2017 eView

Porsche Club of America:
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Date: June 1, 2017

Action Requested: Decision & Order

To: The Texas Department of Motor Vehicles (TxDMV) Board**From: Daniel Avitia, Motor Vehicle Division****Agenda Item: 9****Subject: *Bates Nissan, Inc., Protestant v. Nissan North America, Inc., Respondent;*
MVD Docket Nos. 14-0010.LIC and 15-0013.LIC; SOAH Docket No. 608-14-3211.LIC**

PURPOSE AND EXECUTIVE SUMMARY

The State Office of Administrative Hearings (SOAH) issued the attached Proposal for Decision (PFD) for consideration by the Texas Department of Motor Vehicles Board.

FINANCIAL IMPACT

None to TxDMV

BACKGROUND AND DISCUSSION

On December 23, 2013, Nissan North America (Nissan) provided to Bates Nissan (Bates) notice of its decision to terminate the franchise. Bates protested the proposed termination on February 18, 2014. On December 9, 2014, Nissan provided supplemental notice of termination to Bates. Bates protested the supplemental termination on January 20, 2015.

The Motor Vehicle Division (MVD) referred the contested case matters to SOAH on April 17, 2014. The administrative law judge (ALJ) conducted the hearing on the merits September 15 through September 24, 2015; closed the administrative record February 8, 2016; and issued the PFD on April 8, 2016.

The ALJ found that Nissan failed to establish good cause for termination of its franchise with the Bates dealership and recommended the Board deny the proposed franchise termination. On May 10, 2016, Nissan filed Exceptions to the PFD. On June 8, 2016, Bates filed a Reply in response to Nissan's Exceptions.

On August 18, 2016, the ALJ issued an exceptions letter, providing that the ALJ was making no changes to the PFD. SOAH returned this contested case matter to the TxDMV. The Board now has jurisdiction to consider the contested case and to enter a final Order.

The issue presented in this case is whether Nissan established—by a preponderance of the evidence¹—that there is good cause for termination of its franchise with Bates, in accordance with Texas Occupations Code §2301.455.

¹ Tex. Occ. Code §2301.453(g) requires the Board to determine whether the party seeking the termination has established by a preponderance of the evidence that there is good cause for the proposed termination. Black's Law Dictionary defines "preponderance of the evidence" to mean the greater weight of the evidence; superior evidentiary weight that, though not sufficient to free the mind wholly from all reasonable doubt, is still sufficient to include a fair and impartial mind to one side of the issue rather than the other. This is the burden of proof in a civil trial, in which the jury is instructed to find for the party that, on the whole, has the stronger evidence, however slight the edge may be.

In determining whether Nissan demonstrated good cause for termination, the Board shall consider all existing circumstances, including the following statutory factors.

1. **FACTOR 1: Dealer's Sales in Relation to the Sales in the Market** (PFD pp. 24-26)
The ALJ decided this factor in favor of Bates. After consideration of the evidence and arguments presented by the parties at the hearing, the ALJ concluded that this factor does not support good cause for termination when Bates' sales are considered on the basis of Bates' Primary Market Area. However, the ALJ concluded that if a broader definition of the market is considered, then this factor would weigh in favor of termination due to Bates' poor sales performance.
2. **FACTOR 2: Dealer's Investment and Obligations** (PFD pp. 26-28)
The ALJ decided this factor in favor of Bates. After consideration of the evidence and arguments presented by the parties at the hearing, the ALJ found that because Bates has no other franchises and sells no other vehicle makes, it would cease to exist as a new car dealership and suffer loss of goodwill of approximately \$5.9 million.
3. **FACTOR 3: Injury or Benefit to the Public** (PFD pp. 28 - 29)
The ALJ decided this factor in favor of Bates, concluding that a franchise termination would have a slightly negative impact on the public.
4. **FACTOR 4: Adequacy of the Dealer's Service Facilities, Equipment, Parts, and Personnel in Relation to those of Other Dealers of New Motor Vehicles of the Same Line-Make** (PFD pp. 30 - 31)
The ALJ decided the totality of this factor is neutral and does not support termination.
5. **FACTOR 5: Whether Warranties are Being Honored by the Dealer** (PFD pp. 31)
The ALJ decided that this factor is neutral and does not impact the good cause analysis.
6. **FACTOR 6: Parties' Compliance with the Franchise, Except to the Extent that the Franchise Conflicts with Occupations Code Chapter 2301** (PFD pp. 31 - 33)
The ALJ decided that the evidence does not demonstrate a material breach of the Dealer Agreement by either party, that this is a neutral factor, and does not impact the good cause analysis.
 - A. Nissan argued that Bates was not in compliance with the Dealer Agreement, because:
 - Bates failed to vigorously and aggressively promote the sale of Nissan vehicles; and
 - Bates submitted false or fraudulent information to Nissan and to the IRS relating to vehicle valuations for tax purposes.
 The ALJ decided that Bates did not breach the Dealer Agreement with regard to these two allegations.
 - B. Nissan asserted that Bates violated the dealer agreement by changing its ownership management without prior approval and by making material misrepresentations concerning ownership or management.
The ALJ noted that Nissan did not bring these allegations in either Notice of Termination and did not address the issue in significant detail in its post-hearing closing brief. The ALJ acknowledges that Bates held a special meeting in January 2014, that Jimmy Bates assigned company stock to Bobby Bates changing the ownership interest of both gentlemen, and that the dealership elected new officers.
The ALJ believes that the precise order in which Bates should have taken steps could be an arguable issue (i.e., whether Bates should have notified Nissan of its intentions before the corporate meeting). The ALJ noted that Bates did inform Nissan and sought Nissan's approval of its conduct. The ALJ decided that Bates' actions—in modifying its ownership and management without Nissan's prior approval—do not rise to the level of a contractual violation or a misrepresentation by Bates and do not serve as a ground for termination of the Dealer Agreement.
7. **FACTOR 7: Enforceability of the Franchise from a Public Policy Standpoint, Including Issues of the Reasonableness of the Franchise's Terms, Oppression, Adhesion, and the Parties' Relative Bargaining Power** (PFD pp. 33)
The ALJ decided that this factor is neutral with regard to the good cause analysis, because:
 - Neither party argued this factor in any detail; and
 - There do not appear to be any public policy issues related to the enforceability of the franchise.

Board Authority

Tex. Occ. Code Chapter 2301 provides the Board authority over these parties and the decision in this contested case matter.

- A. **Tex. Occ. Code §2301.453** establishes requirements for a manufacturer's termination of its franchise with a franchised dealership.
- **Tex. Occ. Code §2301.453(c)&(d)** provide requirements for a manufacturer's *notice* of termination of its franchise with a franchised dealership.
 - **Tex. Occ. Code §2301.453(e)** provides requirements for a dealership's *protest* of a manufacturer's notice of termination.
 - **Tex. Occ. Code §2301.453(g)** establishes that the burden of proof is on the manufacturer to establish by a preponderance of the evidence that there is good cause for the termination of the franchise with the dealership.
- B. **Tex. Occ. Code §2301.455** provides factors the Board must consider when determining whether Nissan established good cause for the proposed franchise termination.
- C. **Tex. Occ. Code §2301.711** requires an order of the Board:
1. to include a separate finding of fact for each of the specific issues in Tex. Occ. Code §2301.455; and
 2. to set forth additional findings of fact and conclusions of law on which the order is based.
- D. **Tex. Gov't Code §2001.058(e)** allows the Board to change a finding of fact or conclusion of law made by the ALJ only if the Board determines:
1. that the ALJ did not properly apply or interpret applicable law, agency rules, or prior administrative decisions;
 2. that a prior administrative decision on which the ALJ relied is incorrect or should be changed; or
 3. that a technical error in a finding of fact should be changed.
- The Board shall state, in writing, the ***specific reason*** and ***legal basis*** for a change made under this subsection.

SOAH ALJ's Recommendations

The SOAH ALJ found that Nissan did not meet its burden of proof (preponderance of the evidence) to show good cause for termination of its franchise with Bates. The ALJ recommended the Board deny Nissan's proposed termination. A draft final order is attached to this Executive Summary for the Board's consideration.

Documents

The following documents are attached to this Executive Summary for consideration by the Board:

- | | |
|---|------------|
| 1. Proposed Draft Final Order | |
| 2. SOAH ALJ's Proposal for Decision | 04/08/2016 |
| 3. Nissan's Exceptions to the Proposal for Decision | 05/10/2016 |
| 4. Bates' Reply to Nissan's Exceptions to the Proposal for Decision | 06/08/2016 |
| 5. SOAH ALJ's Exceptions Letter | 08/10/2016 |

**TEXAS DEPARTMENT OF MOTOR VEHICLES
MOTOR VEHICLE DIVISION**

<p>BATES NISSAN, INC., Protestant</p>	<p>§ § § § § § §</p>	<p>MVD DOCKET NO. 14-0010 LIC MVD DOCKET NO. 15-0013 LIC DOCKET NO. 608-14-3211.LIC</p>
<p>v.</p> <p>NISSAN NORTH AMERICA, INC., Respondent</p>		

FINAL ORDER

The referenced contested case matter is before the Board of the Texas Department of Motor Vehicles (TxDMV) in the form of a Proposal for Decision (PFD) from the State Office of Administrative Hearings (SOAH) and involves Nissan North America, Inc.’s (Nissan) proposed termination of Bates Nissan, Inc. (Bates).

The Board enters this final Order, having considered the evidence, arguments, findings of fact, and conclusions of law presented in:

1. The Administrative Law Judge’s April 8, 2016, Proposal for Decision (PFD);
2. Nissan’s May 10, 2016, Exceptions to the PFD;
3. Bates’ June 8, 2016, Replies to the Exceptions to the PFD; and
4. The ALJ’s August 10, 2016, exceptions letter that makes no changes to the ALJ’s April 8, 2016, PFD.

ACCORDINGLY, IT IS ORDERED:

1. That findings of fact numbers 1-125 and conclusions of law numbers 1-14, as set out in the ALJ’s April 8, 2016, PFD, are hereby adopted;
2. That Nissan’s proposed termination against Bates is denied;
3. That Bates’ protest of the proposed termination is granted because Nissan failed to establish good cause for the termination of its franchise agreement with Bates;
4. That any findings of fact or conclusions of law proposed by the parties that are not adopted in this Order are hereby rejected; and
5. That all remaining motions, exceptions, or objections, of any party, if any, are hereby denied.

Date: June 01, 2017

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

ATTESTED:

Daniel Avitia, Director
Motor Vehicle Division
Texas Department of Motor Vehicles

State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

April 8, 2016

Daniel Avitia, Director
Motor Vehicle Division
Texas Department of Motor Vehicles
4000 Jackson Avenue
Austin, TX 78731

VIA INTERAGENCY MAIL

RE: **Docket No. 608-14-3211.LIC; MVD Docket No. 14-0010-LIC and 15-0013.LIC; Bates Nissan, Inc. v. Nissan North America Inc.**

Dear Mr. Avitia:

Please find enclosed a Proposal for Decision (PFD) in this case. It contains my recommendation and underlying rationale. This case involved confidential information. I have tried to ensure that the PFD does not include any confidential information. If the parties determine that some portions of the PFD include confidential information, they may request to have such redacted. If such a motion is filed, I will notify your office and make any necessary arrangements to redact confidential information inadvertently disclosed.

Exceptions and replies may be filed by any party in accordance with 1 Tex. Admin. Code § 155.507(c), a SOAH rule which may be found at www.soah.state.tx.us.

Sincerely,

A handwritten signature in black ink, appearing to read "Craig R. Bennett".

Craig R. Bennett
Administrative Law Judge

CRB/ept
Enclosure

cc: William David Coffey III, Attorney at Law, Coffey & Alaniz PLLC, 13810 FM 1826, Austin, TX 78737 - **VIA REGULAR MAIL**
Billy M. Donley, Attorney, Baker & Hostetler L.L.P., 811 Main Street, Ste. 1100, Houston, TX 77002 - **VIA REGULAR MAIL**
David R. Jarrett, Attorney, Baker & Hostetler L.L.P., 811 Main Street, Ste. 1100, Houston, TX 77002- **VIA REGULAR MAIL**
Alice Carmona, Docket Clerk, Texas Department of Motor Vehicles, 4000 Jackson Avenue, Austin, Texas 78731 - **VIA INTERAGENCY MAIL** (with 12 Boxes -Certified Evidentiary Record; 1 Envelope-Transcript)

SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

<p>BATES NISSAN, INC., Complainant</p> <p>v.</p> <p>NISSAN NORTH AMERICA, INC., Respondent</p>	§ § § § § § § §	<p>BEFORE THE STATE OFFICE</p> <p>OF</p> <p>ADMINISTRATIVE HEARINGS</p>
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TABLE OF CONTENTS

I.	PROCEDURAL HISTORY, JURISDICTION, AND NOTICE.....	1
II.	STATUTORY FRAMEWORK.....	2
III.	BACKGROUND AND SUMMARY OF THE CASE.....	3
IV.	DISCUSSION.....	5
A.	Threshold Issue – the Relevant Time Period	6
B.	NNA’s Notices of Termination	8
1.	Notice of Termination (December 23, 2013).....	8
a.	The RSE Methodology.....	8
b.	Bates’ Sales Performance Under RSE	10
c.	ALJ’s Analysis of RSE.....	12
2.	Supplemental Notice of Termination (December 9, 2014)	17
C.	Statutory Good Cause Factors	24
1.	Bates’ Sales in Relation to the Sales in the Market.....	24
2.	Bates’ Investment and Obligations	26
3.	Injury or Benefit to the Public.....	28
4.	The Adequacy of Bates’ Service Facilities, Equipment, Parts, and Personnel in Relation to Those of Other Dealers of New Motor Vehicles of the Same Line-Make.....	30
5.	Whether Warranties are Being Honored by the Dealer.....	31
6.	The Parties’ Compliance with the Franchise	31

7. **The Enforceability of the Franchise from a Public Policy
 Standpoint, Including Issues of the Reasonableness of the
 Franchise’s Terms, Oppression, Adhesion, and the Parties’
 Relative Bargaining Power..... 33**

 D. **Conclusion 33**

V. **FINDINGS OF FACT..... 34**

VI. **CONCLUSIONS OF LAW..... 46**

**SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC**

BATES NISSAN, INC., Complainant	§ § § § § § §	BEFORE THE STATE OFFICE
v.		OF
NISSAN NORTH AMERICA, INC., Respondent		ADMINISTRATIVE HEARINGS

PROPOSAL FOR DECISION

Bates Nissan, Inc. (Bates), a franchised dealership, filed a protest with the Texas Department of Motor Vehicles (Department or Board)¹ regarding the decision by Nissan North America, Inc. (NNA) to terminate its dealership agreement with Bates. After considering the evidence and arguments presented, the Administrative Law Judge (ALJ) finds that NNA has failed to establish sufficient good cause for termination of the dealership franchise. Therefore, the ALJ recommends that the termination request be denied.

I. PROCEDURAL HISTORY, JURISDICTION, AND NOTICE

On April 17, 2014, the Department referred this case to the State Office of Administrative Hearings (SOAH) for a contested case hearing. The parties jointly requested that the hearing be continued from its original setting, and the evidentiary hearing eventually commenced on September 15, 2015, before ALJ Craig R. Bennett in Austin, Texas, with all parties appearing and participating. The hearing continued day-to-day thereafter and concluded on September 24, 2015. The record closed on February 8, 2016, after the parties submitted written closing arguments. Except as to Bates’ argument that NNA’s supplemental notice of termination should not be considered, the parties did not raise notice or jurisdictional challenges and those matters are addressed in the findings of fact and conclusions of law without discussion here.

¹ The applicable statutes reference the “board” which, for purposes herein, is the Department and its governing board. Tex. Occ. Code § 2301.002(2) and 2301.005(a). The terms Board and Department are used interchangeably.

II. STATUTORY FRAMEWORK

Chapter 2301 of the Texas Occupations Code (hereinafter, that chapter is simply referred to as “the Code”) provides the regulatory framework for this case. Under the Code, the Department has statutory authority to regulate franchise relationships between dealers and motor vehicle manufacturers. Among other things, the Code contains limits on a manufacturer’s ability to terminate its franchise agreements with its dealerships,² requiring that any protested termination must first be approved by the Department. Specifically, the Code provides:

2301.453. TERMINATION OR DISCONTINUANCE OF FRANCHISE.

(a) Notwithstanding the terms of any franchise, a manufacturer, distributor, or representative may not terminate or discontinue a franchise with a franchised dealer or directly or indirectly force or attempt to force a franchised dealer to relocate or discontinue a line-make or parts or products related to that line-make unless the manufacturer, distributor, or representative provides notice of the termination or discontinuance as required by Subsection (c) and:

- (1) the manufacturer, distributor, or representative receives the dealer's informed written consent;
- (2) the appropriate time for the dealer to file a protest under Subsection (e) has expired; or
- (3) the board makes a determination of good cause under Subsection (g).

In determining whether to approve a franchise termination after a protest has been filed, the Department must determine whether the manufacturer, distributor, or representative has established by a preponderance of the evidence that there is good cause for the proposed termination.³ In determining good cause, the Department is mandated to consider all “existing circumstances,” including:

- (1) the dealer’s sales in relation to the sales in the market;
- (2) the dealer’s investment and obligations;

² Code § 2301.453.

³ Code § 2301.453(g).

SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

PROPOSAL FOR DECISION

PAGE 3

- (3) injury or benefit to the public;
- (4) the adequacy of the dealer's service facilities, equipment, parts, and personnel in relation to those of other dealers of new motor vehicles of the same line-make;
- (5) whether warranties are being honored by the dealer;
- (6) the parties' compliance with the franchise, except to the extent that the franchise conflicts with this chapter; and
- (7) the enforceability of the franchise from a public policy standpoint, including issues of the reasonableness of the franchise's terms, oppression, adhesion, and the parties' relative bargaining power.⁴

A desire for market penetration, standing alone, does not establish good cause for termination of a dealer's franchise.⁵ If a dealer files a timely protest, then the Department is required to notify the manufacturer, a hearing must be held, and the manufacturer may not terminate the franchise until the Department issues a final decision finding good cause for the termination.⁶

III. BACKGROUND AND SUMMARY OF THE CASE

Bates is a franchised dealer for Nissan motor vehicles in Killeen, Texas. Bates is the only dealership for Nissan in the greater Killeen area. The next closest Nissan franchise is in Temple, Texas. Bates has been a franchised dealer for Nissan (or Datsun, its predecessor company) for more than 40 years. Currently, the parties are operating under a 1989 Dealer Sales and Service Agreement and subsequent incorporated amendments/addendums (collectively, these are referred to as the "Dealer Agreement").⁷

⁴ Code § 2301.455(a).

⁵ Code § 2301.455(b).

⁶ Code § 2301.453(a)(3), (f)(3).

⁷ The terms of the Dealer Agreement are in the record at Bates Exs. C-16 through C-22.

On December 23, 2013, NNA provided notice to Bates that it intended to terminate the Dealer Agreement and discontinue allowing Bates to sell Nissan vehicles.⁸ Bates filed a protest with the Department, and the Department referred this matter to SOAH for a contested case hearing. On December 9, 2014, NNA provided Bates with a Supplemental Notice of Termination, providing additional grounds for termination of the Dealer Agreement.⁹ The two notices of termination were assigned separate Department docket numbers, but were joined together in this docket for a single hearing and Proposal for Decision (PFD).¹⁰

NNA has two primary grounds for requesting to terminate the Dealer Agreement. First, NNA argues that Bates' sales performance has lagged and is below the required standards for NNA's dealerships. Second, NNA argues that Bates submitted false information to NNA and the United States Internal Revenue Service (IRS) regarding the value of its vehicles, resulting in its sales performance being inaccurately reported to NNA. After considering all of the evidence, the ALJ finds that neither of NNA's proposed grounds for termination provides the requisite good cause for termination.

While it is true that Bates' sales have not met NNA's dealer metrics, those metrics are not consistent with Bates' obligations under the Dealer Agreement. Specifically, under the Dealer Agreement, Bates was tasked with selling into its Primary Market Area (PMA). Bates has done this roughly as well as half of NNA's Texas dealers, particularly those geographically closest to it. Where Bates fails is in regard to capturing sales outside of its PMA. But the Dealer Agreement contains no obligations for Bates outside of its PMA. Rather, those obligations exist as a result of NNA's sales evaluation metric that incorporates sales both inside and outside a PMA. While NNA's evaluation metric may be a legitimate measurement tool in a broader sense, what it measures has not been adequately incorporated into Bates' obligations in the Dealer Agreement. Thus, it should not serve as a basis for terminating Bates' franchise. Namely, the "obligations" language of the Dealer Agreement differs from what NNA's metric generally

⁸ Bates Ex. C-33.

⁹ Bates Ex. C-34.

¹⁰ See Order No. 9 in this case (Mar. 23, 2015).

measures. Thus, even if the metric is incorporated as a measurement tool,¹¹ Bates' failure to meet the metric's expectations does not equate to a failure to meet its obligations under the Dealer Agreement. Therefore, the ALJ finds that the evidence does not establish that Bates breached its sales obligations under the Dealer Agreement.

Furthermore, the ALJ does not find that Bates' tax and sales reporting to NNA and the IRS have been fraudulent. While they do appear to have been based upon an erroneous and aggressive accounting approach designed to minimize taxes, there was no actual fraud by Bates or intent to provide false data. When the practice was shown to be erroneous, Bates filed the necessary paperwork with the IRS and agreed to pay back taxes and penalties. The IRS has taken no enforcement action against Bates. After considering the language of the Dealer Agreement, the ALJ does not find that Bates' past accounting and reporting practices constituted a breach of Bates' obligations under that agreement, nor do they provide a separate good cause ground for termination of the Dealer Agreement.

After considering NNA's reasons for termination, as well as the good cause factors set out by statute, the ALJ concludes there is not sufficient demonstrated good cause for terminating the Dealer Agreement.

IV. DISCUSSION

Between its notices of termination, NNA provided two distinct bases for termination of the Dealer Agreement, both of which relate to Bates' alleged violation of the franchise agreement. In Texas, though, the legislature has established the specific factors to be considered when determining whether a franchise termination should be allowed. So, while NNA's reasons for termination are relevant, they are not dispositive. Rather, NNA's reasons must be analyzed

¹¹ Section 3.B of the Dealer Agreement identifies examples of evaluation methods that NNA may use to measure Bates' performance of its sales obligations. NNA's own expert, Sharif Farhat, testified in his deposition that the measurement tool actually used by NNA does not fall within any of the examples identified in Section 3.B. Bates Ex. C-354 at 84-88. Thus, it is not an evaluation method specifically identified in the Dealer Agreement. Ultimately, even if it is permissible as an evaluation method, it is not reasonably designed to measure Bates' identified sales obligations in Section 3.A and, thus, does not establish a violation of such sales obligations.

in the context of the statutory factors. For purposes of discussion, though, the ALJ first addresses NNA's reasons for termination separately. Then, the ALJ discusses the statutory factors.¹² The analyses of these matters are set out below, starting first with a threshold inquiry: What is the relevant time period to consider?

A. Threshold Issue – the Relevant Time Period

In evaluating whether good cause exists for termination of the franchise, the parties disagree on the relevant period to consider. Bates argues that the relevant time period runs from the first notice of default issued by NNA to Bates in 2010 through the close of the evidentiary hearing in September 2015. Bates notes that the statute requires that the Board determine whether there "is" good cause for the termination, not whether there "was" good cause at some point in the past. Therefore, Bates argues that all relevant information up through the hearing should be considered by the Board in making its determination.

In contrast, NNA argues that only the time periods prior to the notices of termination should be considered. NNA asserts that it has to make a termination decision based on the information known to it at the time it issues its notice of termination, and it would be unfair to evaluate its termination decision based on information not available to it at the time it makes the decision. NNA argues that it is untenable to have a constantly moving time period. Rather, there must be a defined period in which to consider the dealership's actions and performance. NNA contends that the most appropriate time period is that leading up to the point the manufacturer makes the decision to terminate.

Ultimately, the ALJ concludes that the Board should make its determination based on all of the evidence in the record, and this includes any information that bears upon the dealership's performance at any time, including after the notice of termination has issued. The Board is not tasked with reviewing the reasonableness of NNA's decision, but simply whether good cause

¹² Some of the statutory factors obviously overlap with NNA's proffered reasons for termination; in those instances, the more detailed discussion is contained in the section addressing NNA's proffered reasons for termination.

exists for termination. The statute does not set out a specific time period to consider, but requires the Board to consider “all *existing* circumstances.”¹³ Given this language, the ALJ does not find the inquiry is limited to the information available to NNA or to the time period prior to the notice of termination. Rather, the inquiry should include all information available to the Board at the time it makes a final decision.

However, because the APA requires that findings of fact be based upon evidence in the record or matters officially noticed,¹⁴ the close of the evidentiary record serves as the natural end point for the relevant time period. Thus, the Board can take into account all available information from the evidentiary record when making its decision, giving the Board a better factual basis from which to make a decision. This comports with the language “all existing circumstances” found in the statute. At the same time, it also provides a defined “end point” to the inquiry—with such end point being the close of the evidentiary record.

In considering all relevant information, though, the ALJ does not believe that more recent performance information is necessarily entitled to more weight. Instead, it is simply additional information for the Board to consider when evaluating all circumstances. That a dealership may have improved its performance and met standards after being given notice of intended termination should not excuse many years of past poor performance by the dealership. While the Board may consider such improved performance, such consideration would not necessarily preclude good cause for termination or modification of the franchise. Rather, all existing circumstances should be considered—and those existing circumstances include the dealership’s sales and service history before any recent performance improvements. Therefore, the ALJ makes his recommendation based upon all of the existing information and circumstances as demonstrated in the evidentiary record.

Now, the ALJ turns to NNA’s proffered reasons for termination and the statutory factors to be analyzed.

¹³ Tex. Occ. Code § 2301.455(a) (emphasis added).

¹⁴ Tex. Gov’t Code § 2001.141(c).

B. NNA's Notices of Termination**1. Notice of Termination (December 23, 2013)**

In its first Notice of Termination (NOT), NNA advised Bates that it was terminating the Dealer Agreement because of “unsatisfactory sales performance” by Bates.¹⁵ NNA based its termination on Section 3.A of the Dealer Agreement, which sets out the general obligations of the dealer. Of specific relevance, the section provides:

Dealer shall actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and, if Dealer elects, the leasing and rental) of Nissan Vehicles to customers located within Dealer's Primary Market Area (the “Sales Obligation”). Dealer's Primary Market Area is a geographic area which Seller uses as a tool to evaluate Dealer's performance of its obligations hereunder¹⁶

NNA claims that Bates failed to meet this obligation under the Dealer Agreement, as demonstrated by its poor performance in NNA's sales metric tool, Regional Sales Effectiveness (RSE). To understand NNA's argument, it is important to understand NNA's RSE methodology.

a. The RSE Methodology

RSE measures a dealer's “sales effectiveness” within its region. Bates is within NNA's Central Region, which includes 14 states. An RSE score of 100% means that a dealer is capturing the exact amount of sales it is expected to capture, based on the region average. If the RSE expectation for that dealer is 1,000 new vehicle sales, and the dealer sells 1,000 vehicles, then it will be at 100% of RSE. To come up with an RSE measurement for a dealer, there are a number of steps required, which are set out below.

¹⁵ Bates Ex. C-33 at 2.

¹⁶ Bates Ex. C-17 at 4.

First, NNA determines the overall sales penetration of its dealers within the region.¹⁷ If Nissan dealers are obtaining 15% of all competitive sales within the region, then 15% is the target factor applied to a dealer's PMA. So, if the dealer's PMA yields a total of 1,000 competitive sales in a given time period, the dealer would be expected to capture 15% of those sales, or 150 vehicles. If the dealer sold 150 vehicles, then its RSE score would be 100%. If it sold only 75 vehicles, then its RSE score would be 50%.

In determining the number of vehicles sold by a dealer for purposes of RSE, NNA looks not only at vehicles sold in the PMA, but also considers all vehicles sold by the dealer—whether within or outside of the PMA. If a dealer has an RSE target of 150 vehicles in its PMA, and sold 75 vehicles in its PMA and another 75 vehicles outside of its PMA, its total sales of 150 vehicles give it an RSE score of 100%. So, the RSE methodology gives credit for sales outside a dealer's PMA, though the RSE target is based only on the competitive sales available in the PMA. NNA argues that this is a conservative methodology because it holds a dealer to an expected sales amount only within its PMA, but gives credit to the dealer for sales no matter where they occur.¹⁸

It might appear that RSE is a “zero-sum game,” in that if one or more dealers perform above the average, there must be at least one dealer below the average. However, this is not true. Not all geographic areas have been assigned to PMAs, and there are unassigned areas from which a dealer may draw sales. The RSE methodology factors in all areas, including unassigned areas, in determining the overall regional average for dealers. But, in setting a specific dealership's sales goal, only that dealer's PMA is considered. A simple example from the hearing demonstrates this:

¹⁷ The RSE is determined by segment, so there are actually different target RSE numbers for each market segment (such as small cars, light trucks, etc.). However, for simplicity, the ALJ describes the RSE methodology generally here, without reference to the individual market segments.

¹⁸ NNA has subsequently changed from the RSE methodology and now uses a new methodology—the State Sales Effectiveness Represented (SSER) method. Bates' performance under the SSER methodology is not directly in issue in this case.

A region has 1,000 competitive registrations, broken down into five equal territories, each with 200 registrations. Four of the territories are assigned to dealers, but one is unassigned. If the four dealers combined sell 100 vehicles total, the regional average sales penetration is 10% (100 sold divided by 1,000 available in the region). Each dealer would then be expected to have obtained 10% of the registrations available in their own PMA to be at 100% RSE. Because each PMA has 200 registrations available in it, each dealer would have to have sold 20 vehicles to be at 100% RSE. If the four dealers respectively sold 25, 30, 25, and 20 vehicles, then each dealer is at or above 100% RSE, even though three of the dealers were above the average (by selling more than 20 vehicles).¹⁹

This example demonstrates that all dealers can theoretically meet 100% RSE at the same time and it is not simply a zero-sum game whereby one dealer above average necessitates another dealer being below average. The availability of sales into unassigned areas makes it possible for all dealers to achieve 100% RSE.²⁰

b. Bates' Sales Performance Under RSE

It is undisputed that Bates' performance on its RSE scores between 2007 and 2013 was poor.²¹ The following chart demonstrates Bates' cumulative RSE scores for that time period:

Year	Bates' Calendar Year RSE Percentage
2007	87.1%
2008	74.5%
2009	81.0%
2010	85.2%
2011	90.0%
2012	79.8%
2013	75% ²²

¹⁹ Tr. Vol. 6 at 1565-1566 (paraphrased).

²⁰ It is true, though, that an increase in sales by one dealer, with all other things being unchanged, would raise the overall average sales penetration for the region, thus raising the target RSE average for every other dealer. But such an impact by any single dealer would be quite small and would not make it impossible for other dealers to still achieve the RSE target.

²¹ Bates disagrees with the RSE methodology as a proper measure of its sales effectiveness, but no one disputes that Bates' scores on the RSE did not meet the target goals during most of the time period in issue.

To meet NNA's sales expectations, Bates should have been at 100% of RSE for each year. At no point during that time period was Bates at 100% of RSE. In addition to failing to meet its RSE targets, Bates was also near the bottom of all of NNA's Texas dealers in RSE percentage, ranking from 52nd to 60th (out of 63 dealers) in the 2007-2012 time period, and then 63rd (out of 66 dealers) as of January 2013.²³ Overall, Bates was the lowest-scoring dealer in Texas, based on cumulative RSE percentage, for the time period 2009 through September 2013.²⁴ Beginning in 2010, NNA started providing Bates with a Notice of Deficiency each six months, advising that Bates was below RSE and needed to raise its sales or risk termination of the Dealer Agreement. NNA provided six opportunities for Bates to improve its performance before eventually providing the NOT to Bates in December 2013. In sum, this evidence conclusively demonstrates that Bates was not meeting NNA's sales goals and was performing poorly on the RSE even in relation to other NNA dealers in Texas.

However, Bates' performance did dramatically improve, beginning right before Nissan issued the NOT to it in December 2013. In November 2013, Bates hired Kevin Adams as a new sales manager.²⁵ In September 2013, immediately prior to hiring Mr. Adams, Bates had been at 70.5% RSE. After his hiring, Bates went to 96.7% RSE in November 2013, and then to 125% RSE in December 2013, the same month the NOT was issued. For the rolling 12-month period ending in November 2014, Bates' RSE score was 102.2%.²⁶ Similarly, between September 2014 and June 2015, Bates continued to be above 100% RSE on a rolling average.²⁷ Bates argues that this improved performance, which began before the NOT was issued, cured any deficiencies in its prior performance and should prevent the franchise from being terminated.

²² See Bates Exs. C-33, C-35. The 2013 RSE number is only through September 2013, not through year-end.

²³ Bates Ex. C-41 at 2.

²⁴ Tr. Vol. 7 at 1674; NNA Ex. R-361 at A-15.

²⁵ Prior to hiring Mr. Adams, Bates' general sales manager was Eric Morris. Mr. Morris initially improved Bates' RSE score into the 90% range, but the RSE scores declined again after he was diagnosed with pancreatic cancer in 2012. Bates elected to allow Mr. Morris to remain in his position, despite the fact that he often missed work due to cancer treatments. Mr. Morris died in 2014. See Bates Ex. C-338-1 at 53-55; Tr. Vol. 1 at 76-77.

²⁶ Bates Exs. C-231, C-365; See also Bates Ex. C-367.

²⁷ Bates Ex. C-365. As noted previously, RSE scores are no longer used, and NNA measures its dealers by SSER now. However, for purposes of this proceeding, the parties calculated Bates' performance using the RSE methodology even after the SSER methodology was adopted by NNA.

c. **ALJ's Analysis of RSE**

Bates challenges the reasonableness of NNA's RSE methodology and offers numerous explanations for why its sales effectiveness did not meet NNA's RSE expectations. The ALJ finds it unnecessary to address most of these. Specifically, it is not necessary to evaluate NNA's RSE methodology in detail, Bates' excuses for its poor RSE performance, or NNA's explanations for why it believes Bates performed poorly by the RSE methodology. Although the ALJ generally finds RSE to be a reasonable tool to measure and compare NNA's dealers in regard to their sales, and concludes that Bates did perform poorly by RSE standards up until November 2013, the RSE is not a useful tool for measuring Bates' performance under its contractual obligations for reasons explained below.

Although NNA's RSE tool uses a dealer's PMA as the basis of its target, the regional sales average is based on all sales (both in and outside dealers' PMAs) and the RSE method allows dealers to achieve their RSE goals by sales outside of their PMA. The evidence shows that this is what a majority of Nissan dealers in Texas do. They use non-PMA sales to reach their RSE goals (or at least have a better RSE score, even if they still fall short of 100% RSE). From NNA's standpoint this is fine because, in essence, a sale is a sale. But, from the standpoint of the Dealer Agreement, this misses the crux of Bates' obligations under the agreement. Further, using an RSE goal that is based on data that includes dealers' sales outside of their PMAs means the RSE target is not really tied to sales within PMAs.

As noted previously, the Dealer Agreement imposes obligations on Bates only in regard to its own PMA. Specifically, Section 3.A requires Bates to "actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and, if Dealer elects, the leasing and rental) of Nissan Vehicles to *customers located within Dealer's Primary Market Area*" (the "*Sales Obligation*").²⁸ The Dealer Agreement goes on to state that "Dealer's Primary Market Area is a geographic area which Seller uses as a tool to evaluate Dealer's performance of its obligations hereunder." Thus, Bates' obligations under the Dealer Agreement

²⁸ Bates Ex. C-17 at BN000047 (emphasis added).

are only to customers in its own PMA. While NNA might like Bates to pick up more sales regardless of where they come from, the Dealer Agreement requires only that Bates focus on customers in its own PMA. The evidence shows that Bates has done this as well as at least half of the Nissan dealers in Texas.

From a measurement standpoint, a Nissan dealer's sales will come from both inside and outside of its PMA. NNA argues that all sales of a dealer are essentially within its PMA because the sale occurs in the PMA at the dealership location. Accordingly, NNA dismisses many of Bates' arguments regarding the distinction of sales within and outside of a PMA. The ALJ disagrees with NNA's contention and believes that the distinction made by Bates is valid. First, in this age of internet sales, it is not clear that all sales transactions actually are deemed to occur at the dealership. To support such a broad contention, NNA must present persuasive evidence of this and it has not done so. It is certainly possible that an individual outside of a PMA could purchase a vehicle via internet and email communications without ever coming to the dealership to close the sale. If the dealership then delivers the vehicle to the customer and obtains payment upon delivery, that sale arguably occurs at the customer's location and not the dealership.

Moreover, NNA's argument makes little sense in light of the contractual language obligating Bates to actively and effectively promote the sale of Nissan vehicles "to customers located within Dealer's [PMA]." Clearly, the contractual obligation focuses on the geographic area where potential customers are located, not simply where a completed sale occurs. NNA appears to recognize this distinction because it does track the registration location of the vehicles, and uses the competitive registrations in the PMA as the basis for calculating the denominator in the RSE formula.

As noted by NNA, registrations in the PMA are not necessarily the best measure of available sales in a PMA because the "available customers" in a PMA include not only people residing in the PMA, but also those who spend a significant amount of time in the PMA (for work or school, for example) but who live outside of it. While it is true that potential customers may spend a lot of time within a PMA (because of work obligations for example) but reside

outside of the PMA, NNA's evidence does not measure this with precision. Rather, NNA tracks the location of registrations. In the absence of more finely-detailed evidence, the vehicle's registration location is the best way to determine whether the sale occurs inside the PMA and, consequentially, the number of competitive registrations inside the PMA.²⁹ So, in measuring Bates' performance of its obligations under the Dealer Agreement, the ALJ believes the focus must be on Bates' sales in its PMA, as that is the best available measure of Bates' effectiveness at fulfilling its contractual obligation of promoting the sale of Nissan Vehicles "to customers located within Dealer's [PMA]."³⁰

A large number of Nissan dealers in Texas are effective at obtaining sales outside of their PMAs. In contrast, Bates is poor at this. But, when looking solely at the effectiveness of Nissan dealers in their own PMAs, Bates' performance is not as poor. In 2012 and 2013, Bates obtained approximately 71% of all new retail Nissan car and light truck sales in its PMA.³¹ This measures how effective a Nissan dealer is at capturing the sales of its own brand in its PMA, not its effectiveness at taking sales away from non-Nissan dealers. So, it is a measure of how well a Nissan dealer protects its PMA from other Nissan dealers outside the PMA. In contrast, the Texas average was approximately 58% for Nissan dealers, meaning that the "average" Nissan dealer in Texas lost 42% of the Nissan sales in its PMA to other Nissan dealers. By capturing 71% of Nissan sales in its PMA, Bates lost only 29% of Nissan sales to other Nissan dealers

²⁹ The "commuter" factor complicates the analysis of a dealer's effectiveness. For example, a commuter living in Austin but working in Killeen could be positively influenced by Bates' advertising to consider purchasing a Nissan vehicle, but might pursue the purchase at a dealership in Austin on a weekend when the commuter had free time, rather than during the workweek while in Killeen. In such a scenario, it could be argued that Bates had been effective in promoting the sale of Nissan vehicles to a customer located in its PMA, even though Bates never got the sale and the vehicle was registered outside the PMA.

³⁰ In its briefing, NNA cites to *Ralph Gentile, Inc. v. State Div. of Hearings & Appeals*, 800 N.W.2d 555 (Wisc.App. 2011) for the proposition that the Dealer Agreement allows for consideration of all sales, and not just sales within a PMA. The ALJ finds the *Gentile* case cited by NNA to be distinguishable for a number of reasons. First, the applicable statutory standards in Wisconsin are different than in Texas. Second, the court in the *Gentile* case generally found substantial evidence to support the Division's decision, not that the decision was required as a matter of law. Third, the decision was primarily based upon the dealership's clear pattern of diminishing sales year after year, and not based simply on a failure to meet a sales metric that included sales outside the PMA. Finally, the evidence in that case also showed that the dealer's sales in its own PMA were very poor compared to other dealers' sales in their PMAs. See *Gentile*, 800 N.W.2d at 563-64.

³¹ Bates Ex. C-1 at 15 and Tab 11.

outside its PMA. Bates' effectiveness at holding a high number of Nissan sales in its PMA put it in the top one-third to one-half of all Nissan dealers in Texas.

More importantly, if one looks at Bates' performance in its PMA in regard to all competitive sales (and not just sales of Nissan vehicles), it does not fare poorly. In 2012, Bates obtained almost 69% of NNA's expected Nissan sales in its PMA.³² This may sound poor at first blush because one might expect Bates to be at 100% of expected Nissan sales (which is what RSE expects), but it is not poor when compared to other Nissan dealers in Texas. The overall weighted average of Nissan dealers in Texas for 2012 was 65.42% of expected Nissan sales in their own PMAs.³³ So, Bates was better than the average. Further, Bates was in the top half of all dealers in this metric.³⁴ For the period of October 2012 through September 2013, Bates was at 66.17%, while the weighted average was 67.20%.³⁵ For this time period, Bates was slightly below the average, but it was still in the top half of all Texas Nissan dealers.³⁶ So, when looking at how Bates does in selling Nissan vehicles in its own PMA, it stacks up well against other Nissan dealers in Texas. It does better than half of them—both in regard to protecting its market from other Nissan dealers and in obtaining a higher percentage of expected sales in the PMA.

NNA disputes Bates' performance in its own PMA, arguing that when compared to other single-point Nissan dealers in Texas, Bates ranked 22nd out of 26 dealers for the 12-month period ending in September 2013 in regard to its effectiveness at capturing available sales in its own PMA.³⁷ However, this data reflects Bates' performance only in relation to a limited subset (single-point dealers) of Nissan dealers in Texas. As Bates has pointed out, many of these single

³² Bates Ex. C-2 at Tab 1R, pp. 10, 13-14.

³³ Bates Ex. C-2 at Tab 1R, p. 10.

³⁴ Because mean (average) and median are different measurements, it is significant to note that being above or below the "average" does not also equate with placement in regard to other dealers. Thus, a dealer can be above the average and still be in the bottom half of the total number of dealers. Conversely, a dealer can be below the average and still be better than the majority of other dealers. In regard to the 2012 numbers, Bates was both above the average and better than the majority of other Nissan dealers in regard to capturing the projected available sales in its own PMA.

³⁵ Bates Ex. C-2 at Tab 1R, pp. 1, 4-5.

³⁶ See footnote 34 above for why this can be true.

³⁷ NNA Ex. R-362 at SUP-1.

point dealers do not provide a fair comparison to Bates because they have smaller markets and are generally farther away from the nearest other Nissan dealer than is Bates.³⁸ The ALJ generally agrees, and concludes that the best comparison is to all other Nissan dealers in Texas. As noted above, that comparison shows that Bates is better than at least half of them.

Interestingly, the two Nissan single point dealers closest to Bates in proximity—in Temple and Waco—performed equal to or more poorly than Bates according to NNA’s single point dealership evidence. Waco Nissan had nearly the same percentage (64.7%) of sales in its PMA (compared to expected sales under region average) as Bates (64.4%), while the Nissan dealer in Temple had a notably lower percentage (58.8%).³⁹ So, when compared to the two closest Nissan dealers, Bates is actually equal to one and better than the other when compared on the basis of obtaining sales in its PMA.

NNA may point out that the Waco and Temple dealers obtained sales outside of their PMA that ultimately made their overall performance better than Bates. NNA might further argue that this simply reflects that the Temple and Waco dealers, and other Nissan dealers, have chosen to split their efforts between their own PMA and outside their PMA in an effort to achieve RSE. However, this would ignore the Dealer Agreement’s language that creates obligations for a dealer only in its PMA. Thus, the proper comparison of Bates to other Nissan dealers is in regard to sales within the PMA. By this consideration, Bates stacks up acceptably in regard to other Nissan dealers generally and, if only single point dealerships are considered, then Bates is as good as or better than its two nearest single point dealerships.

If Bates’ poor sales in its PMA are a violation of its obligations under Section 3.A of the Dealer Agreement, then more than half of NNA’s dealers in Texas are also in violation of the Dealer Agreement, including the two single point dealerships nearest to Bates. But, NNA is not seeking to terminate those other dealers’ franchises.

³⁸ See Bates Ex. C-2 at Tab 5.

³⁹ Essentially, this means that when considering only sales in the PMA, Bates hit 64.4% of its expected sales, Waco Nissan hit 64.7 % of its expected sales, and the Temple Nissan dealer hit 58.8% of its expected sales.

Given these considerations, the ALJ finds that NNA has not shown that Bates has violated Section 3.A of its Dealer Agreement. Bates has, consistent with other Nissan dealers, captured a reasonable share of all Nissan sales in its own PMA. Its failings relate to its inability to capture sales outside of its PMA. But, the provisions of the Dealer Agreement cited by NNA in the termination notice place no obligations on Bates in regard to areas outside its PMA. Poor performance by Bates outside its PMA is not a contractual violation of Section 3.A that would support termination of the Dealer Agreement.

As a final note in this section, the ALJ disagrees that Bates' improved performance, beginning in November 2013, ameliorated its prior poor RSE performance. NNA had given it numerous chances to improve its performance and, at the time NNA issued the NOT in December 2013, the most updated information available showed Bates to still be poorly performing under the RSE methodology. Thus, Bates had not cured its poor RSE performance at the time the NOT issued in December 2013. Although the ALJ concludes that RSE performance is not an appropriate measurement of Bates' contractual obligations under Section 3.A of the Dealer Agreement—and thus Bates' improved performance is inconsequential in this section—the RSE performance (including Bates' improvement) is a factor the Board may consider in determining all existing circumstances in this case. But, the ALJ finds it is not a basis for concluding that Bates either violated or cured a contractual violation of Section 3.A of the Dealer Agreement. Now, the ALJ turns to the other justification for termination proffered by NNA.

2. Supplemental Notice of Termination (December 9, 2014)

After this protest proceeding had begun, but before it had proceeded to hearing, NNA provided Bates with a Supplemental Notice of Termination (Supplemental NOT). The Supplemental NOT was given to Bates on December 9, 2014, and advised that NNA was terminating the Dealer Agreement because of violations by Bates of Sections 12.A.8, 12.A.9, and 12.A.10 of the agreement. Specifically, NNA alleged that Bates submitted false financial statements and information to NNA, misrepresenting its capitalization, ownership, and

management, and willfully, intentionally, and knowingly failed to comply with applicable tax laws and regulations.⁴⁰

The basis of the Supplemental NOT arises from information NNA discovered during this contested case proceeding related to Bates' accounting and tax practices. The actual facts are mostly undisputed. Bates had a practice of writing down the value of its vehicle inventory at the end of the year in an effort to try to reach a certain amount of taxable income. By writing down the value of the vehicles, this created the appearance of a "loss" to Bates, and this loss offset gains realized by the sale of other vehicles throughout the year. Then, when the vehicles in inventory sold the next year, Bates "recaptured" the write-down in the form of additional profit. The following is a rather simplistic example of what Bates did:

- In Year 1 Bates might acquire a vehicle at a dealer cost of \$20,000.
- At the end of Year 1, Bates was still holding the vehicle in stock. Bates would write down the value of the vehicle to \$15,000. This would then show a loss of \$5,000 to Bates in the value of the vehicle. This "loss" would offset gains realized by Bates from the sale of its other vehicles during that year.
- In Year 2, Bates would sell the vehicle for \$25,000, resulting in a net profit to Bates of \$10,000 (because Bates' cost for the vehicle had been reduced to \$15,000 at the end of Year 1, a sale at \$25,000 was \$10,000 above its cost).

At each year end, Bates wrote down large chunks of its inventory not on the good faith basis of those vehicles' values, but rather in an effort to achieve a certain taxable income level. So, if Bates had a high amount of profits, it would take a high amount of write-downs to inventory. The goal was for Bates to get as close as possible to \$75,000 in taxable income each year. Bates was not truly avoiding taxes, because the profits would be recaptured the following year when the vehicles sold, but its method did allow it to defer taxes. Further, by taking additional write-downs the following year on other vehicles, Bates was essentially deferring taxes in perpetuity, kicking them down the road each year.

⁴⁰ Bates' Ex. C-34.

When NNA discovered this practice during the course of this hearing, it became concerned that Bates was engaging in tax fraud. Moreover, the write-down occurred on a 13th month financial statement that was prepared for the IRS but not submitted to NNA, thus leading NNA to become concerned that it had inaccurate financial records for Bates. Accordingly, NNA submitted the Supplemental NOT to Bates, advising that Bates' accounting practice was a violation of certain provisions of the Dealer Agreement and was a separate ground for termination of the agreement.

After the matter had been brought to its attention by NNA, Bates filed a Form 3115 and related correspondence with the IRS seeking an "Accounting Method Change to Correct Improper Lower of Cost or Market Method for New and Used Automobiles and Trucks" (Form 3115).⁴¹ In the Form 3115, Bates advised the IRS of its past accounting practice and proposed to correct for the improper write-downs over the ensuing four tax periods (essentially, this would result in Bates paying the taxes it should have paid in prior years if a proper accounting method had been used). The IRS accepted Bates' proposal and took no enforcement action against it, and there have been no criminal or civil charges filed against Bates for its past accounting practices.

There is no real doubt that Bates' accounting practice was not consistent with applicable tax regulations and was improper. Even Bates' own accountant admitted as much in the Form 3115 filings to the IRS. But, the more significant question is whether such practices resulted in a violation of the Dealer Agreement. NNA alleges that Bates' actions in regard to the accounting practice constituted grounds for termination under Sections 12.A.8., 12.A.9, and 12.A.10 of the Dealer Agreement. Section 12 of the Dealer Agreement provides the grounds for termination of the agreement, with Sections A.8, A.9, and A.10 stating the following reasons, in pertinent part:

A.8 Any material misrepresentation by Dealer or any person named in the Final Article of this Agreement as to any fact relied on by Seller in . . . continuing with this Agreement, including, without limitation, any representation concerning the ownership, management or capitalization of Dealer;

⁴¹ Bates Ex. C-205.

A.9 [A]ny willful failure of Dealer to comply with the provisions of any laws, ordinances, rules, regulations, or orders relating to the conduct of its Dealership Operations including, without limitation, the sale and servicing of Nissan products;

A.10 Knowing submission by Dealer to seller of: (i) a false or fraudulent report or statement; . . . (iii) false financial information; (iv) false sales reporting data;

Certainly, Bates' conduct was aggressive and unjustified. But, after considering the evidence, the ALJ finds that Bates did not *materially misrepresent* anything to NNA, *knowingly* submit *false* information to NNA, nor *willfully* fail to comply with any applicable law in regard to its accounting and tax practices.

The evidence at hearing establishes that it was Bobby Bates who unilaterally decided how much to devalue the inventory at the end of each year. He made his write-downs with the intent of meeting a certain annual taxable income (\$75,000).⁴² Mr. Bates is not an accountant and has no formal accounting training. He testified at the hearing that he believed he could lawfully write down the inventory as he had done, and that he acted with no intent to defraud anyone. He pointed out that the profits were never actually avoided, just deferred when the adjustments from the write-downs were "recaptured" the next year when the vehicles sold. Mr. Bates testified that he believed he could make the adjustments and that if he were doing anything wrong, his enrolled tax agent⁴³ would notify him. In fact, Mr. Bates testified that he asked his enrolled agent, Buster Gautier, if he could take the write-downs, and Mr. Gautier told him that he did not know of any reason why he could not.⁴⁴

The type of adjustment made by Bobby Bates is a recognized and proper accounting adjustment (namely, valuing inventory at lower of cost or market), so long as such adjustments are based upon genuine good faith valuations and properly supported. The problem with Bates'

⁴² Tr. Vol. 2 at 346-347.

⁴³ An enrolled tax agent is a person authorized by the IRS to file taxes on behalf of another person or entity. Although enrolled tax agents are generally more familiar with tax laws, they are not required to be certified public accountants or to have specialized accounting training.

⁴⁴ Tr. Vol. 2 at 343-345.

adjustments is not that they were taken, but that Bobby Bates did not have a proper accounting basis for the *amount* of adjustments he took. He made the adjustments to reach a certain taxable income level, not based on a true estimation of the value of each of the vehicles adjusted.

The evidence establishes that Bates made the write-down adjustments to inventory on a 13th month financial statement that was not provided to NNA. The use of 13th month financial statements is an accepted accounting practice, and such statements are ordinarily done for tax purposes. Memorandums from NNA are ambiguous as to whether such 13th month financial statements were to be submitted to NNA. An NNA memorandum to its dealerships from December 19, 2011, noted that not all dealerships prepared 13th month statements and that NNA “will accept paper copies of the Nissan Dealer December 13th Month Statement beginning January 21, 2012, through the end of the 2012 calendar year.”⁴⁵ No language in the memo indicated that a dealership must submit its 13th month statement to NNA if it prepared one. Further, by giving dealerships until the end of the calendar year to submit such statements, NNA was not indicating any particular urgency or importance to NNA in receiving the statements. Shortly thereafter, another NNA memorandum (from January 6, 2012) advised that language in its prior memo could have negative tax implications for dealers and it was revising the memo. It noted that the 13th month statement “is optional,” and that NNA “will accept paper copies of your 13th Month Statement, beginning January 21, 2012.”⁴⁶ Again, the memo did not have any language requiring that 13th month statements be filed with it.

Finally, a memo from January 2, 2015, noted that 13th month statements are “optional” and provided that “If your dealership wishes to provide Nissan a 13th month financial statement, we will accept hard copies only beginning January 26, 2015.”⁴⁷ None of the memos indicated that dealerships must file the statements, only that NNA would accept them. Certainly, nothing in the memos unambiguously gave notice to a dealership that a 13th month statement had to be

⁴⁵ Bates Ex. C-106.

⁴⁶ Bates Ex. C-105.

⁴⁷ Bates Ex. C-107.

SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

PROPOSAL FOR DECISION

PAGE 22

submitted to NNA if the dealership had prepared one. On the contrary, the memos gave the impression that a dealership's submission of such a statement was at the dealership's discretion.

NNA points to the Dealer Agreement, which requires all adjusted financial statements to be submitted to NNA.⁴⁸ However, even NNA's own corporate representative and 30-year employee, Patrick Steiner, was unaware that this provision required dealerships to submit 13th month financial statements. In his deposition, Mr. Steiner testified that Bates was under no contractual obligation to submit the 13th month statements.⁴⁹ At the hearing, however, he changed his testimony in reliance on Section 6.G.1 of the Dealer Agreement, advising that he was unaware of it at his deposition.⁵⁰ Given the evidence, the ALJ finds that Bates reasonably believed it was under no obligation to submit the 13th month statements to NNA, and had inadequate notice that the failure to do so would be deemed a contractual violation.

There is no evidence that any financial statements submitted to NNA were literally false. Rather, NNA argues that the failure to send the 13th month financial statements created a mistaken impression in NNA of the profitability of Bates. For example, if the 13th month financial statement showed a loss of \$5,000 because of a vehicle write-down, but the following year's first month financial statement showed a \$10,000 profit on that same vehicle (a true \$5,000 profit and an additional \$5,000 profit to offset the \$5,000 loss taken on the 13th month statement), then one might mistakenly assume that Bates had a profit of \$10,000 on the vehicle when in reality, the true profit was half that. NNA claims that this failure to provide NNA with the 13th month statement led it to have an incorrect view of Bates' financial condition and performance.

It is true that Bates' failure to send the 13th month financial statement to NNA could have created a skewed picture of Bates' capitalization and profitability. However, NNA has not shown any actual reliance on or harm to it by the data submitted by Bates. Under Section 12.A.8

⁴⁸ See Section 6.G.1 of the Dealer Agreement, Bates Ex. C-17 at 13.

⁴⁹ Bates Ex. C-358 at 70-72; Tr. Vol. 5 at 1158-1161.

⁵⁰ Tr. Vol. 5 at 1161-1162.

of the Dealer Agreement, a material misrepresentation must be “as to any fact relied on by” NNA. The evidence does not demonstrate that NNA relied on any “facts” represented in the financial statements submitted by Bates to its detriment. NNA has argued that it relies on the financial data for determining key performance indicators, and these key performance indicators are used for evaluating its dealers. However, beyond this “general” argument, NNA has not shown specifically how it relied on the information submitted by Bates in regard to specific business decisions related to Bates or any other dealership.⁵¹

Moreover, Bates did not actually submit any false information to NNA. It merely omitted sending the 13th month statements to NNA. The evidence does not demonstrate that Bates acted with any intent to defraud or mislead NNA when it failed to send the 13th month statement to NNA. The other, non-13th month financial statements submitted by Bates were accurate in that they accurately represented Bates’ information, and NNA’s guidance to Bates did not inform Bates that it needed to submit 13th month statements to NNA. Thus, the ALJ finds that Bates did not make material misrepresentations to NNA or submit false financial information to it in violation of the Dealer Agreement.

Further, the evidence does not establish that Bates *willfully* failed to comply with any tax laws or regulations. The evidence shows that Bobby Bates believed his actions were acceptable, especially in light of the information given to him by his enrolled tax agent. Bates has subsequently remedied its erroneous tax practice. The IRS has not chosen to prosecute Bates for tax violations, and it accepted Bates’ revised methodology and proposal for paying the back taxes due. Under the circumstances, the evidence simply does not show that Bates *willfully* violated any law.

Accordingly, the ALJ finds that Bates did not make material misrepresentations to NNA, willfully fail to comply with the law, or knowingly submit false information to NNA.

⁵¹ NNA argues that it used the data to evaluate and counsel its dealerships, including Bates. However, NNA’s evidence on this is very general in nature and NNA has not shown any specific detrimental reliance on Bates’ financial information.

While Bates' financial statements may have been misleading in the absence of the 13th month statements, there is no evidence they were provided with any intent to mislead or deceive, or with knowledge that they would mislead or deceive NNA. And, while Bates' tax practices were aggressive and unsupported, the evidence does not show that Bates willfully violated any law. Accordingly, the ALJ finds that Bates has not committed an action that would warrant termination of the franchise under Sections 12.A.8., 12.A.9, or 12.A.10 of the Dealer Agreement.

Now, the ALJ turns from NNA's noticed grounds for termination and addresses the statutory factors that must be considered by the Board in evaluating NNA's proposed termination of Bates' franchise.

C. Statutory Good Cause Factors

1. Bates' Sales in Relation to the Sales in the Market

As discussed previously, the evidence demonstrates that Bates has lagged behind other Nissan dealers in regard to sales in the larger regional market, but has fared generally well in selling in its own PMA—typically selling either right at the average or slightly higher than the average of other Nissan dealers in Texas in selling in their own PMAs. In 2012 and 2013, Bates' sales hit between 66% and 69% of NNA's target sales for Bates' PMA. The average of Nissan dealers in Texas during that time period was approximately 65% to 68% of NNA's target sales in the respective PMAs. So, Bates was an average dealer in that regard, and it placed around the median or in the top half of all Texas dealers in this measurement during that time period.

NNA argues that Bates' sales in only its PMA are not the focus of this statutory factor. Rather, this factor focuses on the broader market. NNA notes that this factor is not identified as the dealer's sales *in its market*, but rather sales *in the market*. NNA contends that this language is intended to focus on the larger market, and not just Bates' own PMA. Thus, NNA argues that its RSE methodology is the best measure of Bates' sales in the market, and it shows Bates lagging behind other Nissan dealers in Texas and the central region.

The statute does not define what is intended by the phrase “sales in relation to sales in the market.” If the Board believes that “the market” includes all areas that Bates might make a sale into, then certainly NNA’s RSE methodology is a reasonable way to measure Bates’ sales in relation to sales in the market. The RSE method identifies Bates’ performance in relation to all other Nissan dealers in the region, and accounts for Bates’ sales both inside and outside its PMA. The evidence clearly shows that Bates is a poor performer in regard to its overall sales when compared to other Nissan dealers in Texas and the central region, ranking near the bottom of all such dealerships during the time period between 2007 and 2013.

But, if the relevant market is simply Bates’ own PMA, then its performance is not nearly as bad. While it is not stellar, it is average when compared to other Nissan dealerships in Texas. According to NNA’s own expert, only 7 of 26 single point Nissan dealers in Texas were able to achieve their RSE target through sales solely within their PMA for the 12-month period ending in September 2013.⁵² This means that 19 of the 26 single point dealers did not achieve their RSE target from their sales within their PMA. The percentage of Nissan dealers not achieving their RSE target in their PMA is even higher if all Nissan dealers in Texas are included (and not just single point dealers).⁵³ As noted previously, if the question is how Bates is selling in its own PMA in regard to other Nissan dealers’ sales in their own PMAs, then Bates is an average performer.

Another appropriate measure might be Bates’ market share in its PMA in comparison to other NNA dealers’ market shares in their own PMAs. However, this evidence has not been presented in sufficient detail to determine whether Bates is a poor performer among all NNA dealers in Texas, or the region. NNA’s evidence shows that, in 2012 and 2013, Bates was significantly below Nissan’s regional averages in regard to its sales against Honda, Kia, and Hyundai, and better than the regional average in its sales against Toyota.⁵⁴ But, the evidence does not demonstrate Bates’ performance in this regard in comparison to all other NNA dealers

⁵² NNA Ex. R-362 at Sup 1.

⁵³ Bates Ex. C-2 at 8 and Tab 1R.

⁵⁴ NNA Ex. R-278 at BN000142, BNA000145, BNA 000148, and BNA000151.

in Texas. This is critical, because in order to know whether Bates' is truly a poor Nissan performer in its PMA in regard to its sales against its competitors, one must know not just the regional averages, but specifically how NNA's other Texas dealers fare in these same metrics. This is because averages can be misleading, as noted previously.

Moreover, Bates' overall performance has improved dramatically and, since November 2013, has satisfied NNA's RSE methodology. Bobby Bates testified that Bates was the top-performing dealership in Killeen at the time of the hearing, even above Toyota and Honda.⁵⁵ He testified that it had been outperforming Toyota and Honda in Killeen for at least the six months prior to September 2015, if not for the entire calendar year.⁵⁶ While this does not excuse past poor performance, it is an additional existing circumstance to be considered in the sales analysis.

Ultimately, given the Dealer Agreement language, the ALJ believes that Bates' "sales in relation to sales in the market" must be considered on the basis of Bates' PMA and not a broader market. Because Bates' performance is average when the market is framed like this, the ALJ concludes that this factor does not support good cause for the termination.

If the Board disagrees and concludes that the broader market should be considered, then Bates was a poor sales performer and generally ranked near the bottom of all Nissan dealers in Texas in regard to its overall sales. Under a broader definition of the market, this factor would weigh in favor of termination.

2. Bates' Investment and Obligations

Bates has been in business as a Nissan dealership for more than 40 years. Much of its investment in the business came long ago, when the land was acquired and the buildings were constructed. Given this, the parties disagree on how to measure the value of Bates' investment and obligations. NNA proposes using a depreciated book value of the dealership to determine

⁵⁵ Tr. Vol. 3 at 593.

⁵⁶ Tr. Vol. 3 at 593.

Bates' investment. NNA notes that Bates' initial investment in the dealership was \$49,800. As of December 31, 2013, the depreciated value of Bates' fixed assets was \$139,493. As of that same time, Bates reported the cost of the land as \$50,085 and the buildings and improvements as \$1,172,743. NNA contends that Bates has recouped all of its investment many times over in the form of the profits it has made through the years. Therefore, NNA asserts that this factor supports NNA's good cause termination or, at a minimum, is neutral.

In contrast, Bates argues that its investment is determined based on the current fair market value of the dealership. Bates' financial expert, Carl Woodward, calculated the dealership's market value using a few different methods. Under these methods, he determined the fair market value of the dealership is between \$6 million and \$21 million. The highest number reflects a "current value" determination that includes the value of all assets, including cash accounts, as well as the goodwill value of the dealership. The lowest number reflects recent offers for the dealership based only on "blue sky valuation"—*i.e.*, the goodwill value of the dealership alone. Mr. Woodward also presented other valuations between these two numbers. Ultimately, Mr. Woodward concluded that Bates would suffer investment losses of \$7.1 million if the dealership franchise is terminated.⁵⁷ He based this on an estimated goodwill loss of \$5.9 million, plus a \$1.2 million loss in the value of the facility itself.⁵⁸

The statute is not clear in setting out what is encompassed by the term "investment," but past Board precedent indicates that the fair market value of a dealership is an appropriate consideration in determining the investment of the dealership.⁵⁹ Specifically, in the *Cardenas* case, the Final Order contains the following relevant language:

On the matter of what is meant by "investment" that would be harmed, GST adamantly contests the suggestion that it includes the fair market value of the dealership. The ALJ correctly found that substantial adverse impact on investment

⁵⁷ All of the prior numbers are reflected in Mr. Woodward's report, Bates Ex. C-4 at 4-7.

⁵⁸ Bates Ex. C-4 at 6.

⁵⁹ *Cardenas Enterprises, Inc. v. Toyota Motor Sales USA, Inc.*, MVD Docket No. 06-0034.LIC, Final Order at 3. (2009)

will protect not only what was originally expended to start the dealership but also the present market value that is at risk.⁶⁰

Although the *Cardenas* case involved a franchise modification, and not a termination, the ALJ concludes that the Board's order is still instructive. While modifications and terminations are different, both require the same good cause analysis under the statute. While there might be reasons to apply different interpretations of "investment" depending on whether a termination or a modification is in issue, the ALJ finds no legal or precedential basis to do so.⁶¹ Such a distinction may be appropriately made by the Board for policy or other reasons, but the ALJ finds no basis to apply different definitions for purposes of this case. Therefore, in light of *Cardenas*, the ALJ concludes that Bates' investment includes the fair market value of the dealership at this time.

The fair market valuations presented by Mr. Woodward include all of the assets of Bates. However, Bates would be compensated for many of those assets (for example vehicles in inventory, etc.) even in the event of a termination.⁶² The more important consideration is what Bates really stands to lose financially in the event of a termination of the franchise by NNA. Because Bates has no other franchises and sells no other vehicle makes, it would cease to exist as a new car dealership. Therefore, it would suffer the loss of the goodwill (blue sky) value of its dealership, which the evidence shows is approximately \$5.9 million. Therefore, the ALJ concludes that this is the actual investment amount at risk to Bates if the termination is approved.

3. Injury or Benefit to the Public

NNA argues that termination will benefit the public because it will replace Bates with a more competitive dealer in the Killeen market, and the replacement dealer would presumably increase interbrand and intrabrand competition, benefitting public consumers. Further, if the

⁶⁰ *Id.* Final Order at 3.

⁶¹ NNA argues numerous reasons why modifications are different than terminations, thus making the *Cardenas* case distinguishable, and why a different definition of investment should be adopted in this case.

⁶² *See* Tex. Occ. Code § 2301.465.

replacement dealer performs better, as NNA expects, the public will benefit from increased employment, income, and tax revenues. For these reasons, NNA contends that termination is in the public interest.

In contrast, Bates argues that Texas public policy favors preserving existing dealership franchises, and argues that the 65 employees of Bates who would lose their jobs are the most relevant “public” that would be affected by NNA’s proposed termination—and they would be affected adversely. Bates points out that its customer service scores have been good, reflecting that the public has been happy with it as a dealer. Further, it notes that it has been serving the Killeen market for 40 years and its removal would hurt the local public by removing a dealer that is well-entrenched in the local community. While acknowledging that NNA would appoint a replacement dealer in the Killeen market, Bates argues that nothing is known about such dealer other than it would be “more competitive,” according to NNA. Bates asserts that a “more competitive” dealer would help NNA, not the general public.

After considering the arguments and evidence, the ALJ finds that a franchise termination would have a slightly negative impact on the public. Bates has been a Nissan dealership in the Killeen area for 40 years and, as such, has an established presence and existing workforce. Disrupting these, through termination, would generally be negative, as the employees would lose their jobs and the general public might temporarily lose a Nissan dealership. However, this is a relatively minor impact upon the public. In the long run, NNA would replace Bates, resulting in presumably a long-term neutral effect on local employment. While a more profitable replacement dealership might generate higher tax revenues from that dealership, such an increase would likely be insignificant, as it might come at the expense of other local dealers, resulting in lower tax revenues from them. Moreover, because the evidence establishes that Bates has significantly improved its sales and, at the time of the hearing, was the top-selling dealership in Killeen, it does not appear that replacing Bates would currently improve the competitiveness of the Nissan brand in Killeen. Thus, the impact upon tax revenues, income, or employment is likely neutral in the long run. But, in the short run, the disruption to these factors (including removing a currently competitive dealer) would be negative.

4. The Adequacy of Bates' Service Facilities, Equipment, Parts, and Personnel in Relation to Those of Other Dealers of New Motor Vehicles of the Same Line-Make

NNA has not challenged the adequacy of Bates' service facilities, equipment, or parts. Rather, NNA challenges the adequacy of Bates' sales personnel. Specifically, NNA alleges that Bates failed to hire and retain a sufficient number of competent, qualified sales personnel. From 2010 through 2013, Bates regularly employed 8 to 10 sales consultants. At hearing, Bobby Bates admitted that the dealership was deficient in the number of qualified sale personnel it was able to employ from 2010 until November 2013.⁶³ The lack of qualified personnel showed itself in consumer reports. Specifically, mystery shopper reports showed that 29% of mystery shoppers were not greeted within five minutes of being on Bates' lot, and another 38% were not greeted within the first two minutes of being on the lot.⁶⁴

Bates disagrees that this factor weighs against termination. Although not addressing it directly, Bates' closing argument appears to focus solely on this factor as it relates to "service" matters.⁶⁵ Bates argues that NNA has never advised it of any complaints about its service facilities or personnel and, accordingly, this factor weighs against a good cause finding for termination.

The evidence is undisputed that Bates was understaffed in qualified sales personnel. Even Bobby Bates admitted as much in his testimony, indicating that he would have liked to have had a couple more qualified salespeople during the time period from 2010 to 2013. However, it is not clear that this good cause factor is intended to address sales issues, or whether it is intended to address personnel only in regard to service issues.⁶⁶ Ultimately, the ALJ finds it unnecessary to decide whether the factor relates solely to service. The evidence indicates that

⁶³ Tr. Vol. 2 at 274-75.

⁶⁴ Bates Ex. C-97 at NNA-024905.

⁶⁵ Bates' title for this issue in its brief is labeled "Dealer's Service Facilities," and it cites to evidence in the record related to its provision of vehicle servicing, not sales.

⁶⁶ Namely, whether the word "service" in the statute modifies all listed factors—facilities, equipment, parts, and personnel—or just the word "facilities."

Bates has had satisfactory performance in regard to its service facilities, equipment, parts, and service personnel. While Bates has clearly had problems maintaining adequate sales staffing, its satisfactory performance with its service facilities, parts, equipment, and service personnel offset any sales staffing inadequacy, thus making this a neutral factor. So, whether Bates' deficient sales staff is an appropriate consideration under this factor, the totality of the factor is neutral and does not support termination.

5. Whether Warranties are Being Honored by the Dealer

NNA does not allege that Bates failed to honor any warranties. Therefore, NNA argues that this factor is irrelevant and neutral. Bates agrees that NNA has not challenged its honoring of warranties but argues that, because of this, this factor weighs against termination. Essentially, Bates asserts that any factor for which Bates is shown compliant or NNA has no issue with Bates, then the factor should be construed as weighing *against* termination.

The ALJ generally disagrees with Bates' position. Some factors will simply be neutral—either because the parties failed to present evidence on them or because the evidence does not establish either exceptionally good or bad performance in regard to them. Regarding this issue, the ALJ concludes it is neutral because the evidence does not establish Bates' conduct regarding warranties to such a degree that it either supports or weighs against termination.

6. The Parties' Compliance with the Franchise

NNA argues that Bates has failed to comply with the Dealer Agreement in the ways previously discussed: (1) by failing to vigorously and aggressively promote the sale of Nissan vehicles; and (2) by submitting false/fraudulent information to NNA and the IRS in regard to vehicle valuations for tax purposes. As noted previously, the ALJ finds that Bates did not breach the Dealer Agreement in regard to these two allegations by NNA.

In addition, NNA also asserts that Bates violated the Dealer Agreement by changing its ownership management without prior approval and by making material misrepresentations concerning such ownership and/or management. NNA's allegation relates to a special meeting by Bates in January 2014, at which Jimmy Bates assigned company stock to Bobby Bates, changing the ownership interest of both, and the company elected new officers.⁶⁷ NNA alleges that such action violates the Dealer Agreement because Bates was required to get NNA approval before changing its management or ownership. Although it has made these allegations, NNA did not include them in either of its termination notices,⁶⁸ nor has it addressed them in significant detail in its closing briefing. After considering the allegations, the ALJ finds that Bates did not violate the Dealer Agreement by its change in ownership and/or management.

Although Bates did take the action noted at the special corporate meeting, it also subsequently notified NNA of its corporate action and its request to change the dealer principal from Jimmy Bates to Bobby Bates.⁶⁹ Bates also indicated that until such time as NNA approved the changes, Jimmy Bates would continue to serve as dealer principal. NNA argues that this was deceptive by Bates because it had already put the changes into effect, as shown in the minutes of the special meeting in January 2014. The precise order in which Bates should have taken the steps may be argued (*i.e.*, should it have notified NNA of its intentions before the corporate meeting? Or, was it necessary for the corporate officers to agree upon the course of action first before notifying NNA?), but the ALJ concludes that Bates did not misrepresent its actions to NNA, nor did it hide its corporate actions. Rather, it notified NNA and sought NNA's approval of its conduct. Therefore, the ALJ concludes that Bates' actions do not rise to the level of a contractual violation or a misrepresentation by Bates, and do not properly serve as a ground for termination of the Dealer Agreement.

⁶⁷ See Bates Ex. C-31.

⁶⁸ Bates argues that NNA's failure to include this issue in the termination notices precludes it from being considered as a ground for termination. The ALJ disagrees, as the statutory good cause factors include a factor on "the parties' compliance with the franchise."

⁶⁹ Bates Ex. C-32.

After considering the arguments and evidence presented, the ALJ finds that both parties have complied with the franchise, at least in regard to the good cause analysis. Although each party points out ways in which the other party perhaps did not vigorously meet its responsibilities under the Dealer Agreement, the ALJ does not find that either party has materially breached its obligations under that agreement. The ALJ construes the statutory factor of “the parties’ compliance with the franchise” to be directed toward actual violations of the franchise, not simply a failure to perfectly perform the required obligations under the franchise. In this case, the evidence does not demonstrate a material breach of the Dealer Agreement by either party. Therefore, the ALJ finds that this is a neutral factor and does not impact the good cause analysis.

7. The Enforceability of the Franchise from a Public Policy Standpoint, Including Issues of the Reasonableness of the Franchise’s Terms, Oppression, Adhesion, and the Parties’ Relative Bargaining Power

Neither party has argued this factor in any detail. There do not appear to be any public policy issues related to the enforceability of the franchise. Thus, this factor is neutral in regard to the good cause analysis.

D. Conclusion

In conclusion, the ALJ finds that Bates has not violated its Dealer Agreement with NNA, and there is not good cause supporting termination of the dealership. The ALJ recognizes that Bates was a poorly-performing dealer for Nissan between 2007 and 2013. But, Bates’ poor performance was primarily in relation to its failure to make sales outside of its PMA. Because the Dealer Agreement places obligations on Bates only in regard to its own PMA, Bates’ poor performance is, although not entirely excused, somewhat mitigated by the dissonance between its obligations under the Dealer Agreement and the metrics applied to it in the RSE. After considering the grounds for termination and the factors identified in the statute, the ALJ simply concludes that good cause has not been shown for the termination. Therefore, the ALJ

recommends that the proposed termination be denied. In support of this recommendation, the ALJ makes the following findings of fact and conclusions of law.

V. FINDINGS OF FACT

Procedural and Background Findings

1. Nissan North America, Inc. (NNA) is a licensed new motor vehicle distributor in the State of Texas.
2. Bates Nissan, Inc. (Bates) is a licensed new motor vehicle dealer of Nissan vehicles and is located at 5501 East Cen-Tex Expressway, Killeen, Texas 76543.
3. Bates has been a Nissan (or Datsun) dealer since 1974 and operates under a Nissan Dealer Sales and Service Agreement (the "Dealer Agreement") dated June 2, 1989.
4. Pursuant to Section 3.A of the Dealer Agreement, Bates is obligated to "actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and, if Dealer elects, the leasing and rental) of Nissan Vehicles to customers located within Dealer's Primary Market Area" (the "Sales Obligation").
5. Section 3.A of the Dealer Agreement also provides that "Dealer's Primary Market Area is a geographic area which Seller uses as a tool to evaluate Dealer's performance of its obligations hereunder . . ."
6. Section 12.B of the Dealer Agreement addresses termination for non-performance:

Termination by [NNA] for Non-Performance by Dealer.

If, based upon evaluations thereof made by [NNA], Dealer shall fail to substantially fulfill its responsibilities with respect to:

a. Sales of new Nissan Vehicles and the other responsibilities set forth in Section 3 of this Agreement;

...

[NNA] will notify Dealer of such failure and will review with Dealer the nature and extent of such failure and the reasons which, in [NNA's] or Dealer's opinion, account for such failure. Thereafter, [NNA] will provide Dealer with a reasonable opportunity to correct the failure. If Dealer fails to make

substantial progress towards remedying such failure before the expiration of such period, [NNA] may terminate this Agreement by giving Dealer notice of termination, such termination to be effective at least ninety (90) days after such notice is given.

7. On July 6, 2010, NNA issued a Notice of Default (NOD) to Bates citing Bates' failure to fulfill its Sales Obligation.
8. On January 28, 2011, NNA granted Bates an extension of the NOD and afforded Bates an additional 180 days to cure its alleged default.
9. On July 25, 2011, NNA granted Bates a second extension of the NOD. This second extension provided Bates until January 31, 2012, to cure its alleged default.
10. On January 31, 2012, NNA granted Bates a third extension of the NOD and provided Bates until May 31, 2012, to cure its alleged default.
11. On May 18, 2012, NNA granted Bates a fourth extension of the NOD and provided Bates until September 30, 2012, to cure its alleged default.
12. On October 3, 2012, NNA granted Bates a fifth extension of the NOD and provided Bates until March 31, 2013, to cure its alleged default.
13. On April 10, 2013, NNA granted Bates a sixth extension of the NOD and provided Bates until September 30, 2013, to cure its alleged default.
14. On December 23, 2013, NNA issued a Notice of Termination (NOT) to Bates citing Bates' failure to cure its alleged defaults over the more than 3 years afforded by the NOD. The NOT stated it would be effective 90 days from Bates' receipt of it.
15. On February 18, 2014, Bates filed a protest (Protest) of the NOT with the Texas Department of Motor Vehicles (Department). Bates' protest was assigned Motor Vehicle Docket (MVD) Docket Number 14-0010.LIC.
16. NNA filed a reply to the Protest on March 14, 2014.
17. The parties participated in a mandatory mediation on April 11, 2014, but were unable to resolve the matter.
18. On April 17, 2014, the Department referred MVD Docket Number 14-0010.LIC to the State Office of Administrative Hearings (SOAH) for assignment of an Administrative Law Judge (ALJ) to conduct a contested case hearing and issue a proposal for decision. The case was assigned SOAH Docket Number 608-14-3211.LIC.

19. Section 12.A of the Dealer Agreement expressly provides for termination if the Dealer:
(1) materially misrepresents its management, ownership or capitalization to NNA;
(2) willfully violates the provisions of any laws, ordinances, rules or regulations; or
(3) submits false or fraudulent financial statements to NNA.
20. On December 9, 2014, NNA issued a Supplemental Notice of Termination to Bates (Supplemental NOT) alleging that Bates breached Sections 12.A.8, 12.A.9 and 12.A.10 of the Dealer Agreement by submitting false financial statements and information to NNA misrepresenting its capitalization, ownership, and management, and willfully, intentionally, and knowingly failing to comply with applicable tax laws and regulations.
21. On January 20, 2015, Bates filed its protest of the Supplemental NOT, as well as a Plea in Abatement of the Protest. Bates' protest of the Supplemental NOT was assigned MVD Docket No. 15-0013.LIC.
22. On March 3, 2015, the Department referred MVD Docket Number 15-0013.LIC to SOAH, and the case was assigned SOAH Docket Number 608-15-2684.LIC.
23. On March 13, 2015, the Department issued a letter ruling stating that the matters raised in the Supplemental NOT were properly part of the Protest and finding that it would be most efficient to hear all matters related to the NOT and Supplemental NOT in one proceeding.
24. On February 6, 2015, the ALJ issued an order denying Bates' Plea in Abatement.
25. On March 23, 2015, the ALJ issued Order No. 9 consolidating SOAH Docket Numbers 608-14-3211.LIC and 608-15-2684.LIC into one proceeding under SOAH Docket Number 608-14-3211.LIC (collectively, the two consolidated protests are simply referred to hereafter as the "Protest").
26. The evidentiary hearing convened on September 15, 2015, before ALJ Craig R. Bennett. Bates appeared and was represented by attorneys William David Coffey and Martin Alaniz. NNA appeared and was represented by attorneys Billy M. Donley, David R. Jarrett and Mark E. Smith. The hearing concluded on September 23, 2015.
27. The record closed on February 8, 2016, after the parties submitted written closing arguments and proposed findings of fact and conclusions of law.

Bates Ownership, Management, and Facilities

28. Bates is owned in near one-thirds by three shareholders: Bobby Bates, Jimmy Bates, and the Estate of Robert Bates, who is deceased.

29. Bobby Bates and his father, Jimmy Bates, are the active owners of Bates, and the third shareholder is a trust for the benefit of Robert Bates' daughter, Sherry Singley, and his son, Jim Bob Bates.
30. Bates' facility is Nissan Retail Environmental Design Initiative (NREDI) compliant.
31. Bates spent \$2 million to remodel the facility in 2004 per Nissan's design standards. Bates was the first dealership on the NREDI program.
32. Bates' departments are: New Car, Pre-Owned, Finance, and Service. John Johnston serves as the dealer's General Manager and oversees day-to-day operations. The New Car department is run by the General Sales Manager, Kevin Adams. The New Car department has two sales managers under the General Sales Manager, Victor Miranda and Loab Burke.
33. Eric Morris was the former Sales Manager for Bates Nissan from 2010 through April 2014, when he passed away from cancer. Mr. Morris initially improved Bates' sales effectiveness, but Bates' sales effectiveness declined again after he was diagnosed with pancreatic cancer in 2012. Bates elected to allow Mr. Morris to remain in his position, despite the fact that he often missed work due to cancer treatments.
34. Bates' salespeople are called sales consultants. Bates currently employs between 12 and 14 sales consultants, although it had only approximately 8 to 10 sales consultants prior to 2013.

Bates' Sales and the NOT

35. Pursuant to the Dealer Agreement, Bates has a contractual obligation to "actively and effectively" promote the sale of Nissan vehicles to customers located within its Primary Market Area (PMA).
36. The Dealer Agreement imposes no sales obligations on Bates outside of its PMA.
37. A dealer's PMA is the geographic area in the immediate vicinity of a Nissan dealership where the resident dealer is considered to have a competitive advantage over all other Nissan dealers solely because of location.
38. PMAs are not market restrictions. Dealers are free to make sales anywhere in the United States.
39. Bates' assigned PMA consisted of certain census tracts and was defined using the same methodology used by NNA to define all of its dealers' PMAs.
40. Bates was assigned to NNA's Central Region.

41. The Central Region was made up of all areas assigned to the region dealers across 14 states (Arkansas, Colorado, Kansas, Louisiana, Mississippi, Missouri, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Utah and Wyoming), *i.e.* PMAs, as well as certain unassigned territories or territories designated for open points.
42. Throughout the time period from 2010 through 2013, there were between 63 and 66 Nissan dealers located in the State of Texas.
43. Unassigned territories are areas that are not included in any Nissan dealer's PMA.
44. A territory designated for an open point is a PMA established for a dealer that has not yet been established but will be in the future.
45. NNA used Regional Sales Effectiveness (RSE) as its criteria for evaluating Bates' sales performance. NNA used RSE for decades to evaluate the sales performance of all its dealers. NNA has subsequently stopped using RSE, and now uses a different metric.
46. When it used RSE, NNA ranked dealers based on their RSE scores within a particular state, which allowed NNA to assess how a dealer was performing on a relative basis against an even more localized group of peers.
47. RSE is calculated by first determining the average sales penetration of Nissan dealers in the region.
48. NNA applied RSE to the specific vehicles it offered, and Nissan dealers were only compared against those vehicle segments in which NNA had a competitive offering.
49. A dealer's sales effectiveness was calculated under RSE by finding the ratio of the number of the dealer's actual sales (regardless of where they were registered) to the expected number of Nissan registrations in the dealer's PMA expressed as a percentage.
50. Under RSE, a dealer's expected registrations were derived by multiplying the total competitive registrations in each vehicle segment within the dealer's PMA by the regional sales penetration for that same vehicle segment by month. This process was repeated for each month of the reporting period (12 months) and summed to arrive at the number of Nissan sales necessary to achieve region average.
51. RSE was then calculated by dividing the dealer's total sales, regardless of where they were registered, by the total expected registrations in the dealer's PMA.
52. An RSE score of 100% meant that the dealer performed at the level of an average Central Region Nissan dealer.
53. NNA required its dealers to achieve 100% RSE on a rolling 12 month basis to comply with the Sales Obligation pursuant to Section 3 of the Dealer Agreement.

- 54. NNA evaluated Bates’ sales performance on the basis of its 12 month rolling RSE score. A 12 month rolling score looked at the last 12 months of reported sales data to calculate the RSE score.
- 55. Bates’ performance on its cumulative RSE scores between 2007 and 2013 was poor, as reflected by the following chart for that time period:

Year	Bates’ Calendar Year RSE Percentage
2007	87.1%
2008	74.5%
2009	81.0%
2010	85.2%
2011	90.0%
2012	79.8%
2013	75% (through 9/30/13)

- 56. At no point between 2007 and 2013 was Bates at 100% of RSE on a cumulative 12 month rolling average.
- 57. In addition to failing to meet its RSE targets, Bates was near the bottom of all of NNA’s Texas dealers in RSE percentage, ranking from 52nd to 60th (out of 63 dealers) in the 2007-2012 time period, and then 63rd (out of 66 dealers) as of January 2013.
- 58. Overall, Bates was the lowest-scoring dealer in Texas, based on cumulative RSE percentage, for the time period from 2009 through September 2013.
- 59. Beginning in November 2013, Bates’ sales performance dramatically improved when it hired Kevin Adams to be the new general sales manager.
- 60. In September 2013, immediately prior to hiring Mr. Adams, Bates had been at 70.5% RSE.
- 61. After hiring Mr. Adams, Bates went to 96.7% RSE in November 2013, and then to 125% RSE in December 2013, the same month the NOT was issued.
- 62. For the rolling 12-month period ending in November 2014, Bates’ RSE score was 102.2%.

63. Between September 2014 and June 2015, Bates continued to be above 100% RSE on a rolling average.
64. In 2012 and 2013, Bates obtained approximately 71% of all new retail Nissan car and light truck sales in its PMA. This statistic measures how effective a Nissan dealer is at capturing the sales of its own brand in its PMA, not its effectiveness at taking sales away from non-Nissan dealers. By capturing 71% of Nissan sales in its PMA, Bates lost only 29% of Nissan sales to other Nissan dealers outside its PMA.
65. The Texas average for 2012 and 2013 for dealers obtaining the Nissan sales in their own PMA was approximately 58%, meaning that the average Nissan dealer in Texas lost 42% of the Nissan sales in its PMA to other Nissan dealers.
66. Bates' effectiveness at holding a high number of Nissan sales in its PMA put it in the top one-third to one-half of all Nissan dealers in Texas during 2012 and 2013.
67. In 2012, Bates obtained almost 69% of NNA's expected Nissan sales in its PMA, meaning that Bates achieved 69% of its RSE target through sales within its PMA.
68. The overall weighted average of Nissan dealers in Texas for 2012 was 65.42% of expected Nissan sales in their own PMAs. Bates was better than the average, and higher than the median, of all Texas Nissan dealers in obtaining its target sales in its PMA for this time period.
69. For the period of October 2012 through September 2013, in regard to the percentage of RSE sales obtained within the PMA, Bates was at 66.17% while the weighted average for all of NNA's Texas dealers was 67.20%. For this time period, Bates was slightly below the average, but still in the top half of all Nissan dealers in Texas.
70. For the 12-month period ending in September 2013, Bates was one of 19 single point Nissan dealers in Texas that did not reach 100% of RSE through sales in its PMA. For that time period, only 7 of 26 single point Nissan dealers in Texas reached 100% of RSE through sales in their PMAs.
71. For the 12-month period ending in September 2013, the two Nissan single point dealers closest to Bates in proximity—in Temple and Waco—performed equally to or more poorly than Bates in regard to achieving their RSE target through sales in their PMAs.
72. Waco Nissan captured 64.7% of its RSE through sales in its PMA and Bates captured 64.4%, while the Nissan dealer in Temple captured 58.8%.
73. Bates did not fail to fulfill its Sales Obligation under the Dealer Agreement.

Bates' Accounting Practices and the Supplemental NOT

74. Between 2009 and 2013, Bates annually adjusted (i.e., wrote down) the value of its vehicle inventory, purportedly under the Lower of Cost or Market (LCM) accounting methodology, in an attempt to reach an annual taxable income goal of \$75,000.
75. Bobby Bates asked his enrolled tax agent, Buster Gautier, if he could take write-downs to vehicle inventory based on the LCM method, and Mr. Gautier told him that he did not know of any reason why he could not.
76. Bobby Bates is not an accountant and has no formal training in accounting.
77. At the time he made the LCM adjustments, Bobby Bates believed his actions were proper.
78. To obtain the write-downs, Bobby Bates determined the value of each vehicle for which a write-down was taken and provided those values to Mr. Gautier.
79. Bates did not follow accepted accounting principles in determining the inventory write-downs under the LCM method.
80. The write-downs to vehicle inventory taken by Bates did not have a justified factual basis and were improper.
81. Bates prepared a 13th month financial statement reflecting the vehicle write-downs and determined taxable income on the basis of such write-downs.
82. Bates did not submit its 13th month financial statements to NNA.
83. The effect of the LCM adjustments to vehicle inventory was to reduce Bates' taxable income for each year.
84. The amount of the vehicle inventory reductions taken by Bates through the LCM adjustments were in the hundreds of thousands and generally increased year over year (with the exception of 2013).
85. On February 13, 2015, Bates filed a Form 3115 and related correspondence with the United States Internal Revenue Service (IRS) seeking an "Accounting Method Change to Correct Improper Lower of Cost or Market Method for New and Used Automobiles and Trucks" (Form 3115).

86. In the Form 3115, Bates advised the IRS of its improper use of the LCM accounting practice and proposed to correct for the improper write-downs over the ensuing four tax periods. The correction resulted in Bates paying the taxes it would have paid in prior years if the LCM accounting method had been used properly.
87. The IRS accepted Bates' proposal and took no enforcement action against Bates, and there have been no criminal or civil charges filed against Bates for its past accounting practices.
88. The use of 13th month financial statements is an accepted accounting practice, and such statements are ordinarily prepared for tax purposes.
89. Memorandums from NNA were ambiguous as to whether 13th month financial statements were to be submitted by dealers to NNA.
90. An NNA memorandum to its dealerships on December 19, 2011, noted that not all dealerships prepared 13th month statements and that NNA would accept paper copies of the Nissan Dealer December 13th Month Statement beginning January 21, 2012, through the end of the 2012 calendar year. No language in the memo indicated that a dealership must submit its 13th month statement to NNA if it prepared one.
91. Another NNA memorandum, dated January 6, 2012, advised that language in its prior memo could have negative tax implications for dealers and it was revising the memo. It noted that the 13th month statement was "optional" and that NNA would accept paper copies of 13th Month Statements, beginning January 21, 2012. The memo did not have any language requiring that 13th month statements be filed with NNA.
92. An NNA memorandum from January 2, 2015, noted that 13th month statements were "optional" and provided that "If your dealership wishes to provide Nissan a 13th month financial statement, we will accept hard copies only beginning January 26, 2015." This memo did not indicate that dealerships were required to file 13th month statements, only that NNA would accept them.
93. NNA's own corporate representative and long-time employee, Patrick Steiner, was not aware of a requirement in the Dealer Agreement that dealerships submit 13th month financial statements. Mr. Steiner testified in deposition that Bates was under no contractual obligation to submit the 13th month statements. He later modified his testimony after reviewing the Dealer Agreement
94. There is no evidence that any financial statements submitted by Bates to NNA were actually false.

SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

PROPOSAL FOR DECISION

PAGE 43

95. While Bates' failure to send the 13th month financial statement to NNA could have created a skewed picture of Bates' capitalization and profitability in NNA's eyes, the evidence does not show that NNA specifically relied on Bates' financial statements in any way that harmed NNA, materially affected its operations, or impacted the way it conducted business with Bates or its other dealers.
96. The evidence does not demonstrate that Bates acted with any intent to defraud or mislead NNA when it failed to send the 13th month statement to NNA.
97. The evidence does not demonstrate that Bates made material misrepresentations to NNA or submitted false financial information in violation of the Dealer Agreement.
98. The evidence does not demonstrate that Bates willfully failed to comply with any laws or regulations, including any tax laws or regulations.

Statutory Good Cause Factor – Sales in Relation to the Market

99. Bates overall sales, both inside and outside its PMA, were near the bottom of all other NNA dealers in Texas for the period 2010 through September 2013.
100. Despite its overall poor sales performance prior to November 2013, Bates' sales in its PMA have been average in comparison to other NNA dealers in Texas.
101. Because Bates' sales in its PMA have been average in comparison to other NNA dealers in Texas, this statutory factor weighs against a finding of good cause for terminating the dealer franchise.

Statutory Good Cause Factor – Bates' Investment and Obligations

102. Bates' initial investment in the dealership was \$49,800.
103. As of December 31, 2013, the depreciated value of Bates' fixed assets was \$139,493, the cost of the land for the dealership was \$50,085, and the cost of the buildings and improvements as \$1,172,743.
104. The blue sky value of Bates' dealership is approximately \$5.9 million.
105. The amount at risk to Bates if the dealership franchise is terminated is approximately \$5.9 million.
106. The risk to Bates' investment and obligations is a factor that weighs against a finding of good cause for terminating the dealer franchise.

Statutory Good Cause Factor – Injury or Benefit to the Public

107. The termination of Bates' dealer franchise would have a slightly negative impact on the public.
108. If the franchise is terminated, approximately 65 employees of Bates would lose their jobs and the public may temporarily lose the availability of a local Nissan dealership.
109. NNA would replace Bates at some point in time, likely resulting in a long-term neutral effect on local employment.
110. While the long-term effect on the public of the termination of Bates' franchise would likely be neutral, in the short run the disruption to employment, tax revenues, and the availability of a local Nissan dealership would be negative.
111. The slightly negative impact to the public in the short term is a factor that weighs against a finding of good cause for terminating the dealer franchise

Statutory Good Cause Factor – Adequacy of Bates' Service Facilities, Equipment, Parts and Personnel

112. From 2010 through 2013, Bates regularly employed 8 to 10 sales consultants, which was an inadequate number of sales personnel for the dealership.
113. The lack of qualified sales personnel at Bates showed itself in negative consumer reports. Specifically, mystery shopper reports from that time period showed that 29% of mystery shoppers were not greeted within five minutes of being on Bates' lot, and another 38% were not greeted within the first two minutes of being on the lot.
114. There is no evidence that Bates has had any poor performance in regard to its service facilities, equipment, parts, or service personnel.
115. Although Bates clearly had problems maintaining adequate sales staffing prior to 2013, its satisfactory performance with regard to its service facilities, parts, equipment, and service personnel offset any sales staffing inadequacy in consideration of the totality of this factor.
116. In total, the adequacy of Bates' service facilities, equipment, parts, and personnel is a neutral factor that does not impact the good cause analysis.

Statutory Good Cause Factor – Bates' Honoring of Warranties

117. There is no evidence or argument that warranties were not being honored by Bates and, thus, this neutral factor is not an existing circumstance that impacts the good cause analysis.

Statutory Good Cause Factor – The Parties' Compliance with the Franchise

118. At a special corporate meeting conducted by Bates in January 2014, Jimmy Bates assigned company stock to Bobby Bates, changing the ownership interest of both, and the company altered its management by electing new officers.
119. NNA argues that Bates violated the Dealer Agreement because it was required to get NNA approval before changing its management or ownership. Although it has made these arguments at hearing, NNA did not include them in any specific detail in either of its termination notices.
120. Although Bates did take action to modify its ownership and management at the special corporate meeting, it subsequently notified NNA of its corporate action and its request to change the dealer principal from Jimmy Bates to Bobby Bates.
121. When it notified NNA of its action at the special company meeting in January 2014, Bates also indicated that until such time as NNA approved the changes, Jimmy Bates would continue to serve as dealer principal.
122. Bates did not misrepresent its corporate actions to NNA, nor did it hide its corporate actions from NNA. Rather, Bates notified NNA and sought NNA's approval of its conduct.
123. Bates' actions at its corporate meeting in January 2014 are not a material breach of the Dealer Agreement, nor did they result in a misrepresentation by Bates.
124. The evidence does not establish that either party failed to comply with the franchise agreement and, thus, this neutral factor is not an existing circumstance that impacts the good cause analysis.

Statutory Good Cause Factor – The Enforceability of the Franchise from a Public Policy Standpoint

125. There is no evidence or argument that the franchise is unenforceable from a public policy standpoint and, thus, this neutral factor is not an existing circumstance that impacts the good cause analysis.

VI. CONCLUSIONS OF LAW

1. The Department and its governing board (Board) has jurisdiction over this matter. Tex. Occ. Code ch. 2301.
2. SOAH has jurisdiction over the contested case hearing and the authority to issue a proposal for decision, including findings of fact and conclusions of law. Tex. Gov't Code ch. 2003; Tex. Occ. Code § 2301.704.
3. NNA properly notified Bates of the intent to terminate Bates' franchise pursuant to Texas Occupations Code § 2301.453(c).
4. Bates timely filed a protest with the Department. Tex. Occ. Code § 2301.453(e).
5. Notice of Bates' protest and of the hearing on the merits of the protest was properly provided as required by law. Tex. Gov't Code §§ 2001.051, 2001.052; Tex. Occ. Code § 2301.705; 1 Tex. Admin. Code § 155.401; 43 Tex. Admin. Code §§ 215.105 and 215.307.
6. A "franchise" is one or more contracts between a franchised dealer and a manufacturer. Tex. Occ. Code § 2301.002(15).
7. A manufacturer may not terminate or discontinue a franchise with a franchised dealer unless the manufacturer provides notice of the termination and (1) the franchised dealer consents in writing to the termination, (2) the appropriate time for the dealer to file a protest has expired, or (3) the Board makes a determination of good cause. Tex. Occ. Code § 2301.453(a).
8. A protested termination may not be approved by the Board unless good cause exists for the termination. Tex. Occ. Code § 2301.453(a)(3), (g).
9. NNA has the burden of proving by a preponderance of the evidence that good cause exists for the proposed termination. Tex. Occ. Code § 2301.453(g).
10. In determining whether NNA established by a preponderance of the evidence that there is good cause for terminating Bates' franchise, the Board is required to consider all existing circumstances, including seven statutory factors. Tex. Occ. Code § 2301.455(a).
11. The Board has the exclusive jurisdiction to determine the issue of good cause, including the weight to be given each statutory factor. *Austin Chevrolet, Inc. v. Motor Vehicle Bd.*, 212 S.W.3d 425, 432 (Tex. App.—Austin 2006, pet. denied).

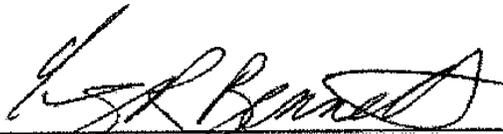
SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

PROPOSAL FOR DECISION

PAGE 47

12. NNA has not established that Bates materially breached any of its obligations under the Dealer Agreement.
13. Based on a consideration of all existing circumstances, NNA has not established by a preponderance of the evidence that good cause exists for the proposed termination of Bates' franchise.
14. NNA's proposed termination of Bates' franchise should be denied.

SIGNED April 8, 2016.



**CRAIG R. BENNETT
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS**

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May 10, 2016

VIA ELECTRONIC FILING

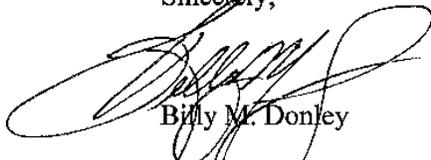
Hon. Craig R. Bennett
Administrative Law Judge
State Office of Administrative Hearings
300 W. 15th Street, Suite 502
Austin, Texas 78701

Re: Bates Nissan, Inc. v. Nissan North America, Inc.
SOAH Docket No. 608-14-3211.LIC; MVD Docket No. 14-0010.LIC

Dear Judge Bennett:

Enclosed please find for filing *Respondent Nissan North America, Inc.'s Exceptions to the Proposal for Decision*. By copy of this letter, I am providing three (3) hard copies to the Motor Vehicle Division via UPS overnight delivery.

Sincerely,



Billy M. Donley

cc: William David Coffey, III
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Via Email and First Class Mail

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Via Email and UPS overnight delivery

Atlanta Chicago Cincinnati Cleveland Columbus Costa Mesa Denver
Houston Los Angeles New York Orlando Philadelphia Seattle Washington, DC

TEXAS DEPARTMENT OF MOTOR VEHICLES
MOTOR VEHICLE DIVISION

BATES NISSAN, INC.,	§	
COMPLAINANT	§	SOAH Docket No. 608-14-3211.LIC
v.	§	
	§	
NISSAN NORTH AMERICA, INC.,	§	MVD Docket No. 14-0010.LIC
RESPONDENT	§	

**RESPONDENT NISSAN NORTH AMERICA, INC.'S
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

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TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
A. The Dealer Agreement	1
B. Bates’ Submissions of False Financial Statements and Violation of Tax Laws and Regulations	4
II. APPLICABLE LAW	5
III. ARGUMENT	5
A. RSE Is a Proper “Reasonable Criteria” for Evaluating Sales Performance Under the Dealer Agreement.....	5
B. The PFD Fails to Construe the Dealer Agreement as a Whole	8
C. When Read as a Whole, the Dealer Agreement Plainly Permitted Nissan to Terminate Bates’ Based on its Poor Sales Performance	8
D. Courts and Agencies Across the United States Have Uniformly Arrived at the Same Conclusion that RSE is a Permitted Reasonable Criteria for Evaluating Dealer Sales Performance under the Nissan Dealer Agreement	13
E. The PFD Also Failed to Properly Construe the Dealer Agreement because of a Fundamental Misunderstanding of Sales, Curbstoning and Registration	17
F. The Two Methods that the PFD Uses to Measure Bates’ Performance Lead to Unreasonable Results, Unintended Consequences and Bad Policy	20
1. The PFD’s First Method	21
2. The PFD’s Second Method.....	24
G. The PFD Misinterpreted “Sales in Relation to Sale in the Market” in Code Section 2301.455(a)(1).....	26
1. The Plain Language of the Statute Controls	26
2. A Correct Interpretation of Section 2301.455 Favors Termination.....	28
H. The PFD Erroneously Concludes that Bates Did Not Breach Sections 12.A.8.-10. of the Dealer Agreement	29

1. The PFD’s Finding that Bates’ Write-Down were “Not on a Good Faith Basis” can only lead to a Finding that Bates Knowingly Submitted False Financial Statements to NNA and Willfully Violated Federal Tax Law.....	33
2. The PFD Reached Its Erroneous Findings that Bates Did Not Breach the Dealer Agreement by Incorrectly Concluding that NNA Failed to Provide any Evidence that the Financial Statements Submitted to NNA Were False	36
3. The 13 th Month Statements do not Make the 12 Month Statements True or Accurate	40
4. The PFD Applies the Wrong Standard	43
5. Bates Did Not use LCM.....	44
6. The Board Should Find that the Injury or Benefit to the Public Factor Weighs in Favor of Termination.....	46
7. All Existing Circumstances do not include Bates’ Post-NOT Performance	46
IV. CONCLUSION.....	46

TEXAS DEPARTMENT OF MOTOR VEHICLES
MOTOR VEHICLE DIVISION

BATES NISSAN, INC.,	§	
COMPLAINANT	§	SOAH Docket No. 608-14-3211.LIC
v.	§	
	§	
NISSAN NORTH AMERICA, INC.,	§	MVD Docket No. 14-0010.LIC
RESPONDENT	§	

**RESPONDENT NISSAN NORTH AMERICA, INC.’S
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

Nissan North America, Inc. (“NNA”) files its Exceptions to the Proposal for Decision (“PFD”) pursuant to SOAH Rule 155.507(c).¹ For the reasons described herein, in NNA’s Closing Argument and Post-Hearing Brief (“Brief”), and in NNA’s Post-Hearing Reply Brief (“Reply”), good cause exists under Texas Occupations Code (“Code”) Section 2301.455 for the termination of Bates Nissan, Inc. (“Bates”) Nissan Dealer Sales and Service Agreement. Because the PFD reached the wrong conclusions as a matter of law, the Texas Department of Motor Vehicles Board (“Board”) has the authority under Texas Government Code § 2001.058(e)(1) to modify the PFD and find good cause for termination.

I. INTRODUCTION

A. The Dealer Agreement

The PFD concludes that sales effectiveness or RSE—the standard methodology for evaluating dealer’s sales performance that has been held by courts and administrative forums throughout the country as permitted, reasonable criteria under the Standard Provisions of Nissan’s Dealer Sales and Service Agreement (the “Dealer Agreement”)—is not a permissible method to evaluate the *sales* performance of Bates Nissan under those same Standard Provisions of Bates Nissan’s Dealer Agreement. The PFD reaches this conclusion because the RSE

¹ The deadline for submission of exceptions to the PFD was extended by Order No. 17.

methodology actually takes into account *all of the sales* actually made by Bates Nissan. This erroneous and illogical conclusion infects the entire PFD and is contrary to the rules of contractual construction, substantial evidence presented at the hearing, and a reasonable interpretation of the Code. If adopted by the Board, the PFD would have harmful far-reaching ramifications for motor vehicle manufacturers, distributors, and dealers, as it upends the sales performance evaluation method currently used throughout the country for virtually every line-make. As a result, the Board is authorized under Texas Government Code § 2001.058(e)(1) to vacate or modify the PFD and find that good cause for termination of Bates' Dealer Agreement exists.²

NNA's method for measuring Bates' sales performance through RSE is a reasonable method for measuring dealer sales performance, that NNA has been using for over 30 years, and that Bates was fully aware of, was routinely evaluated upon and accepting of NNA using RSE to evaluate the dealership's sales performance under the Dealer Agreement. Despite this, the PFD concludes as a matter of law that *because* RSE credits dealers for all sales it makes, RSE is an unreasonable criteria for evaluating Bates' contractual sales responsibilities under the Dealer Agreement and applicable law because it counts what the PFD repeatedly refers to as sales made by Bates (or any other dealer) "outside the PMA."

This makes no sense. Evaluating Bates' sales performance (or that of any other dealer) based on every sale it makes reflects the realities of the automotive industry that customers in the

² Section 2001.058(e) states, in part:

HEARING CONDUCTED BY STATE OFFICE OF ADMINISTRATIVE HEARINGS.

(c) A state agency may change a finding of fact or conclusion of law made by the administrative law judge, or may vacate or modify an order issued by the administrative judge, only if the agency determines:

- (1) that the administrative law judge did not properly apply or interpret applicable law, agency rules, written policies provided under Subsection (c), or prior administrative decisions;

market for cross shop dealerships (and of course of have no knowledge of the boundaries of a dealer's PMA) and dealers compete for the business of these customers on both an interbrand and intrabrand basis. And a methodology that counts each sale made by a Nissan dealer is certainly reasonable and fair criteria for evaluating performance under the Dealer Agreement, as each sale reflects that the dealer won the competition for a customer's business, and thus "actively and effectively promote[d] the sale" of a Nissan [v]ehicle" to a customer "located in the Primary Market Area" whether because that customer lives in the PMA, works in the PMA or is otherwise drawn by the dealer's advertising and promotional efforts to shop at the dealership's authorized location, which in the case of Bates, and every other Nissan dealer, is located in the dealer's PMA and is where, under Section 2.A Dealer Agreement and as a matter of Texas law, a sale must take place.

Ignoring these realities, the PFD concludes that, under the Dealer Agreement, Nissan can reasonably evaluate Bates' or any other dealer's sales performance in Texas based *only* on those sales made by the dealer that are later registered by the customer to an address in the PMA, reading Section 3.A to say that Bates is only obligated to make sales "in the PMA," not "outside the PMA." A plain reading of Section 3.A reveals that is not what it says. And even if it did, it would not foreclose NNA under the Dealer Agreement from evaluating Bates' performance using RSE or any other methodology that counts all sales made by Bates because as noted above, every sale takes place at the dealership's authorized location, and is therefore a sale "in the PMA." Unsurprisingly, the PFD's conclusion that NNA cannot use RSE to evaluate Bates' performance of its sales responsibilities under Section 3 is directly contrary to every other court and administrative agency that has construed the exact same Section 3 of the Dealer Agreement—each of which has concluded that RSE is reasonable criteria for evaluating Nissan

dealer compliance with its sales responsibilities under the Dealer Agreement.³ Because termination based on Bates' undisputed chronic poor sales performance under the RSE standard is clearly permitted by the Dealer Agreement, the PFD failed to properly apply the applicable law in this matter. As a result, the Board should modify the PFD under Texas Government Code § 2001.058(e)(1) and hold that NNA established by that good cause exists for the proposed termination of Bates' franchise.

B. Bates' Submission of False Financial Statements and Violation of Tax Laws and Regulations

The PFD also erroneously concludes that there is no evidence that Bates submitted false financial statements to NNA and that Bates' unlawful vehicle inventory write downs were not a willful violations of tax laws and regulations in breach of the Dealer Agreement. These conclusions are wrong as a matter of law. In order to reach these erroneous conclusions, the PFD ignores its own findings that Bates' accounting practices were "unjustified," "not consistent with applicable tax regulations and was improper," and that it had no "good faith basis" for its unlawful inventory write downs. The PFD also ignore Bates' undisputed testimony that its financial statements submitted to NNA contained false information, as well as testimony of NNA's witnesses and experts, and other evidence that conclusively demonstrate that each and every monthly financial statement submitted to NNA between 2010-2013 was false resulting in a breach of the Dealer Agreement.

It is undisputed that Bates' false financial statements were the result of its scheme to write down its new and used vehicle inventory by whatever amount necessary in order to reduce its taxable income to approximately \$75,000 each year. Because of its scheme, Bates had it both ways—it overstated its profits and capitalization to NNA and understated its profits to the IRS.

³ See, *infra*, Section III.D.

Bates' tax scheme necessitated it taking increasingly larger inventory write downs each year in order to achieve its tax goal. Bates' scheme was unlawful, as the PFD found, which means that Bates knowingly submitted false financial statements to NNA and willfully violated the tax laws and regulations in breach of its Dealer Agreement.

As a result and for this independent reason, the Board is authorized under Texas Government Code § 2001.058(e)(1) to vacate or modify the PFD and find that good cause for termination of Bates' Dealer Agreement exists.

NNA has set forth its proposed changes to the PFD's Findings of Fact and Conclusions of Law in Attachment 1.

II. APPLICABLE LAW

Because there is no conflict between the Code and the Dealer Agreement, the interpretation of the Dealer Agreement is governed by California law. (Ex. C-17 at BN000075, § 17.F).⁴ Even if Texas law applied, nothing would change because California law and Texas law are the same, as noted in footnotes, regarding the contract construction issues in this case. Texas law applies to the interpretation of the Code.

III. ARGUMENT

A. RSE Is a Proper "Reasonable Criteria" for Evaluating Sales Performance under the Dealer Agreement

In finding that RSE is not permitted by the Dealer Agreement, the PFD failed to construe "customers located within Dealer's Primary Market Area Agreement" found in Section 3.A of the Dealer Agreement as required by law. Because of this, the Board should reject the PFD's interpretation of the Dealer Agreement.

⁴ Section 17.F of the Dealer Agreement states:

This Agreement shall be deemed to have been entered into in the State of California, and all questions concerning the validity, interpretation or performance of any of its terms or provisions, or of any rights or obligations of the parties hereof, shall be governed by and resolved in accordance with the internal laws of the State of California, including, without limitation, the statute of limitations.

Bates' Dealer Agreement clearly permits termination based on a failure to fulfill its sales performance responsibility under Section 3, and allows Nissan to evaluate its performance of this responsibility using *any* "reasonable criteria." (Ex. C-17 at BN000047, § 3.B). Although the PFD found that RSE is not a permitted measure of dealer performance under the Dealer Agreement, RSE is the *standard method* for measuring sales performance and is *expressly permitted* under the terms of the Dealer Agreement.

Section 3 of the Dealer Agreement, entitled "Vehicle Sales Responsibilities of Dealer," sets forth the dealer's sales responsibilities. The dealer's general sales obligations are addressed in Section 3.A, which provides:

Dealer shall actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and if Dealer elects, the leasing and rental) of Nissan Vehicles to customers located within Dealer's Primary Market Area. Dealer's Primary Market Area is a geographic area which Seller uses as a tool to evaluate Dealer's performance of its sales obligations hereunder

(PFD at 34, FoF 4). Importantly, the Dealer Agreement goes on in Section 3.B to provide that "performance of [a dealer's] sales responsibility for Nissan Cars and Nissan Trucks [under Section 3.A] will be evaluated by [NNA] on the basis of such *reasonable criteria as [NNA] may develop from time to time.*" (Ex. C-17 at BN000047, § 3.B) (emphasis added). This section makes clear that Bates does have a "sales responsibility" and that NNA can evaluate its sales performance using *any* method, so long as the method it chooses is reasonable. Yet, and relying solely on the provisions of Section 3.A, the PFD concludes that RSE "is not a useful tool for measuring Bates' performance under its contract obligations" because it is based on "data that includes dealers' sales *outside* of their PMAs...." (PFD at 12) (emphasis added). Sales do not occur outside the PMA. (*See, infra*, Section III.E).

With no support, the PFD reached this erroneous conclusion by reading into Section 3.A language and limitations that do *not* exist. Specifically, citing only Section 3.A, the PFD holds that the “Dealer Agreement contains no obligations for Bates outside of its PMA.” (PFD at 4). While Section 3.A does provide that the dealer has a general obligation to actively and effectively “promote” the sale of Nissan vehicles to customers located in its PMA, the provision in no way indicates that each dealer’s performance of its Section 3 Vehicles Sales Responsibilities must be evaluated based solely on or limited to those sales made by a dealer that are then registered by customers to addresses inside the dealer’s PMA. *See, e.g., Love Nissan, Inc. v. Nissan North America, Inc.*, 2005 WL 1662263 at * 6 (Fla. Div. Admin. Hearings July 14, 2005).⁵

By virtue of the realities of cross-shopping and intra-brand competition, it is common sense and indeed, undisputed based on the record in this case, that every dealer’s promotion of the sale of vehicles to customers located in its PMA results in some sales to customers who register the vehicles outside the PMA. This fact does not undermine Nissan’s use of the standard method for evaluating the dealer’s sales performance under Section 3. To find otherwise, the PFD creates limitations and language in the agreement that do not exist, which is improper under both California and Texas law.⁶ *See e.g. E.M.M.I. Inc. v. Zurich Am. Ins. Co.*, 84 P.3d 385, 400 (Cal. 2004) (“It is not for this court to rewrite the parties’ contract by construing language to

⁵ Other cases hold the same. *Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc.*, 2012 WL 1079719 at *22 (E.D. Mich. March 30, 2012); *Hampton Automotive Group, Inc. v. Nissan North America, Inc.*, 2012 WL 5305152 at *3 (Fla. Div. Admin Hrgs. Sept. 12, 2012); *Ralph Gentile Inc. v. State, Div. of Hearings and Appeals*, 800 N.W.2d 555, 565 (Wis. Ct. App. 2011, rev. dism’d); *Classic Nissan, Inc. v. Nissan North America, Inc.*, Case No. 05-2426, 2007 WL 841365 at *2 (Fla. Div. Admin. Hearings March 20, 2007); *In the Matter of Seacoast Imported Auto, Inc. d/b/a Nissan of Stratham*, Docket No. 04-06 at 17 (N.H. Motor Veh. Indus. Board April 12, 2010).

⁶ The PFD, in effect, either rewrites or adds words to “customers located in the Dealer’s Primary Market Area” to say “customers who purchase a vehicle from the dealership and subsequently registers the vehicle in the Dealer’s Primary Market Area.” This too is improper as a matter of law. *E.M.M.I.*, 84 P.3d at 400; *Royal Indemnity*, 388 S.W.2d at 181.

mean something it does not mean.”); *Royal Indemnity Co. v. Marshall*, 388 S.W.2d 176, 181 (Tex. 1965) (“Courts cannot make new contracts between the parties, but must enforce the contracts as written.”).

The PFD ignores the plain language of the Dealer Agreement and instead reads into the Dealer Agreement restrictions that are not there and that were not intended by the parties. As a result, NNA excepts to the PFD’s statements, analysis, findings of fact and conclusions of law relating to the PFD’s interpretation of the contractual sales obligation pursuant to the Dealer Agreement and Bates’ performance of that sales obligation. (See PFD at 4-5, 12-17, 37, 40, 47, FoF 36, 38, 73, 124 and CoL 12-14).

B. The PFD Fails to Construe the Dealer Agreement as a Whole.

Moreover, the PFD *focuses solely* on one provision (*i.e.* the general sales obligation language contained in Section 3.A), while completely ignoring Section 3.B, which specifically governs Nissan’s evaluation of the dealer’s sales performance. This is improper. The California Supreme Court has held that “[f]or the purpose of ascertaining the intention of the parties, their agreement must be construed as a whole, so that when read together all of its provisions may be given effect.” *Moore v. Wood*, 160 P.2d 772, 777 (Cal. 1945); *see also Lemm v. Stillwater Land & Cattle Co.*, 19 P.2d 785, 788 (1933) (“[T]he meaning [of a contract] is to be obtained from the entire contract and not from any one or more isolated portions thereof.”). In the present case, Section 3.A cannot be read in isolation from the other material provisions in Dealer Agreement which clearly set forth a dealer’s Vehicle Sales Responsibilities.

C. When Read as a Whole, the Dealer Agreement Plainly Permitted Nissan to Terminate Bates’ Based on its Poor Sales Performance

When the Dealer Agreement is read as a whole and each provision is given its proper effect (as is required under California law and Texas law, for that matter), it is clear that RSE,

which accounts for all sales made by a dealer, is permitted by the Dealer Agreement, and is a reasonable criteria that Nissan has established for evaluating for Bates' performance of sales responsibilities.

It is axiomatic that Section 3.A must be read in conjunction with Section 3.B, which immediately follows. As noted above, Section 3.B provides that **“performance of [a dealer’s] sales responsibilities for Nissan Cars and Nissan Trucks [under Section 3.A.] will be evaluated by [NNA] on the basis of such reasonable criteria as [NNA] may develop from time to time.”** (Ex. C-17 at BN000047, § 3.B) (emphasis added). Thus, under the terms of the Dealer Agreement, Nissan has the right to choose the evaluation criteria it uses, so long as it is reasonable. RSE is a reasonable criteria to measure dealer sales performance.

To explain, RSE is calculated by first determining the dealer's sales as a percentage of all the registrations of competitive vehicles in that dealer's PMA. (*See* Ex. R-361 at A-6). If a dealer sold 10 vehicles during a month when 100 total competitive vehicles were registered in the dealer's PMA, that dealer's sales penetration would be 10%. The second step is to determine the percentage of all the manufacturer's sales compared to competitive vehicles registered in the entire region. (*See* Ex. R-361 at A-8). If the manufacturer's dealers sold 2,000 vehicles during a month when 10,000 total competitive vehicles were registered in the region, the regional sales penetration would be 20%. The final step to determine a dealer's RSE is to divide the dealer's sales penetration percentage (in this example, 10%) by the manufacturer's regional sales penetration (20%). In this example, the dealer's RSE is only 50% and well below average. 100% RSE is merely average—a “C” grade.

The PFD held, however, that because RSE credits dealers for all the sales, regardless of whether the vehicles sold are registered, it is unreasonable criteria for evaluating a Nissan

dealer's sales responsibilities under its Dealer Agreement. The PFD makes this completely untenable finding, even though *no* other case in the country has ever reached such a result. To the contrary, every court or administrative agency that has addressed the issue in conjunction with Nissan's Dealer Agreement's Standard Provisions has held that RSE is a reasonable and proper contractual method for measuring a Nissan's dealer's sales performance under Section 3. *See, e.g., Love Nissan*, 2005 WL 1662263 at * 6.⁷ RSE is a reasonable criteria that measures Bates' contractual sales responsibilities under Section 3 when read as a whole, inclusive of the general sales obligations language in Section 3.A. As a result, the PFD erred as a matter of law in finding that NNA should have used the alternative standards selected by the ALJ (which are not used by anyone in the industry).

Notably, even though Nissan could evaluate a dealer's sales performance using any reasonable method, the Dealer Agreement also includes non-exhaustive specific examples of reasonable criteria that NNA *may* use to evaluate sales performance, and these examples incorporate the key elements of RSE.⁸ For example, Section 3.B.2(ii) provides that NNA can evaluate a dealer's sales performance by examining the dealer's sales (regardless of where they might be registered) as a percentage of registrations of competitive vehicles. (Ex. C-17 at BN000047, § 3.B.2 ii.). Section 3.B.3 also specify benchmarks to which a dealer's sales performance may be compared, *i.e.*, a comparison to the "sales and/or registrations of all other

⁷ Other cases hold the same. *Superior Pontiac Buick GMC*, 2012 WL 1079719 at *22; *Hampton Automotive Group*, 2012 WL 4044353 at *3; *Gentile*, 800 N.W.2d at 565; *Classic Nissan*, Case No. 05-2426, 2007 WL 841365 at *3; *In re Seacoast*, Docket No. 04-06 at 17.

⁸ In footnote 11, the PFD takes issue with the fact that RSE is not specifically named as an example in Section 3.B of the Dealer Agreement. However, the language "including for example," as found in Section 3.B, is a term of enlargement. *See People v. W. Air Lines*, 268 P.2d 723, 733 (Cal. 1954) ("The term 'includes' is ordinarily a word of enlargement and not of limitation"). Texas law is the same. *See Republic Ins. Co. v. Silvertown Elevators, Inc.*, 493 S.W.2d 748, 753 (Tex. 1973) ("[T]he words 'include,' 'including,' and 'shall include' are generally employed as terms of enlargement rather than limitation or restriction."). As found in *Gentile*, "[t]he listed sales performance standards are only intended to be examples of criteria that Nissan NA may use." *Gentile*, No. TR-07-0001 at 15 (Attachment 2).

Authorized Nissan Dealers combined in Seller's Sales Region and District" or "to the sales or registrations of Dealer's competitors." (Ex. C-17 at BN000047, §§ 3.B.3, 3.B.4). This is how RSE works. It compares the dealer's total sales, regardless of where they are registered, as a percent of competitive registrations, as contemplated in Section 3.B.2, to other Nissan dealers in a benchmark area. *See Love Nissan*, 2005 WL 1662263, at *6, ¶ 18.

In holding that RSE is an unreasonable criteria for evaluating a dealer's sales responsibilities under its Dealer Agreement, the PFD also completely fails to consider Section 3.H of the Dealer Agreement. (*See, generally*, PFD). Section 3.H is part of Bates' sales responsibilities and provides:

Evaluation of Dealer's Sales Performance.

[NNA] will periodically evaluate Dealer's performance of its responsibilities under this Section 3. Evaluations prepared pursuant to this Section 3.H. will be discussed with and provided to Dealer, and Dealer shall have an opportunity to comment, in writing, on such evaluation. Dealer shall promptly take such action as may be required to correct any deficiencies in Dealer's performance of its responsibilities under this Section 3.

(Ex. C-17 at BN000048, § 3.H). It is undisputed that NNA consistently: (1) evaluated Bates' sales performance based on RSE; (2) discussed with and provided to Bates in writing those evaluations; and (3) gave Bates the opportunity to comment in writing about its RSE evaluations. For example, and consistent with Section 3.H, on November 4, 2009, NNA sent Bates a letter evaluating its sales performance based on RSE. (Ex. C-57). Bates responded in writing on December 4, 2009 stating, in part, "[w]e are aware of the RSE numbers that Nissan shows for Bates Nissan..." (Ex. C-58). Similar correspondence occurred periodically leading up to the notice of termination. (*See, e.g.*, Ex. C-59). Moreover, NNA consistently met with Bates to discuss the RSE evaluations, among other dealership issues and concerns. These discussions were memorialized in several contact reports and culminated in NNA issuing a Notice of Default

(“NOD”) on July 6, 2010 based on Bates’ failure to fulfill its RSE sales obligations. (*See, e.g.*, Exs. R-64, 66, 68, 261). As such, the undisputed evidence establishes that Bates’ sales performance was evaluated by Nissan using RSE, Bates was fully aware it, and *never* objected to NNA’s use of RSE to evaluate the dealership’s sales performance.

Section 12.B.1.a. of the Dealer Agreement provides that Nissan may terminate Bates if, based upon the evaluations set forth in Section 3.H, the Dealer “fail[s] to substantially fulfill its responsibilities with respect to Sales of new Nissan Vehicles or the other responsibilities of Dealer *set forth in Section 3 ...*” (Ex. C-17 at BN000048, § 3.H) (emphasis added). This provision clearly permits termination of Bates’ franchise based on its chronic poor sales performance. As a result, under Section 12.B.1 a., Nissan may terminate the Dealer Agreement based upon Bates’ failure to substantially perform its sales responsibilities under Section 3 after being provided with the opportunity to cure. Bates was provided ample opportunity over a number years to cure its RSE deficiencies, yet refused or failed to do so. (Exs. C-33, 35-41). Thus, Bates’ termination is clearly permitted by the Dealer Agreement.

In summary, read as a whole, the plain language of the Dealer Agreement expressly allows NNA to terminate Bates for consistently failing to fulfill its sales responsibilities as measured by RSE. Because the PFD added language and limitations into the Dealer Agreement that do not exist, failed to construe the contract as a whole, and ignored the plain language of the Dealer Agreement and Texas law (*see, supra*, Section III.A), the Board should reject the PFD’s analysis, Findings of Fact 36, 73 and 124 and Conclusions of Law 12-14 pursuant to Texas Government Code § 2001.058(e)(1) and find instead that Bates’ breached its Dealer Agreement and that RSE is permitted by the Dealer Agreement. (*See* PFD at 4-5, 12-17, 37, 40, 45, 47). In addition, because the PFD’s conclusion that Bates did not breach its Dealer Agreement is

incorrect, its conclusion that the statutory factor regarding the parties' compliance with the franchise weighs in favor of Bates is also incorrect. The Board should instead find that this factor weighs in favor of termination and that good cause for termination exists.

D. Courts and Agencies Across the United States Have Uniformly Arrived at the Same Conclusion that RSE is a Permitted Reasonable Criteria for Evaluating Dealer Sales Performance under the Nissan Dealer Agreement

Section 3 of the Dealer Agreement has been thoroughly examined, scrutinized and construed by multiple courts and agencies in a variety of jurisdictions in NNA sales performance termination cases. Contrary to the PFD's narrow and isolated reading of selected provisions in the Dealer Agreement, each of these courts and agencies, construing the Dealer Agreement as a whole, properly concluded that RSE is permitted, reasonable criteria by which Nissan can evaluate the sales performance of its dealers. The most relevant excerpts from several of these cases are quoted below, and for ease of reference, each such case is submitted by Nissan as Attachment 2. Although Nissan cited to each of the cases in its briefing to the ALJ, none of them were addressed in the PFD, with the sole exception of footnote 30. In that footnote, the PFD sought to distinguish the legal conclusion in *Gentile* that RSE was a permitted, reasonable criteria under the Dealer Agreement for evaluating sales performance based on the fact that are different *statutory* provisions in Texas and Wisconsin and different evidentiary record. Of course, neither of these differences affects the legal conclusion in *Gentile*, that RSE is permitted, reasonable criteria under the same Standard Provisions of the Dealer Agreement. *Gentile*, 800 N.W.2d at 563, 565.

FLORIDA⁹***Hampton Automotive Group, Inc. v. Nissan North America, Inc.*, 2012 WL 5305152 (Fla. Div. Admin Hrgs. Oct. 24, 2012)**

- Section 3A sets forth the general sales obligations of Hampton, which is to ‘actively and effectively promote through its own advertising and sales promotion activities the sale at retail... of Nissan Vehicles to customers located within the Dealer’s Primary Market Area.’ Article Second, Section B outlines the same general obligations. *Id.* at *3.
- Section 3B of the Dealer Agreement provides that ‘performance of [Hampton’s] sales responsibility for Nissan Cars and Trucks will be evaluated by [Nissan] on the basis of such reasonable criteria as [Nissan] may develop from time to time.’ This provision allows Nissan to evaluate Hampton’s sales performance using any method, so long as it is reasonable. *Id.*
- As permitted by section 3 of the Dealer Agreement, Nissan uses Retail Sales Effectiveness (RSE) to determine whether a dealer is meeting its sales obligations under the Agreement. *Id.*
- Although the terminology and calculations may vary slightly, RSE or sales penetration is the industry standard method used to measure dealer sales performance. *Id.* at 4.
- RSE is a fair method of evaluating dealer performance with conservative expectations because no dealer is expected to perform above an average level and because the dealer gets credit for sales anywhere, while only being held responsible for the sales opportunities within its PMA. *Id.*
- RSE is a reasonable criterion to measure dealer sales performance and it was reasonable for Nissan to evaluate Hampton’s sales performance using RSE. *Id.*

***Love Nissan v. Nissan North America, Inc.*, 2005 WL 1662263 (Fla. Div. Admin. Hrgs. July 14, 2005)**

- The dealer agreement permits Nissan to select its methodology for evaluating its dealers’ sales performance. One commonly-accepted, industry-wide methodology for measuring “effectiveness” of a dealership is the methodology employed by Nissan [*i.e.*, RSE]. Nissan demonstrated, and it is undisputed, that sales penetration is an industry-wide accepted standard for evaluation of dealers, and therefore falls within the scope of “reasonable criteria,” as permitted by the dealer agreement. *Id.* at *19.

⁹ In all three Florida cases, like in this case, NNA’s expert was from Urban Science and the dealers’ expert was from The Fontana Group.

- Historically, by case law, and by expert testimony in the instant proceeding, it is found that Nissan's method for evaluating its dealers' sales performance is a reasonable, industry-accepted practice for evaluating new car dealers. *Id.* at *6.

***Classic Nissan, Inc. v. Nissan North America, Inc.*, 2007 WL 841365 (Fla. Div. Admin. Hrgs. Mar. 20, 2007)**

- Section 3.B. of the Dealer Agreement permits the Respondent to develop and select the criteria by which sales are measured, as long as the measurement criteria is reasonable. *Id.* at *2.
- The dealer's sales penetration is compared to Nissan's regional sales performance to determine the dealer's sales performance as measured against other Nissan dealers in the region....[i.e., RSE] *Id.*
- Nissan's use of sales penetration as a measurement of dealer performance was reasonable or was permitted by the specific terms of the Dealer Agreement. *Id.* at 3.

MICHIGAN

***Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc.*, No. 08-10642, 2012 WL 1079719 (E.D. Mich. Mar. 30, 2012)¹⁰**

- Concluded, based upon poor RSE scores, "that Superior failed to perform its obligations under the Dealer Agreement, and the excuse for nonperformance is inadequate" and that Nissan complied with its contractual obligations to Superior as set forth in the Dealer Agreement." *Id.* at *22.

WISCONSIN

***In the Matter of Ralph Gentile, Inc., d/b/a Gentile Nissan v. Nissan North America, Inc.*, Case No. TR-07-0001 (Wis. Div. of Hearings and Appeals Feb. 4, 2010)¹¹**

- "[B]ased on the language in the [Dealer Agreement], the appropriate performance standard is sales effectiveness." *Id.* at 16.
- "Sales effectiveness is a reasonable standard for Nissan NA to evaluate Gentile Nissan's sales performance and based on this standard, Gentile Nissan breached the Dealer Agreement." *Id.* at 3.

¹⁰ Like this case, Urban Science was NNA's expert witness.

¹¹ Urban Science also provided expert testimony on behalf of NNA in *Gentile*.

Ralph Gentile, Inc. v. Wis. Div. of Hearings and Appeals, 800 N.W.2d 555 (Wis. App. 2011)

- “The Division determined that sales effectiveness, not registration effectiveness, was the appropriate standard to measure Gentile Nissan’s compliance with Section 3 of the term dealership agreement. That is certainly a reasonable construction of industry practice” *Id.* at 565.

NEW HAMPSHIRE***In the Matter of Seacoast Imported Auto, Inc. d/b/a Nissan of Stratham, No. 04-06 (N.H. Motor Veh. Ind. Bd. Apr. 12, 2010)***

- “[S]ales performance, as reasonably and objectively defined by Nissan in the Dealer Agreement, which it clearly articulated to Seacoast, is a reasonable and material element of such agreement.” *Id.* at 15.
- “Nissan’s method of assigning and using PMAs and RSE to measure performance is recognized and is one used within the automotive industry and is standard practice. It is a practice used by various manufacturers to evaluate dealer performance. This method is applied throughout the country by Nissan to all of its dealers.” *Id.* at 17.
- “The methodology that Mr. Farhat used in reaching his conclusion that Nissan properly terminated Seacoast, has been recognized and accepted by court’s, administrative agencies, and this Board.”¹² *Id.*

These decisions validate that the plain meaning and intent of the Standard Provisions of the Nissan Dealer Agreement, which is that those provision permits the use of RSE as reasonable criteria to evaluate dealer sales performance.

Because the PFD failed to construe the Dealer Agreement giving it its plain and ordinary meaning and failed to read it as a whole as a matter of law, the PFD’s analysis, Findings of Fact 36, 38, 73 and 124 and Conclusions of Law 12-14 should not be accepted by the Board. (*See* PFD at 4-5, 12-17, 37, 40, 45, 47). Instead, consistent with its authority under Texas Government Code § 2001.058(e)(1), the Board should find that Bates breached its Dealer Agreement, that RSE is permitted by the plain language of the Dealer Agreement and that, as a result, good cause for termination exists. (Attachment 1).

¹² Sharif Farhat of Urban Science was also NNA’s expert in this case.

E. The PFD Also Failed to Properly Construe the Dealer Agreement because of a Fundamental Misunderstanding of Sales, Curbstoning and Registration

The PFD's failure to properly construe the Dealer Agreement also demonstrates a fundamental misunderstanding of a lawful sale, curbstoning and the registration of a vehicle. The PFD failed to understand that a sale is the transfer of possession of a vehicle for consideration,¹³ which may only occur at the dealership per Section 2.A of the Dealer Agreement¹⁴ and Texas law, and that a registration is simply the subsequent act of recording the vehicles' ownership with the state.¹⁵ Customer, not dealers, control where vehicles are registered.¹⁶ The PFD also fails to understand that a sale from any location other than the dealership is curbstoning and is unlawful. Code § 2301.362 states that dealers "may only sell or offer to sell a motor vehicle from [its] established and permanent place of business." Tex. Occ. Code § 2301.362(a). Likewise, the Texas Department of Motor Vehicles Dealer Manual states:

- i. Off-site Sales, Curbstoning. Dealers are not allowed to sell vehicles from anywhere but their licensed premises. (43 TAC §215.136) Dealers are strictly prohibited from curbstoning, which is the practice of selling vehicles away from a dealer's licensed location....

¹³ The Board defines "sale" as "with regard to a specific vehicle, the transfer of possession of that vehicle to a purchaser for consideration." 43 TAC § 215.123(10).

¹⁴ Section 2.A of the Dealer Agreement states that "Dealer shall conduct its Dealership Operations only from the Dealership Location...." (Ex. C-17 at BN000046, § 2.A). Bates' "Dealership Location" is within its PMA at 5501 E. Cen-Tex Expressway, Killeen, Texas. (PFD at 34, FoF 2; Protest at 1; Ex. C-30). "Dealer Operations" are defined by the Dealer Agreement to "mean[] all dealer functions contemplated by this Agreement including, without limitation, sales...of Nissan Products."¹⁴ (Ex. C-17 at BN000044, § 1.M) (emphasis added).

¹⁵ Texas Administrative Code, title 43, § 215.144 (f).

¹⁶ While the sale only occurs at the dealership, customers may elect to have their vehicles registered in either: (a) their county of domicile, which may or may not be a county within the dealer's PMA; (b) the county where the vehicle was purchased, which always will be a county within the PMA since every Nissan dealership is situated within its own respective PMA; or (c) the county where the vehicle is encumbered, which may or may not be a county within the dealership's PMA since customers may finance from an entity situated anywhere. Tex. Transp. Code § 502.041(a). The PFD's confusion regarding "sale" and "registration" leads to erroneous Findings of Fact 36 which references "sales" outside Bates' PMA and Finding of Fact 38 which references "sales" anywhere in the United States. Both of these findings confuse "sales," which only occur at the dealership location, with "registration" which might occur outside the PMA or, indeed, anywhere in the United States. As a result of this confusion, both Findings of Fact 36 and 38 should be rejected.

The Motor Vehicle Dealer Manual at § 4.30(1) (2014 Ed.). It is undisputed that Bates is licensed to sell only from its dealership location in Killeen.

The PFD's confusion of these basic concepts is readily apparent in the PFD:

From a measurement standpoint, a Nissan dealer's sales will come from **both inside and outside of its PMA**. NNA argues that all sales of a dealer are...within its PMA because the sale occurs in the PMA at the dealership location. Accordingly, NNA dismisses many of Bates' arguments regarding the distinction of sales within and outside of a PMA. The ALJ disagrees with NNA's contention and believes that the distinction made by Bates is valid. First, in this age of internet sales, it is not clear that all sales transactions actually are deemed to occur at the dealership. To support such a broad contention, NNA must present persuasive evidence of this and it has not done so. It is certainly possible that an individual outside of a PMA could purchase a vehicle via internet and email communication without ever coming to the dealership to close the sale. If the dealership then delivers the vehicle to the customer and obtains payment upon delivery, that sale arguably occurs at the customer's location and not the dealership.

(PFD at 13) (emphasis added). The PFD goes on to state that a majority of Nissan dealers make "sales outside of their PMA" and use "non-PMA sales to reach their RSE goals". (PFD at 12). The PFD sums up its confusion by stating "[f]urther, using an RSE goal that is based on data that includes dealers' sales outside of their PMAs means the RSE target is not really tied to sales within PMAs." (PFD at 12).

The findings that sales occur "outside of the PMA" are central to the PFD's conclusions that RSE is not permitted by the Dealer Agreement and that good cause for termination does not exist. (PFD at 12-17). They are also demonstrably wrong. First, as set forth above, and despite the PFD's statement to the contrary, NNA provided irrefutable evidence that sales can only occur at the dealership per Section 2.A of the Dealer Agreement and state law. (*See* Ex. C-17 at BN000046, § 2.A); *see also*, Tex. Occ. Code § 2301.362(b); Motor Vehicle Dealer Manual at § 4.30(1) (2014 Ed.). Second, what the PFD considers to be a "sale outside of the PMA" is actually a sale that occurred within the PMA and at the dealership but that was subsequently registered

outside of the PMA. *See* Tex. Occ. Code § 2301.362(b); Motor Vehicle Dealer Manual at § 4.30(I) (2014 Ed.); (Ex. C-17 at BN000046, § 2.A; Tr. at 1601:19-1602:7 (Farhat)). It defies the Dealer Agreement, common sense and all notions of fairness for NNA to, as this PFD would do, give absolutely no credit to the selling Nissan dealer for a vehicle the dealer unquestionably sold in its PMA but registered somewhere else. The best way to measure, and certainly a reasonable and fair measure, of a dealer's efforts is to simply give it credit for each sale that it makes. Third, the internet and email sale situation mentioned in the PFD is a sale that is deemed to have occurred at the dealership. *See* Tex. Occ. Code § 2301.362(b). The Legislative history of § 2301.362(b), which is Attachment 3, makes it clear that online sales that occur when the customer never comes to the dealership are sales that occur at the dealership.¹⁷ And finally, if what the PFD describes as a sale outside of the PMA were actually a sale outside of the PMA, and not simply sale in the PMA that resulted in a subsequent registration outside of the PMA, it would be an unlawful sale.¹⁸ *See* Tex. Occ. Code § 2301.362(b); Motor Vehicle Dealer Manual at § 4.30(I) (2014 Ed.); (Ex. C-17 at BN000046, § 2.A). Bates, just like every other dealer, made every sale from its dealership and no sales from outside of its PMA. (*See* Tr. at 1601:17-1602:7 (Farhat)).

Had the PFD construed the Dealer Agreement as required by law and understood that all of Bates' sales must occur and did occur in its PMA, the PFD would have concluded that RSE is permitted by the Dealer Agreement and that good cause for termination exists. Because the

¹⁷ There is no evidence that Bates, or any other dealer, made any sales in which the customer used the internet and did not come to the dealership. As a result, they are irrelevant.

¹⁸ The dealer in *Gentile* made the same argument accepted by the PFD in this case that "by using dealer sales anywhere in the country, sales effectiveness does not measure the effectiveness of a dealer's promotional efforts within its own Primary Market Area" and that "sales' outside of the PMA are just a bonus." *Gentile*, 800 N.W.2d at 563. The Wisconsin Court of Appeals disagreed with the dealer holding that "if Gentile Nissan had done a superb job of promoting and selling Nissan vehicles within its Primary Market Area, as Section 3.A of the agreement required, its sales effectiveness would have been high; again, *contrary to Ralph Gentile's contention*, that it was a bonus that it also got credit for sales outside its Primary Market Area." *Id.* (emphasis added).

PFD does not properly apply or interpret controlling law or policies, the Board, consistent with its authority under Texas Government Code § 2001.058(e)(1), should reject the PFD's analysis, Findings of Fact 36, 38, 73 and 124 and Conclusions of Law 12-14 pursuant to Texas Government Code § 2001.058(e) and find, instead, that Bates' breached its Dealer Agreement, that RSE is permitted by the Dealer Agreement and that good cause exists for termination. (*See* PFD at 4-5, 12-17, 37, 40, 45, 47); (Attachment 1).

F. The Two Methods that the PFD Uses to Measure Bates' Performance Lead To Unreasonable Results, Unintended Consequences and Bad Policy

Failing to read the Dealer Agreement as a whole, the PFD erroneously concludes that Bates' sales performance should be based *solely* on its sales that are actually registered in its PMA. Contrary to California law, and as discussed further below the PFD's methods for measuring Bates' sales performance under the Dealer Agreement lead to unreasonable results, unintended consequences and establish bad policy.¹⁹ As the California Supreme Court has held “[w]here one construction would make a contract unreasonable or unfair, and another construction, equally consistent with the language, would make it reasonable, fair and just, the latter is the one which must be adopted. *Cohn v. Cohn*, 123 P.2d 833, 836 (Cal. 1942).²⁰ As such, the Board should reject these unreasonable methods and accept RSE as the appropriate measure under the Dealer Agreement and Code § 2301.455.

¹⁹ The Dealer agreement requires that the method be chosen by NNA and that it be reasonable. (Ex. C-17 at BN000047, § 3.B). Neither method used by the ALJ meet these requirements. As a result, both methods should be rejected as a matter of law.

²⁰ Texas law is the same and “construes contracts from a utilitarian standpoint bearing in mind the particular business activity sought to be served, and, when possible and proper, we avoid a construction which is unreasonable, inequitable, and oppressive.” *Hooks v. Samson Lone Star, Limited Partnership*, 457 S.W.3d 52, 63 (Tex. 2014).

1. The PFD'S First Method

The PFD's first method for measuring sales performance is based only on Bates' sales actually registered in its PMA as compared to all Nissan vehicles registered in its PMA. (PFD at 14).

First, this method does not measure Bates' sales performance. (Tr. at 1576:17-1577:7 (Farhat)). It measures only registrations of Nissan vehicles sold by Bates that are subsequently registered in Bates' PMA as compared to all Nissan vehicles registered in Bates' PMA. It measures something that dealers have no control over, which is where a vehicle is registered by a consumer. *Id.* This has nothing to do with how well Bates performs in selling Nissan vehicles, and, as noted above, is not the criteria NNA used to evaluate Bates' performance under the Dealer Agreement. *Id.*

Second, this method flows from the same seriously flawed premise that is found throughout the PFD—that sales occur outside the PMA. This section begins by stating “[a] large number of Nissan dealers in Texas are effective at obtaining sales outside of their PMAs.” (PFD at 14). As stated above in Section III.E, dealers cannot and do not make sales outside of their PMAs. *See* Tex. Occ. Code § 2301.362(b); Motor Vehicle Dealer Manual at § 4.30(I) (2014 Ed.); (Ex. C-17 at BN000046, § 2.A). Because the PFD's premise is flawed, the measure that flows from it is also flawed.

Third, this method ignores the cases cited in Section III.D above where courts and agencies have found that RSE is permitted by the Dealer Agreement, is reasonable, and as the evidence established in this case, recognized that NNA, consistent with industry standards, has used RSE for decades to measure the sales performance of its dealers, including Bates. (PFD at 38, FoF 45); *see, e.g., Hampton*, 2012 WL 5305152, at *4; (“Nissan has been using RSE as its

standard to measure dealer sales performance for over 30 years.”); *Superior Pontiac Buick GMC*, 2012 WL 1079719, at *8 (“RSE merely constituted the standard by which the industry measured dealer performance.”).²¹ Should the PFD’s method be accepted, the same language in the Dealer Agreement will be interpreted in a wholly different manner in Texas than in any other jurisdiction. There is no basis or explanation for this, other than the PFD’s failure to properly construe the Dealer Agreement.

Fourth, this measure, as the PFD admits, ignores the competitive landscape, and as a result, is anticompetitive. The PFD states that this method does not measure Bates’ “*effectiveness at taking sales away from non-Nissan dealers*”. (PFD at 14) (emphasis added). Nissan and its dealers compete against dealers of other brands such as Honda, Toyota, Hyundai, Kia, Mitsubishi, Chevrolet, Ford etc. (See Ex. R-361 at A-11). Nissan is rightfully concerned with its dealers’ sales performance against the competition, not simply how well its dealers are doing at capturing customer registrations within their PMAs.

Fifth, because this method only considers sales that result in registrations in the selling dealer’s PMA, it fails to take into account approximately half of the new Nissan vehicles sold by Nissan dealers. (See Ex. C-1, tab 11, pp. 3R-4R). For the time period that the PFD considered, which is October 2010 through September 2013, this means that 49,086 new Nissan sales are credited to Texas dealers, but 47,002 sales are not credited to any dealer because those sales were registered by customers outside of the selling dealer’s PMA. (See Ex. C-1, tab 11, pp. 3R-4R). As such, under the PFD’s interpretation, a strong performing Nissan dealer that sells a higher

²¹ Other cases hold the same. *Classic Nissan*, 2007 WL 841365, at *3 (“The use of sales penetration calculations as a measurement of dealer performance is common in the automotive industry.”); *In re Gentile*, Case No. TR-07-0001 at 7 (“This standard is referred to as regional sales effectiveness and is a common performance standard in the motor vehicle retail industry.”); *Love Nissan*, 2005 WL 1662263, at *19 (RSE is “an evaluation methodology which is generally accepted in the industry and which is a reasonable one.”); *In re Seacoast*, No. 04-06 at 17 (“Nissan’s method of assigning and using PMAs and RSE to measure performance is recognized and is one used within the automotive industry and is standard practice.”).

proportion of vehicles that are ultimately registered outside its designated PMA could be subject to termination under the Dealer Agreement. Such a method that fails to account for approximately half a dealer's sales and penalizes a strong performing dealer can in no way be considered a fair, reasonable, or just measurement of a dealer's sales performance.

Indeed, this method would result in high performing RSE dealers being deemed, under the PFD's method, poor performing dealers that should be subject to termination. Attachment 4 charts this effect with respect to a number of high performing Texas Nissan dealers as measured by RSE. (Attachment 4). As an example, Gunn Nissan in San Antonio, as an example, would be one of the worst dealers in Texas ranking 60th out of 66 Texas dealers based on the PFD's method. (See Ex. C-1, tab 11, pp. 3R-4R; Ex. R-275). Its registrations of its sales in its PMA were only 39.77% of the total Nissan registrations in its PMA. (Attachment 4; see Ex. C-1, tab 11, pp. 3R-4R). However, Gunn Nissan is one of the best performing Nissan dealers based a measure that accounts for all of its sales - i.e., RSE—207%, ranking it 7th out of 66 Texas Nissan dealers; consideration of it as a candidate for termination would be unreasonable.²² (Ex. R-274).

Sixth and finally, the PFD's interpretation ultimately hurts consumers in that it weakens competition. Under the PFD's ruling Texas Nissan dealers will not be motivated or incentivized to sell to customers who ultimately choose to register their vehicles outside of their PMAs because the dealer would not get credit for such a sale toward sales performance requirements. Dealers would prioritize their sales efforts and pricing strategies to customers who will register their vehicles in their PMA (as opposed to all customers shopping the dealership), which is

²² See also Attachment 4 (Ex. C-1, tab 11, pp. 3R-4R; Ex. R-274), which shows that many Nissan dealers, like Gunn, that are performing above average based on RSE over the time period that the PFD considered would be deemed poor performers based on the PFD's method. Effectively, what the PFD's measure does is to take almost all single point dealers and move them to the top of the list, and at the same time, drops some good performing metro dealers to the bottom of the list. What this means is that the PFD's method favors single points dealers over metro dealers.

obviously bad for consumers as it would reduce interbrand and intrabrand competition, leading to higher prices and lower customer satisfaction. (See Tr. at 1633:20-1634:22 (Farhat)); *see also*, *Rockwall Imports, LP d/b/a Honda Cars of Rockwall v. The Allee Corp. d/b/a Rusty Wallis Honda*, 2011 WL 1621638, at *60, FoF 197 (Tex. State Office of Admin. Hrgs. 2011).

This method should be stricken from the PFD and the Board, based on its authority under Texas Government Code § 2001.058(e)(1), should reject the PFD's analysis, Findings of Fact 36, 38, 73 and 124 and Conclusions of Law 12-14 and find instead that Bates' breached its Dealer Agreement, that RSE is permitted by the Dealer Agreement and that good cause exists for termination. (See PFD at 4-5, 12-17, 37, 40, 45, 47); (Attachment 1).

2. The PFD's Second Method

For the first, second, third, fourth and sixth reasons cited in Section III.F.1 above, and for other reasons discussed below, the PFD's second method of measuring sales performance—Bates' sales registered in its PMA as a percentage of the expected Nissan sales in Bates' PMA—should also be stricken because it causes unreasonable results, unintended consequences and is bad policy. (See PFD at 15-16). This method uses the time period from October 2012 through September 2013 (Ex. C-2, tab 1R, pp. 4-5), as well as calendar year 2012. (Ex. C-2, tab 1R, pp.13-14).

Like the first method, the second method still only takes into account approximately half of the Nissan vehicles sold by Texas dealers.

- 47,002 of 96,088 total Nissans sold in Texas during the rolling 12 month period ending September 2013 (approximately 49%).²³ (See Ex. C-2, tab 1R, pp. 4-5; Ex. R-275).

²³ The chart shows the sales registered in the PMA for Baytown Nissan, Victoria Nissan and Baker South Nissan based on Ted Stockton's expert report. However, the total sales for those three dealerships, which went through buy/sells during the rolling 12 month period, are not known. Therefore, their total sales were presumed to be equal to their sales registered in their respective PMAs to avoid any miscalculations. If the total sales numbers for those three dealerships were known, the number and percentage of Nissan sales not being credited to any dealer would both increase.

- 46,056 of 89,753 total Nissans sold in Texas during calendar year 2012 (approximately 51%). (See Ex. C-2, tab 1R, pp. 13-14; Ex. R-209).

Again, no Texas dealer wants a manufacturer to consider only half of its sales.

Also consistent with the first method, the second method results in good Nissan dealers, although a different list, being cast as poor performers. For the period October 2012 to September 2013, Gunn Nissan is once again a good example. Gunn is ranked 7th among Texas Nissan dealers based on RSE. (Ex. R-274). However, Gunn Nissan would rank 60th out of 66 Texas Nissan dealers at 38.89% using the PFD's second method and would be subject to consideration for termination. (Ex. C-2, tab 1R, pp. 4-5). This outcome makes no sense and is the type of unreasonable result that both California and Texas law avoids when interpreting contractual language. The outcome is the same for calendar year 2012 where Gunn Nissan's RSE score is 253.8%, but is only 49.13% based on the PFD's method. (See Ex. C-2, tab 1R, pp. 13-14; Ex. R-208).

Other examples like Gunn that occur from applying the PFD's method are demonstrated in the two charts included as Attachments 5 (October 2012 through September 2013) and 6 (calendar year 2012). As with the first method, turning good performing dealers into bad performing dealers makes it clear that the PFD's second method is unreasonable.

Accordingly, because it leads to unreasonable results, unintended consequences and sets bad policy, the PFD's second method is contrary to California law and should be stricken from the PFD. The Board, based on its authority under Texas Government Code § 2001.058(e)(1), should reject the PFD's analysis, Findings of Fact 36, 38, 73 and 124 and Conclusions of Law 12-14 and, instead, find that Bates violated its Dealer Agreement, that RSE is permitted under

the Standard Provisions of the Dealer Agreement, and that good cause for termination found. (See PFD at 4-5, 12-17, 37, 40, 45, 47); (Attachment 1).

G. The PFD Misinterpreted “Sales in Relation to Sale in the Market” in Code Section 2301.455(a)(1)

NNA also excepts to the PFD’s statements, analysis, Findings of Fact and Conclusions of Law relating to the interpretation of Code § 2301.455. (See PFD at 24-26, 43, 47, FoF 100-101 and CoL 12-14).

The same confusion and misunderstanding about lawful sales, curbstoning and registrations that infected the PFD’s analysis of the Dealer Agreement also caused the PFD to misinterpret “sales in relation to sales in the market” in Code § 2301.455(a)(1). The PFD made this abundantly clear when it stated that:

Ultimately, given the Dealer Agreement language the ALJ believes that Bates’ “sales in relation to sales in the market” must be considered on the basis of Bates’ PMA and not a broader market. Because Bates’ performance is average when the market is framed like this, the ALJ concludes that this factor [“sales in relation to sales in the market”] does not support good cause for the termination.

In other words, the PFD construction of § 2301.455(a)(1) is based on the same mistaken belief that the PFD applied to the Dealer Agreement that sales occur inside and outside of the PMA.

For all of the reasons stated above with respect to the Dealer Agreement, this is incorrect. Every sale Bates makes is made from its physical dealership location in its PMA to customers located in its PMA. There are no sales made outside of the PMA.

1. The Plain Language of the Statute Controls

In addition to misunderstanding where sales must legally occur, the PFD also fails to properly construe the plain language of the statute. As the Texas Supreme Court has held, a court’s “objective in construing a statute is to give effect to the Legislature’s intent, which requires us to first look to the statute’s plain language. *Lippincott v. Whisenhunt*, 462 S.W.3d

507, 509 (Tex. 2015).²⁴ The legislature’s intent is determined from the plain and ordinary meaning of the words used. *Nathan v. Whittington*, 408 S.W.3d 870, 872 (Tex. 2013).

The Code does not define “sale” but instead defines “retail sale” — “means any sale of a motor vehicle....” Tex. Occ. Code § 2301.002(30). The Board, however, defines “sale” as “with regard to a specific vehicle, the transfer of possession of that vehicle to a purchaser for consideration.” 43 TAC § 215.123(10). Given these definitions, the plain language of Code § 2301.455(a)(1) does not limit sales to only those registered in the dealer’s PMA as found by the PFD.²⁵ *See generally*, Tex. Occ. Code § 2301.455. The legislature set forth plain language and a straightforward comparison—“the dealer’s sales” (defined as the transfer of possession of that vehicle to a purchaser) versus “sales in the market.” The omission by the legislature of a restriction, such as where a sale is registered, must be considered intentional and given full effect. *Lippincott*, 462 S.W.3d at 509 (“We presume the Legislature included each word in the statute for a purpose and that words not included were purposefully omitted.”).²⁶ There is simply nothing in the Code that suggests that the legislature intended for a dealer to get credit for anything less than every sale that it makes.

Instead of giving the statute its plain meaning, the PFD adds the words “registered in the market” to “the dealer’s sales.” (*See* PFD at 26). Section 2301.455(a)(1) does not speak in terms of registrations, it states “sales.” Tex. Occ. Code §2301.455(a)(1). Sales and registrations are not synonymous. It is improper under Texas law for the PFD to add words to the statute. *Greater Houston P’ship v. Paxton*, 468 S.W.3d 51, 94 (Tex. 2015) (“[O]ur job is to interpret and

²⁴ Because this is statutory interpretation, Texas law is controlling.

²⁵ When the legislature meant a registration as opposed to a sale, it made that distinction in the Code. For example, as part of the definition of “towable recreational vehicle”, the Code requires that the vehicle “meets the requirements to be issued a certificate of title and registration by the department....” Tex. Occ. Code § 2301.002 (32)(B).

²⁶ The Code does not concern itself with where a consumer records a sale, *i.e.* a registrations. Instead, the focus is on the sale itself.

apply the statute as written, not to rewrite it to achieve the policy outcomes they or we may prefer.”).

Giving the statute its plain meaning, it is necessary to consider all of Bates’ sales, regardless of where they are registered, compared to sales in the market. As testified to by NNA’s expert, Sharif Farhat, this is exactly what RSE measures—all of a dealer’s sales compared to sales in the market. (Ex. C-354 at 130:3-11). The numerator of the RSE formula is Bates’ total sales. (Ex. R-361 at A-6). The denominator is the expected number of sales Bates should make to perform as an average Central Region Nissan dealer. *Id.*

2. A Correct Interpretation of Section 2301.455 Favors Termination

The plain language of Section 2301.455 makes it clear that the PFD’s narrow interpretation is improper. In addition, the PFD recognizes that if the “Board interprets Section 2301.455(a)(1) more broadly than the PFD’s narrow construction, then certainly NNA’s RSE methodology is a reasonable way to measure Bates’ sales in relation to sales in the market.” (PFD at 25). The PFD goes on to state that “[t]he evidence clearly shows that Bates is a poor performer in regard to its overall sales when compared to other Nissan dealers in Texas and the central region, ranking near the bottom of all such dealerships during the time period between 2007 and 2013.” (PFD at 25).

Because the PFD ignores the plain language of the statute, adds words to it, and misinterprets § 2301.455(a)(1) to include restrictions that simply are not present based on its confusion about sales, curbstoning and registrations, its erroneous interpretation must be rejected as a matter of law and a matter of sound policy. Because the PFD misinterprets and misapplies the Code, the Board should reject the PFD’s analysis, Findings of Fact 100-101 and Conclusions of Law 12-14 pursuant to Texas Government Code § 2001.058(e) and, instead, find that RSE is

the appropriate measure of Bates' sales in relation to sales in the market and that good cause for termination exists. (See PFD at 24-26, 43, 47); (Attachment 1).

H. The PFD Erroneously Concludes that Bates Did Not Breach Sections 12.A.8.-10. of the Dealer Agreement

Beginning in at least 2009, Bates created and implemented a scheme to pay federal income tax on approximately \$75,000 a year, regardless of its actual taxable income after all lawful deductions were taken. Because it was a perpetual tax deferral scheme, it, in reality, was a tax avoidance scheme. (See PFD at 18). No dealer in Texas or anywhere in the country has done what Bates' did. (See Tr. at 791:3-13 (Davis)).

To carry out its scheme, Bates wrote down its new and used motor vehicles to whatever amount was necessary in order to arrive at approximately \$75,000 in taxable income. (Tr. at 346:21-347:1 (Bates)). If Bates' taxable income did not reach the \$75,000 goal when Bates initially completed its write-downs, it would simply increase the new and used vehicle write-down until the tax goal was reached. (See Tr. at 383:23-384:11, 398:24-400:10 (Bates)).

Bates told many stories about what it used as "guidance" to write down the vehicles.²⁷ At various times, Bobby Bates testified that he used loan value (Ex. C-205; Tr. at 357:23-358:7 (Bates)), his own judgment (Ex. C-205; Tr. at 363:10-364:24, 366:18-367:11, 568:10-14 (Bates)), something between loan and wholesale value (Ex. R-495 at 181:5-22; Ex. C-338-2 at 22:29-23:6; Tr. at 357:23-359:18 (Bates)) and a percentage off invoice (Tr. at 363:10-364:24

²⁷ The PFD suggests that Bates' improper and unlawful inventory reductions should be excused because of instructions it allegedly received from its enrolled tax agent, Buster Gautier ("Gautier"). (See PFD at 23). However, the evidence conclusively proves that Gautier provided Bates with no instruction on how to take its inventory write-downs. (Tr. at 344:16-346:11 (Bates), 611:24-612:10, 618:19-619:17 (Gautier)). Instead, Bates merely asked Gautier if it could write-down prior year model vehicles, nothing more. (Tr. at 343:15-345:14 (Bates)). Gautier said it could. *Id.* Bates never asked how it could lawfully accomplish the write-downs, what rules apply, what proof of the write downs was required etc. (Tr. at 345:22-346:2 (Bates)). Bates cannot be excused from its unlawful actions because it chose not to seek advice on how to take the write downs. The PFD's suggestion is akin to a taxpayer asking his accountant if it is lawful to take a home office deduction and the accountant saying yes. If, however, the taxpayer seeks no further guidance about how to properly claim the deduction, he cannot blame his accountant when he is found to have violated tax laws by deducting the entirety of his home as a home office.

(Bates)). It should come as no surprise that Bates does not have any documents to support anything that it claims that it did despite the fact that every taxpayer knows that you have to retain tax documents.²⁸ (Tr. at 346:3-11, 374:1-4, 527:16-528:1 (Bates)). In reality, what Bates did was grab numbers out of thin air. Bates' financial expert, Robert Davis, testified that he was unaware of any evidence that showed that Bates' "did anything other than make up [the write-downs in this case] in its head, put them down on a piece of paper...to be included in a tax return." (Tr. at 877:24-878:25 (Davis)).

The festering problem with Bates' plan was that it knew that it had no basis whatsoever for the write-downs. Every tax payer knows that you cannot create a taxable income goal and then simply write-down inventory, with no basis in fact or law, to reach that goal. As the PFD found, Bates' actions in writing down the vehicles were not in good faith and were "unjustified." (See PFD at 18, 20).

Bates' scheme is the classic example of "the snowball effect." Bates' improper write-downs from one year rolled into the following year as "recaptured profits," but then also continued rolling into the next year and the next because ever increasing write downs were taken by Bates as part of its scheme. Exhibit R-493, which is Attachment 8, shows this graphically using Bates' actual numbers. It shows that Bates improperly wrote down \$121,571 of new and used vehicle inventory in 2009. As a result, Bates' 2010 "total profits" of \$323,114 included \$121,571 of inflated or false profits from vehicles improperly written down in 2009 being sold in 2010. To get to the \$74,988 in taxable income reported to the IRS for 2010, Bates had to improperly write-down \$277,447 in new and used motor vehicles (the \$121,571 written down from 2009 plus \$155,876 of actual profits). This \$277,447 then rolled into 2011 as "profit" because each written down vehicle from 2010 was sold in 2011. The \$277,447 was then added

²⁸ See IRS Publication 583 at 15 (January 2015) (excerpt attached as Attachment 7).

to the actual profit made in 2011 of \$254,567 for \$532,014 in “total profit.” The \$532,014, which is inflated or false by \$277,447 in unlawful write downs from 2010, was reported to NNA on Bates’ 2011 financial statements. To get to the \$68,251 in taxable income reported to the IRS for 2011, Bates had to write-down \$442,245 in new and used vehicles, which was comprised of \$277,447 in write downs from 2010 for a second time plus \$164,798 of the true profits that were made in 2011. Because of the snowball effect, the \$442,245 from 2011 rolled into 2012 and when combined with the true profits of \$549,859 resulted in \$992,104 in “total profits.” The \$992,104, which is inflated or false by \$442,245 of unlawful write downs from 2010 and 2011, was reported to NNA on the 2012 financial statements. The \$992,104 in reported profits meant that Bates now had to write-down \$813,448 in new and used vehicle inventory in order to meet its tax goal for 2012. As R-493 shows, Bates’ scheme continued until it was caught as a result of NNA’s efforts in this case.

By the time it was caught, Bates had improperly written-down \$2,259,672 in new and used vehicle inventory causing it to falsely overstate profits on its financial statements provided to NNA by 2010-\$121,571 or 60%, 2011-\$277,447 or 109%, 2012-\$442,245 or 80% and 2013-\$813,448 or 488% for a total of \$1,654,711 or 141% and under report taxable income to the IRS and on its 13th month financial statements by 2010-\$126,555 or 63%, 2011-\$186,316 or 73%, 2012-\$473,254 or 86% and 2013-\$66,244 or 40% for a total of \$852,369 or 73%. With each subsequent monthly financial statement submitted to NNA and each subsequent federal tax filing, the snowball grew larger until Bates’ actions were exposed by NNA. During this period, Bates improperly wrote down over 500 new and used vehicles.²⁹ In addition to falsely reporting

²⁹ The number of vehicles that Bates unlawfully wrote down for each corresponding year are—2010-78 used, 2011-29 new and 91 used, 2012-54 new and 99 used and 2013-34 new and 129 used. The number of vehicles that Bates had to write-down to keep its scheme going is another example of the snowball effect. Bates had to write down more vehicles with each passing year in order to keep its scheme going.

profits to NNA, Bates' return on sales, new working capital, and effective net worth set forth on its financial statements were also false. (Tr. at 1418:8-1422:3 (Walter); Ex. R-368 at 11R-12R, ¶¶ 34-35 and Attachments 8R-10R).

Once NNA caught on to Bates' scheme, Bates became fearful that the IRS would discover its scheme. For this reason, Bates sent the IRS Form 3115 to report what it had done, sort of. What Bates told the IRS was "inaccurate." (Tr. at 864:4-8 (Davis)). Bates did not tell the IRS that it simply had made up the write downs in its head. (*See, generally*, Ex. C-205). Instead, it told the IRS that is used loan value for writing down used vehicles and its "judgment" for new vehicle.³⁰ *Id.* Bates' tax scheme breached Section 12.A.8-A.10 of the Dealer Agreement, which states:

Section 12. Termination

A. Termination Due to Certain Acts or Events

The following represent events which are within the control or originate from actions taken by Dealer or its management or owners and which are so contrary to the intent and purpose of this Agreement that they warrant its termination:

...

8. *Any material misrepresentation* by Dealer or any person named in the Final Article of this Agreement as to any fact relied on by seller in entering into, amending or continuing with this Agreement, including, without limitation, any representation concerning the ownership, management, or *capitalization* of Dealer;

9. *... any willful failure* of Dealer to comply with the provisions of any laws, ordinances, rules, regulations, or orders relating to the conduct of its Dealership Operations including, without limitation, the sale and servicing of Nissan Products.

10. *Knowing submission* by Dealer to Seller of: (i) *a false or fraudulent report or statement*; . . . (iii) *false financial information*; (iv) *false sales reporting data*

Upon the occurrence of any of the foregoing events, Seller may terminate this Agreement by giving Dealer notice thereof, such termination to be effective upon the date specified in such notice, or such later date as may be required by any applicable statute.

³⁰ In Finding of Fact 87, the PFD states that the IRS has accepted Bates' proposal set forth in the Form 3115 and that the IRS "took no enforcement action, and there have been no criminal or civil charges filed against Bates for its past accounting practices." (FoF 87). NNA excepts to this because there is no evidence that the IRS has accepted what Bates sent to it. As a result, the Board should reject Finding of Fact 87 and the related statements on page 19 of the PFD pursuant to Texas Government Code § 2001.058(e)(1). All that can be said is that the form was filed and no one knows when or if the IRS may take any action against Bates.

(Ex. C-17 at BN000065-66, §§12.A.8.-10.). Bates breached Section 12.A.8 because it materially misrepresented the dealership's capitalization. It breached Section 12.A.9 because its scheme willfully failed to comply with tax laws; and it breached Section 12.A.10 because its tax scheme caused Bates to knowingly provide false financial statements to NNA.

As a result, NNA excepts to the PFD's statements, analysis, Findings of Fact 75, 77-79, 83-84, 86-87, 89-92, 94-98 and Conclusions of Law 12-14. (See PFD at 5, 17-24, 41-43, 47).

1. The PFD's Finding that Bates' Write-Down were "Not on a Good Faith Basis" can only lead to a Finding that Bates Knowingly Submitted False Financial Statements to NNA and Willfully Violated Federal Tax Law

The PFD erroneously concludes in Findings of Fact 77, 97-98 and 124 and Conclusions of Law 12-14 that Bates did not breach Section 12.A.9 of the Dealer Agreement by willfully failing to comply with tax laws and regulations and did not breach Section 12.A.10 of the Dealer Agreement by submitting false financial information to NNA. The PFD itself makes clear that these findings are erroneous.

At the outset of its analysis on page 18, and after laying out a partial example of Bates' tax scheme, the PFD correctly and succinctly finds that "[a]t each year end, Bates wrote down large chunks of its inventory *not on the good faith basis* of those vehicles' values, but rather in an effort to achieve a certain taxable income level."³¹ (PFD at 18) (emphasis added). The PFD also correctly finds that "[c]ertainly, Bates' conduct was aggressive and *unjustified*." (PFD at 20) (emphasis added). Because they were not in good faith nor justified, Bates' actions were, at a minimum, not honest, had no lawful purpose, were deceitful and were unwarranted in light of

³¹ Bates' CPA expert, Mr. Robert Davis, testified:

Q: And you do not hold the opinion do you, Mr. Davis, that Bates Nissan can take write-downs on new and used motor vehicles that in good faith it knows not to be accurate, do you sir?

A: If they knew in good faith that it was not accurate, then they should not have used those write-downs.

(Tr. at 783:21-784:2 (Davis)).

the surrounding circumstances. The plain and ordinary meanings of “good faith” and “unjustified” make this clear. Webster’s defines good faith as a “state of mind indicating honesty and lawfulness of purpose” and as “absence of fraud, deceit, collusion, or gross negligence”. *Webster’s Third Int’l Dictionary* 978 (1986). Black’s Law Dictionary defines good faith as a “state of mind consisting in (1) honesty in belief, (2) faithfulness to one’s duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.” *Black’s Law Dictionary* 808 (10th ed. 2009). Webster’s defines unjustified as “not justified; not demonstrably correct or judicious; unwarranted in light of the surrounding circumstances.” *Webster’s Third Int’l Dictionary* 2502 (1986). As a result, the only conclusion that can be reached is that Bates breached Section 12.A.9 by willfully failing to comply with tax laws and regulations and Section 12.A.10 by knowingly submitting false financial statements to NNA.

These breaches are also supported by Bobby Bates’ admissions. Bobby Bates admitted the following on questioning by NNA’s counsel:

- Q:I had asked you whether you did that act of increasing the reduction amount on used and including the new and that you did so arbitrarily. Is that a truthful statement?
- A: Yes.
- Q: And that you did so knowingly, willfully, deliberately and consciously. This was not a mistake, was it, Mr. Bates?
- A: No, it was not a mistake.

(Tr. at 385:16-24 (Bates)). Bates’ counsel followed up with Bobby Bates admitting:

- Q: When you were agreeing with counsel that you were willfully and knowingly making the write-downs, what did you mean by that?
- A: I think knowingly and willing, I mean, that’s – obvious I knowingly and willingly did it. It was something I did every year....

(Tr. 450:14-19 (Bates)). The fact that Bates made the write downs that resulted in overstating the profits on its financial statements submitted to NNA and understating its taxable income reported to the IRS arbitrarily, deliberately, consciously, knowingly, willingly, not in good faith and without justification makes it clear that Bates breached Sections 12.A.8-10 of the Dealer Agreement.

The definition of willful also makes it clear that Bates breached of Section 12.A.9.

California law holds:

In civil cases, the word ‘willful,’ as ordinarily used in courts of law, does not necessarily imply anything blamable, or any malice or wrong toward the other party, or perverseness or moral delinquency, but merely that the thing done or omitted to be done was done or omitted intentionally. It amounts to nothing more than this: That the person knows what he is doing, intends to do what he is doing, and is a free agent.

Ibrahim v. Ford Motor Co., 214 Cal. App. 3d 878, 894, 263 Cal. Rptr. 64, 74 (Ct. App. 1989).³²

It is undisputed that Bates knew what it was doing and intended to do in unlawfully writing down the vehicles and reporting the results of the write down to the IRS as it did.³³

The definition of “knowing” also establishes that Bates violated Section 12.A.10. Knowingly is defined as “in a knowing manner; with awareness, deliberateness, or intention.” *Webster’s Third Int’l Dictionary* 1252 (1986).³⁴ Bobby Bates’ testimony cited above makes it clear – Bates’ actions were knowing, deliberate, intentional and conscious.

³² Under Texas law, the term willfully means with evil intent or legal malice *or* without reasonable ground for believing the act to be lawful. *Brown v. State*, 322 S.W.2d 626, 627-28 (Tex. Crim. 1959). This definition has been adopted by the Board. *In re License of Bill Heard Chevrolet Corp.*, Docket No. 99-0165-ENF (Nov. 16, 2000). Bates had no reasonable grounds to believe its reductions were lawful when Bobby Bates has admitted that he determined to amounts of the reductions arbitrarily and for the sole purpose of reducing Bates’ taxable income to \$75,000. (See Tr. at 346:21-347:1, 384:3-11, 385:16-24 (Bates)).

³³ The PFD suggests on page 23 that because Bates sent the IRS Form 3115 it did not willfully violate tax laws. The fact that Bates sent the form to the IRS has nothing to do with whether Bates’ action in taking the unlawful write downs was willful. This is especially true given that Bates did not tell the IRS the truth.

³⁴ Both California and Texas law provide that contractual language should be given its plain and ordinary meaning. *Cohn v. Cohn*, 123 P.2d 833, 835 (Cal. 1942) (“Terms used in a written contract are to be construed according to the ordinary and usual meaning of the language unless an intent that they should be interpreted otherwise plainly appears.”); *Dynegy Midstream Servs. v. Apache Corp.*, 294 S.W.3d 164, 168 (Tex. 2009) (same).

Because Bates' actions in writing down the vehicles were arbitrary, deliberate, conscious, knowing, willful, not in good faith and were unjustified, the PFD's analysis, Findings of Fact 77, 94-98, 124 and Conclusions of Law 12-14 should be rejected by the Board pursuant to Texas Government Code § 2001.058(e)(1).³⁵ (See PFD at 5, 17-24, 42-43, 45, 47). The Board should find, instead, that Bates breached Section 12.A.8 by materially misrepresenting its capitalization on its financial statements, Section 12.A.9 of the Dealer Agreement by knowingly providing false financial statements to NNA from, at least, 2010 to 2014 and breached Section 12.A.10 of the Dealer Agreement by willfully violating tax laws and, as a result, good cause for termination exists. (Attachment 1).

2. The PFD Reached Its Erroneous Findings that Bates Did Not Breach the Dealer Agreement by Incorrectly Concluding that NNA Failed to Provide any Evidence that the Financial Statements Submitted to NNA were False

The PFD erroneously concludes that Bates did not breach its Dealer Agreement by submitting false financial information to NNA, and did not willfully fail to comply with tax laws and regulations based on the flawed findings that "[t]here is no evidence that any financial statements submitted by Bates to NNA were actually false," which leads the PFD to erroneously conclude that "[t]he evidence does not demonstrate that Bates made material misrepresentations to NNA or submitted false financial information in violation of the Dealer Agreement."³⁶ (FoF 94 and 97). The PFD could not be more wrong. The record is full of evidence that the financial statements submitted to NNA, month-after-month, were indeed false because of Bates' perpetual tax scheme that the PFD found to be unlawful.

³⁵ As the Austin Court of Appeals has held, "an agency acts arbitrarily if it makes a decision without regard for the facts, if it relies on fact findings that are not supported by any evidence, or if there does not appear to be a rational connection between the facts and the decision." *Dutchmen Mfg., Inc. v. Texas Dept. of Transp., Motor Vehicle Div.*, 383 S.W.3d 217, 221 (Tex. App.—Austin 2012, no pct.).

³⁶ The PFD also erroneously states that "...Bates did not actually submit any false information to NNA." (PFD at 23). NNA excepts to this statement for the reasons stated in this section.

To find not only evidence but also a thorough analysis as to why the financial statements are false, one need look no further than Exhibit R-368, an expert report from NNA's financial expert, Herbert Walter.³⁷ With almost every page of his 60 page report, Walter explains why Bates' financial statements are false. Below are representative samples of the evidence and analysis provided by Walter in his report, which are backed-up by numerous charts and tables:

10. These inventory adjustments would have caused Bates' income statements as well as, at a minimum, the following to be inaccurate and unreliable:

- a. Gross profit for each new Nissan new vehicle model
- b. Gross and net profit for the new vehicle department
- c. Gross profit for used vehicles
- d. Gross and net profit for the used vehicle department
- e. Overall dealership net profit
- f. Various new and used inventory accounts
- g. Net working capital
- h. Effective Net Worth

12.b. ...The 12th-month financial statements are distorted by the carry-over effect of the new and used vehicle adjustments with unsupported write-downs booked in one year and abnormal gross profits recorded in the next year. As discussed in my Report, this is compounded in the second year because if income is to be reduced in the second year, the write-down in year two will need to be larger. This pattern with increasing write-downs as the years progress repeats in the third year and years beyond. I found this pattern of write-downs for 2009 through 2013, as discussed in my Report....

16. ...The inaccuracies associated with Bates' year-end financial statements would also extend to its financial statements for the other months of these years, rendering them similarly inaccurate and unreliable.

72. Bates' financial statements, as reported to Nissan, were inaccurate and unreliable, not because of a difference between its 12th-month and 13th-month financial statements caused by normal year-end adjustments....Rather, Bate's inaccurate and unreliable financial statements were caused by the arbitrary manner in which Bates...manipulate[d] its financial statements with selective, and in some cases duplicative, write-downs for new and used vehicles in its inventory.

(Ex. R-368 at ¶¶ 10, 12, 16, 72). Walter also provided evidence and analysis that Bates' provided false financial statements to NNA in two other reports. (Exs. R-366, 367). Walter also

³⁷Walter is a CPA and former PricewaterhouseCoopers partner. He has more than 35 years of finance and management consulting experience in the automotive industry. (Ex. R-366 at Attachment 1).

created and testified to Exhibit R-493 (Attachment 8), which, as explained above, explains how the financial statements are false. The testimony is Attachment 9.

NNA's fraud examiner, Bryne Liner,³⁸ also provided an expert report that concluded that Bates' provided false financial statements to NNA in which he stated:

The improper inventory reductions taken in period 13 causes the "gross profits" shown in the subsequent year on the financial statements submitted to Nissan to be materially overstated. This pattern occurred for years 2009 through 2013. Mr. Gautier acknowledged such conduct does not represent the actual dollars of profit earned because that amount 'includes accounting tricks.'

Additionally, Mr. Bates agreed that the gross profits reported to Nissan are not true and that some of the gross profit figures are "paper profits". As such, Bates financial statements received by Nissan are materially inaccurate, materially misleading, improper, not reliable, and are not credible.

(Ex. R-365 at 5-6).

The expert reports of Walter and Liner are not the only evidence that NNA provided regarding the falsity of the financial statements. Examples of witness testimony providing evidence that Bates' submitted false financial statements to NNA are set forth in Attachment 10.

A few examples from this Attachment are set forth below:

Bobby Bates testified:

- When asked about his deposition testimony claiming that Bates' financial statements submitted to NNA accurately reported the financial condition of the dealership, Bobby Bates answered, "After some education I probably have to amend that to some degree, at least for the first few months in the timeframe that we're talking about. The first few months of the Year the financial picture is a recovery of written down amounts, which are shown as profit – paper profits, if you will, on the financial statement for the first 90 days of the Year." (Tr. at 318:2-19 (Bates)).
- The financial statements submitted by Bates to NNA were distorted or "skewed." (Tr. at 318:20-319:3 (Bates)).

³⁸ Liner, a CPA and Certified Fraud Examiner, is a Partner of the accounting firm of Fitts, Roberts & Co., P.C. where he specializes in forensic accounting and fraud investigations. He is also certified in Financial Forensics. (Ex. R-364 at 17-22).

- The financial statements submitted to NNA by Bates contained “inflated profit.” (Tr. at 329:16-21 (Bates)).
- The “inflated profits” affect each financial statement submitted after the month the vehicle is sold. (Tr. at 340:1-25 (Bates)).

Bates’ financial expert, Robert Davis, testified:

- Recovery of profits as a result of prior year vehicle inventory write-downs “makes [Bates’ financial statements] inaccurate – it makes certain aspects of that statement unreliable, depending upon which KPIs you’re trying to deal with.” (Tr. at 831:9-13 (Davis)).
- Once there is an aberration in one of Bates’ financial statements, it starts carrying over into the year-to-date column of that statement and each of the subsequent monthly statements. (Tr. at 832:6-12 (Davis)).

Buster Gautier, Bates’ enrolled agent testified:

- That he knew that Bates’ monthly financial statements “would show Nissan more profit than what the dealership had actually earned in true dollars.” (Tr. at 606:18-22 (Gautier)).

Beyond the expert reports and testimony, the PFD itself recognizes that the financial statements submitted to NNA were false. In discussing Bates’ monthly financial statements, the PFD states:

For example, if the 13th month financial statement showed a loss of \$5,000 because of a vehicle write-down, but *the following year’s first month financial statements [submitted to NNA] showed a \$10,000 profit on that same vehicle (a true \$5,000 profit and an additional \$5,000 profit to offset the \$5,000 loss taken on the 13th month statement), then one might mistakenly assume that Bates had a profit of \$10,000 on the vehicle when in reality, the true profit was half that.*

(PFD at 22) (emphasis added). This simple (and partial) example of Bates’ actions makes it clear that the true profits for each vehicle at issue was something other than what Bates told NNA in its financial statements making each financial statement false. In the PFD’s example, the financial information included in Bates’ monthly statements submitted to NNA was false as

overstated—profit of \$10,000—versus the true actual profit of \$5,000.³⁹ Based on the PFD’s simple example, Bates’ monthly financial statements submitted to NNA were false.⁴⁰

Because there is a mound of evidence in the record that the financial statements submitted to NNA were false, the PFD’s analysis, Findings of Fact 94, 97 and 124 and Conclusions of Law 12-14 should be rejected by the Board pursuant to Texas Government Code § 2001.058(e)(1). (See PFD at 5, 17-24, 42-43, 45, 47). The Board should find, instead, that Bates knowingly provided false financial statements to NNA from at least 2010 to 2013 and willfully violated tax laws and, as a result, good cause for termination exists. (Attachment 1).

3. The 13th Month Statements do not Make the 12 Month Statements True or Accurate

The PFD’s erroneous conclusion that Bates did not submit false financial statement is also based on the erroneous premise that, because Bates did not have to provide its 13th month statements to NNA, Bates did not submit false financial 12 month statements to NNA. The PFD is demonstrably wrong.

The PFD states on page 22:

There is no evidence that any financial statements submitted to NNA were literally false. Rather, NNA argues that the failure to send the 13th month financial statements created a mistaken impression in NNA of the profitability of Bates....NNA claims that this failure to provide NNA with 13th month statement led it to have an incorrect view of Bates’ financial condition and performance.

The PFD states on page 23:

Moreover, Bates did not actually submit any false information to NNA. It merely omitted sending the 13th month statement to NNA. (PFD at 23)...The other, non-13th month financial statements submitted by Bates were accurate in that they accurately

³⁹ “An agency acts arbitrarily if it makes a decision without regard for the facts, if it relies on fact findings that are not supported by any evidence, or if there does not appear to be a rational connection between the facts and the decision.” *Dutchmen Mfg., Inc. v. Texas Dept. of Transp., Motor Vehicle Div.*, 383 S.W.3d 217, 221 (Tex. App.—Austin 2012, no pct.).

⁴⁰ The PFD’s example leaves out critical facts that are established by R-493. The write-downs in one year would roll from one year to the next and then the next result in ever increasing write-downs in order for Bates to meet its tax goal. (R-493).

represented Bates' information, and NNA's guidance to Bates did not inform Bates that it needed to submit 13th month statements to NNA. Thus, the ALJ finds that Bates did not make material misrepresentations to NNA or submit false financial information to it in violation of the Dealer Agreement.

(PFD at 22-23). Nothing about whether Bates had to submit its 13th month statements to NNA made the 12 month statements submitted to NNA any less false. If Bates had submitted its 13th month statements to NNA, it would have knowingly submitted additional false financial statements.

Bates' 13th month statements were as false as the 12 month statements submitted to NNA. In fact, the PFD does not find that the 13th month statements were truthful. Each 13th month statement was false because each understated Bates' profits as a result of the unlawful write downs.⁴¹ (See Exs. C-122, 135, 148, 161, 174; R-366 at 8, ¶¶ 30-31, Attachment 18). From 2010-2013, the 13th month statements collectively understated Bates' profit by \$852,369 or 73%. (Exs. C-135, 148, 161, 174; R-493). Each 12 month statement, on the other hand, was false because each overstated profits to NNA based on the unlawful write downs. (Tr. at 329:2-21, 340:1-25 (Bates); see also, Exs. R-366 at 10, ¶¶ 35-38, R-368 at 3-5, 22-23, ¶¶ 10, 12, 72). From 2010-2013, the 12 month statements overstated profits by \$1,654,711 or 141%.

NNA raised issues regarding the 13th month statement for a simple reason. Had Bates provided the 13th month statements to NNA as part of its regular financial reporting to NNA, Bates improper write-down scheme might have been exposed sooner.⁴² For example, the 2011 12 month financial statements sent to NNA reflected a profit of \$532,014. (Ex. R-142 at 2, line 65). The 2011 13th month statement produced in this case reflected a profit of \$68,251. (Ex. R-

⁴¹ The PFD states on page 22 that "[i]t is true that Bates' failure to send the 13th month financial statement to NNA could have created a skewed picture of Bates' capitalization and profitability." NNA excepts because the 13th month statements were just as false as the 12 month statements. What the PFD should state is that the unlawful write downs caused the 13th month statements to understate profits and the 12 month statements to overstate profits.

⁴² NNA did not receive the 13th month statements until discovery in this case. Once its financial expert, Walter, reviewed them, NNA learned for the first time that the financial statements provide to it were false.

146 at 2, line 65). As set forth above in the discussion of R-493 in Section III.H, the \$532,014 overstates the profits by \$277,447, and the \$68,251 understates profits by \$186,316. Had Bates provided this 13th month statement to NNA, the \$345,698 difference in reported profits may have alerted NNA earlier that something was wrong in the way that Bates was reporting profit.⁴³ Nevertheless, with or without the false 13th month statements, the 12 month statements are, in and of themselves, false because the improper write-downs inflate profits and also misrepresented Bates' capitalization by overstating return on sales, overstating net working capital, and overstating effective net worth. (See Exs. R-366 at ¶¶ 35-38, R-368 at ¶¶ 10, 12, 72, Attachments 8R-10R; Tr. at 1418:8-1421:16 (Walter)). Stated differently, even if the 13th month statements had been provided to NNA, the 12 month statements still would have been false.⁴⁴

The PFD's statement on page 23, and included in the quote above, that the 12 month statements "were accurate in that they accurately represented Bates' information...." makes no sense. The PFD takes the position that because the 12 month statements reflected the improper write-downs that were also accounted for on the 13th month statement, the 12 month statements are accurate. Therefore, the PFD concludes, Bates did not provide false financial reports to NNA. The fact that Bates *accurately* reported its false information to NNA does not make the reported information true. The reported figures are still false.

The PFD's example on page 22 is once again instructive of the fact that the reported figures are false. It makes clear that the 13th month would show a loss of \$5,000 when the true

⁴³ The same is true of the profit difference in 2011—\$517,651 v. \$56,191, 2012—\$977,727 v. \$62,310, 2013—\$2,921,534 v. \$257,674. (R-366 at fn. 16).

⁴⁴ The PFD states on page 24 that "[w]hile Bates' financial statements may have been misleading in the absence of the 13th month statements, there is no evidence they were provided with any intent to mislead or deceive, or with knowledge that they would mislead or deceive NNA." NNA excepts to this for the reasons stated in this section and in Section III.H.1. Moreover, the question under the Dealer Agreement is whether the financial statements were knowingly false not whether Bates had intent to mislead or deceive. The PFD applies the wrong standard to Bates' actions. The Board should reject this under Texas Government Code § 2001.058(c)(1) and find that the 13th month and the 12 month financial statements were false and that Bates knowingly provided false financial statements to NNA.

profit is actually \$5,000 and the 12 month statement, instead of showing the \$5,000 profit, would show a \$10,000 profit. This example shows exactly how both the 13th month and the 12 month statements were false and that the 12 month statement was false with or without the 13th month statement.

Because the 12 month statements were false with or without the 13th month statements, the PFD's analysis, Findings of Fact 94, 97 and 124 and Conclusions of Law 12-14 should be rejected by the Board pursuant to Texas Government Code § 2001.058(e)(1). (*See* PFD at 5, 17-24, 42-43, 45, 47). The Board should find instead that Bates knowingly provided false financial statements to NNA from 2010 to 2014 and willfully violated tax laws and regulations and, as a result, good cause for termination exists. (Attachment 1).

4. The PFD Applies the Wrong Standard

NNA objects to Finding of Fact 95. (*See* PFD at 22-23, 43). The PFD erroneously finds that Bates did not breach Section 12.8.A of the Dealer Agreement because NNA did not show any reliance on or harm to it by the false information submitted to it. Not only is that erroneous, it misses the point.

The financial information Bates submitted to NNA made Bates look much more profitable than it actually was; therefore, NNA had no reason to concern itself with Bates' profitability. (*See* Ex. R-368 at ¶¶ 32-33, Attachments 6R-7R). The fact that NNA fell for the false information by thinking that Bates was more profitable than it was does not mean that NNA did not rely on the false information. To the contrary, the fact that NNA did not counsel Bates on its profitability is proof that NNA relied on the inflated profits and capitalization provided.

NNA's Pat Steiner ("Steiner"), the former regional vice president of NNA's Central Region and current Director of Project Lead Acceleration, testified that Bates' false monthly financial were relied upon by NNA:

NNA relies on the financial data submitted by its dealers to assess the health of its dealer network, develop composite reports and calculate a number of performance related measures, often referred to as key performance indicators ("KPI"), these include, without limitation, dealer net worth, return on sales, working capital, gross and net profits. NNA uses KPI, composite reports and other measures it derives from the financial data submitted by its dealers to counsel dealers on how they can strengthen their operations. NNA also uses this information to make business decisions on how to go to market by way of advertising, incentives and other programs that are meant to benefit both NNA and its dealer network.

(Ex. R-492 at ¶ 41). Steiner also explained that he could not point to any specific decisions made by NNA in reliance on Bates' misrepresentations because he still does not "know what the right information is," and accordingly, cannot know what different decisions or recommendations might have been made by NNA. (Tr. at 1140:22-1141:10 (Steiner)).

Because NNA relied on the false financial statements provided by Bates, Finding of Fact 95 should be stricken in accordance with Texas Government Code § 2001.058(e)(1). In its place, the Board should find that NNA did rely on the information that Bates provided to it. (Attachment 1).

5. Bates Did Not Use LCM

After finding that the write-downs were unlawful, not in good faith, were unjustified, improper, and not consistent with applicable tax regulations, the PFD erroneously states in Findings of Fact 75, 77, 79, 83-84 and 86 that Bates used LCM (lower of cost or market) for its write-downs. Bates did not use LCM.⁴⁵ It made the numbers up in its head just like its financial

⁴⁵ LCM must be applied to all of a dealer's new and/or used inventory. (See Tr. at 871:12-17 (Davis)). Bates did not determine true market values for any of its vehicles, as required under LCM, but also did not apply the same methodology to all of its new or used vehicle inventory. (See Tr. at 871:12-20 (Davis)). This is another, independent, reason why it is clear that Bates did not use LCM.

expert testified. (See Tr. at 877:24-878:25 (Davis)). Under LCM, a taxpayer may reduce the cost of its inventory only if it “compare[s] the market value of each item on hand on the inventory dates with its cost and use the lower of the two as its inventory value.” (Ex. R-348 at 17). Market value for used vehicles is determined by reference to their wholesale value from an official used car guide.⁴⁶ (Ex. C-322). Market value for new vehicles is their replacement cost for “the same goods in the same quantities the taxpayer would normally acquire them.” (Ex. C-305 at § 4.43.1.5.6.3(3)). As Davis acknowledged, new vehicle inventory simply is not reduced using LCM. None of his hundreds of other auto dealer clients uses LCM to write-down new vehicle inventory. (Tr. at 953:8-13 (Davis)). What Bates did in writing down new vehicles is unprecedented.

Bates did not value used vehicles at their used car guide wholesale value as required by LCM. (See Tr. at 358:16-359:15 (Bates); Ex. R-367 at ¶ 34, Attachments 11-14, R-368 at ¶¶ 48-50, Attachments 21-26). It did not determine the replacement value for each new vehicle in its inventory, because there simply is not one. (See Tr. at 417:16-418:14 (Bates)). Instead, as the PFD acknowledges, Bates’ write downs were not based on “the good faith basis of those vehicles’ value, but rather in an effort to achieve a certain taxable income level.” (PFD at 18). Bates made the values up.

Because Bates did not use LCM to reduce its new and used vehicle inventory, Findings of Fact 75, 77, 79, 83-84, 86 and Conclusions of Law 12-14 should be rejected pursuant to Texas Government Code § 2001.058(e)(1). (See PFD at 17-24, 41-42, 47). The Board should instead

⁴⁶ IRS Revenue Ruling 67-107 expressly states that “a car dealer may value his used cars for inventory purposes at valuations comparable to those listed in an official used car guide as the average wholesale prices for comparable cars.” (Ex. C-322). The Ruling also acknowledges that “[t]his is the practice recommended by the auto industry and used by nearly all car dealers.” *Id.*

find that Bates did not use LCM for writing down its new and used vehicle inventory and that, as a result, good cause for terminations exists. (Attachment 1).

6. The Board Should Find that the Injury or Benefit to the Public Factor Weighs in Favor of Termination

NNA excepts to Findings of Fact 107, 100 and 111, by which the PFD finds that the public interest factor weighs in favor of Bates. (See PFD at 28-29, 44). Because Bates took unlawful write downs and violated tax laws, the Board should find that this factor weighs in favor of termination. The public must be honest in its tax preparation and so must Bates. Moreover, the public interest factor would not be negative in the short run in the event of termination as the PFD finds. Bates was a poor performer, breached its Dealer Agreement and violated tax laws. The public is benefitted by having good dealers not one like Bates.

7. All Existing Circumstances do not Include Bates' Post-NOT Performance

NNA excepts to the PFD's determination that all existing circumstances includes all information available to the Board at the time it makes it decision. (PFD at 6-7). NNA's decision to terminate Bates was based on Bates' sales performance through the end of the cure period—September 2013. Accordingly, all existing circumstances must be viewed as all circumstance existing when the NOT was issued on December 23, 2013. As noted in *Love Nissan*, efforts to increase sales after issuance of the NOT were "late." 2005 WL 1662263, at * 12.

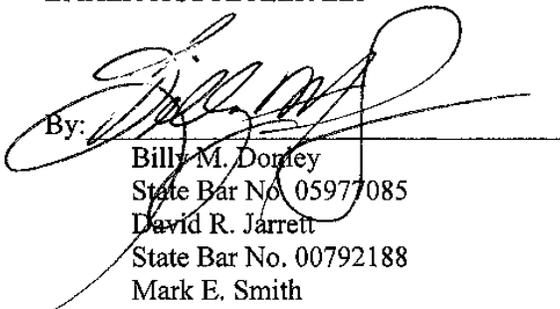
IV. CONCLUSION

Because Bates poor performance breached its Dealer Agreement as a matter of law, the Board, consistent with its authority under Texas Government Code § 2001.058(e)(1), should reject the PFD and, instead, find that good cause for termination exists and dismiss Bates'

protest. Independent of its poor performance, because Bates breached its Dealer Agreement as a matter of law by providing NNA with false financial statements, misrepresenting its capitalization and violating tax laws, the Board, consistent with its authority under Texas Government Code § 2001.058(e)(1), should reject the PFD and instead should find that good cause exists for termination and dismiss Bates' protest.

Respectfully submitted,

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CERTIFICATE OF SERVICE

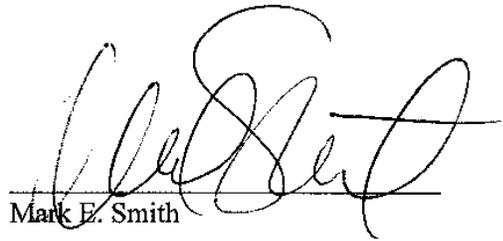
I certify that on May 10, 2016 a true copy of this document was served on the following according to 43 T.A.C. § 215.30 and SOAH Rule of Procedure §155.103.

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Mark E. Smith

ATTACHMENT 1

NNA's PROPOSED CHANGES TO FINDINGS OF FACT
AND CONCLUSIONS OF LAW**The following Findings of Fact should be rejected entirely:**

Finding of Fact No. 36

Finding of Fact No. 38

Finding of Fact No. 75

Findings of Fact No. 77-78

Findings of Fact No. 86-87

Findings of Fact No. 89-92

Finding of Fact No. 107

Finding of Fact No. 110

The following Findings of Fact should be modified as follows:**Bates' Sales and the NOT**

Finding of Fact No. 73: Bates breached its Dealer Agreement by failing to fulfill its Sales Obligation under that agreement.

Bates' Accounting Practices and the Supplemental NOT

Finding of Fact No. 79: Bates did not follow accepted accounting principles in determining its inventory write-downs.

Finding of Fact No. 83: The effect of Bates' inventory reductions was to improperly reduce Bates' taxable income for each year.

Finding of Fact No. 84: The amount of Bates' improper inventory reductions were in the hundreds of thousands of dollars and generally increased year over year.

Finding of Fact No. 94: Bates knowingly submitted false financial statements to NNA.

Finding of Fact No. 95: NNA relied on the false financial data submitted by Bates to create composite reports used to counsel Bates and other dealers, and to calculate certain key performance indicator such as return on sales, effective net worth and net working capital used to evaluate the health of the NNA dealer network.

Finding of Fact No. 96: The evidence demonstrates that Bates knowingly submitted false financial statements to NNA in breach of Section 12.A.10 of the Dealer Agreement.

Finding of Fact No. 97: The evidence demonstrates that Bates made material misrepresentations to NNA regarding its capitalization in breach of Section 12.A.8 of the Dealer Agreement.

Finding of Fact No. 98: The evidence demonstrates that Bates willfully failed to comply with tax laws and regulations in breach of Section 12.A.9 of the Dealer Agreement.

Statutory Good Cause Factor – Sales in Relation to the Market

Finding of Fact No. 100: Bates' sales performance was poor and ranked at or near the bottom among all Texas Nissan dealers for the entire period at issue – July 2010 to November 2013.

Finding of Fact No. 101: Because Bates sales in relation to sales in the market was at or near the bottom among all Texas Nissan dealers this factor weighs in favor of a finding of good cause for terminating the dealer franchise.

Statutory Good Cause Factor – Injury or Benefit to the Public

Finding of Fact No. 111: The fact that Bates was not honest in its tax preparation and filings (or submission of its financial statements) is harmful to the public and accordingly this factor weighs in favor of termination.

Statutory Good Cause Factor – The Parties' Compliance with the Franchise

Finding of Fact No. 124: The evidence establishes that Bates committed the following breaches of its Dealer Agreement: (1) breached its Sales Obligation pursuant to Section 3 as stated in the NOT; (2) breached Section 12.A.8 by materially misrepresenting its capitalization to NNA; (3) breached Section 12.A.9 by willfully failing to comply with tax laws and regulations; and (4) breached Section 12.A.10 by knowingly submitting to NNA false financial statements. Accordingly, this factor weighs in favor of terminating the dealer franchise.

The following Finding of Fact should be added to the PFD:

Statutory Good Cause Factor – Injury or Benefit to the Public

Finding of Fact No. 126: The fact that Bates was a poor performing dealer is harmful to competition and the public and accordingly weighs in favor of termination.

The Conclusions of Law should be modified as follows:

Conclusion of Law No. 12: Nissan established by a preponderance of the evidence that Bates materially breached numerous of its obligations and responsibilities pursuant to the Dealer Agreement resulting in grounds for termination under Section 12 of the Dealer Agreement.

Conclusion of Law No. 13: Based on consideration of all existing circumstances, NNA has established by a preponderance of the evidence that good cause exists for the proposed termination of Bates' franchise.

Conclusion of Law No. 14: NNA's proposed termination of Bates' franchise is granted and Bates' protest is dismissed.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

2012 WL 5305152 (Fla.Div.Admin.Hrgs.)

Division of Administrative Hearings

State of Florida

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON NISSAN, Petitioners

v.

NISSAN NORTH AMERICA, INC., Respondents

DOAH CASE NO.: 11-1157

FINAL ORDER NO.: HSMV-12-853-FOF-MS

MS CASE NO.: 11-261

October 24, 2012

FINAL ORDER

*1 This matter came before the Department for entry of a Final Order upon submission of a Recommended Order by James H. Peterson, III, an Administrative Law Judge of the Division of Administrative Hearings, a copy of which is attached and incorporated by reference in this order.¹ The Department hereby adopts the Recommended Order as its Final Order in this matter. Accordingly, it is

ORDERED and ADJUDGED that this case is CLOSED and the Dealer Sales and Service Agreement between Hampton Automotive Group, Inc. d/b/a Hampton Nissan and Nissan North America, Inc. is terminated.

DONE AND ORDERED this 24 day of October, 2012, in Tallahassee, Leon County, Florida.

Julie Baker
Chief
Bureau of Issuance Oversight
Division of Motorist Services
Department of Highway Safety and Motor Vehicles
Neil Kirkman Building, Room A338
Tallahassee, Florida 32399

Filed with the Clerk of the Division of Motorist Services this 24 day of October, 2012.

Nalini Vinayak
Dealer License Administrator

APPENDIX TO FINAL ORDER RULINGS ON PETITIONER'S EXCEPTIONS

Having carefully considered Petitioner's Exceptions and Petitioners' Responses thereto, the Department rules as follows on the exceptions:

EXCEPTION 1

Rejected. Findings of Fact 8-12, 18, 23-25 and 28-29 are based on competent substantial evidence.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

EXCEPTION 2

Rejected. Findings of Fact 111-122 are based on competent substantial evidence.

Rejected. Conclusions of Law 167-172 and 174 are legally correct.

EXCEPTION 3

Rejected. Finding of Fact 77-78 are based on competent substantial evidence.

Rejected. Conclusions of Law 160-161 are legally correct.

EXCEPTION 4

Rejected. Conclusions of Law 160 is legally correct.

EXCEPTION 5

Rejected. Conclusions of Law 176 is legally correct.

EXCEPTION 6

Rejected. Conclusions of Law 165 is legally correct.

RECOMMENDED ORDER

An administrative hearing was held in this case on February 9-10, February 13-16, and July 19, 2012, in Tallahassee, Florida, before James H. Peterson III, Administrative Law Judge of the Division of Administrative Hearings.

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Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

One Nissan Way
Franklin, Tennessee 37067

STATEMENT OF THE ISSUE

Whether the intended termination under that Notice of Termination of the Dealer Sales and Service Agreement, dated December 7, 2010, between Respondent Nissan North America, Inc., and Petitioner Hampton Automotive Group, Inc., d/b/a Hampton Nissan, is unfair or prohibited within the meaning of section 320.641, Florida Statutes.

PRELIMINARY STATEMENT

On December 7, 2010, Nissan North America, Inc. (Nissan or Respondent), sent Hampton Automotive Group, Inc., d/b/a Hampton Nissan (Hampton or Petitioner), a notice of intent to terminate the Dealer Agreement between the parties. Hampton filed a Petition pursuant to section 320.641(3), Florida Statutes, seeking a ruling that Nissan's termination is unfair and prohibited under Florida law. The matter was referred to the Division of Administrative Hearings for the assignment of an Administrative Law Judge to conduct a final hearing.

At the final hearing held February 9-10, February 13-16, and July 19, 2012, Nissan presented the testimony of Patrick Doody, Kim Maas, Will James, Nick Reese, Fred Adcock, Herbert Walter, and Sharif Farhat, and offered 98 exhibits which were admitted into evidence as Exhibits R1 through R35, R37 through R41, R43 through R89, R91 through R99, R101, and R105.

Hampton presented the testimony of Mike Perry, Donald Moyers, Mark Hampton, and Joe Roesner, and offered 24 exhibits which were received into evidence as Exhibits P3, P5 through P7, P9, P13, P16 through P19, and P21 through P34.

The final hearing was initially concluded on February 16, 2012. However, on March 29, 2012, Hampton filed a Motion to Reopen Final Hearing and Hearing Record, for Additional Discovery, and to Schedule Additional Hearing Time. Nissan timely filed a Response to the Motion. After hearing argument on the Motion, an Order was entered reopening the final hearing, granting a limited scope of additional discovery, and setting July 19, 2012, as an additional hearing date.

These proceedings were recorded and a transcript was prepared. Ten volumes of Transcript were filed prior to the last day of hearing. After close of the final hearing on July 19, 2012, the parties were given 10 days from the filing of the Transcript of the last day of hearing within which to file proposed recommended orders. The Transcript of the final hearing consists of a total of 11 volumes, including the Transcript of the last day of the hearing, which was filed August 8, 2012. The parties timely filed their respective Proposed Recommended Orders which have been considered in preparing this Recommended Order.

FINDINGS OF FACT

- *3 1. Hampton is a "motor vehicle dealer," as defined by-section 320.60(11)(a), Florida Statutes.
2. Nissan is a "licensee" as defined by section 320.60(8).
3. Nissan does not sell cars directly to consumers in the state of Florida. Rather, it relies on its dealers to market and sell its vehicles to consumers.
4. Hampton Automotive Group, Inc., purchased the Nissan dealership in Fort Walton Beach, Florida, on August 4, 1998, and entered into a Dealer Sales and Service Agreement with Nissan (Dealer Agreement). Mark Hampton is the 100 percent owner of Hampton.¹
5. The Dealer Agreement is a "franchise agreement" as defined by section 320.60(1).

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

6. The Dealer Agreement, like other Dealer Sales and Service Agreements that Nissan enters with its dealers, contains several provisions designed to ensure that Hampton achieves and maintains sufficient levels of sales performance.

7. Section 3 of the Dealer Agreement entitled "Vehicle Sales Responsibilities of Dealer," sets forth Hampton's obligations with respect to the sale of vehicles.

8. Section 3A sets forth the general sales obligation of Hampton, which is to "actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and if Dealer elects, the leasing and rental) of Nissan Vehicles to customers located within the Dealer's Primary Market Area." Article Second, Section B outlines the same general obligation.

9. Section 3B of the Dealer Agreement provides that "performance of [[Hampton's] sales responsibility for Nissan Cars and Nissan Trucks will be evaluated by [Nissan] on the basis of such reasonable criteria as [Nissan] may develop from time to time." This provision allows Nissan to evaluate Hampton's sales performance using any method, so long as it is reasonable.

10. The Dealer Agreement contains specific examples of reasonable criteria that Nissan may use to evaluate sales performance. Although the Agreement does not restrict Nissan to the listed examples, Nissan uses sales penetration, which is "Dealer's sales as a percentage of registrations of competitive vehicles," as an example of reasonable criteria in section 3(B) (2) (ii).

11. Section 3(B)(3) of the Dealer Agreement also specifies the region benchmark to which a dealer's sales penetration is compared, stating that a dealer's sales penetration may be compared to the "sales and/or registrations of all other Authorized Nissan Dealers combined in Seller's Sales Region."

12. As permitted by section 3 of the Dealer Agreement, Nissan uses Retail Sales Effectiveness (RSE) to determine whether a dealer is meeting its sales obligation under the Agreement.

13. RSE is calculated by first determining the dealer's sales penetration or market share, which is the dealer's total new Nissan vehicle sales anywhere, divided by the number of competitive new vehicles registered in the dealer's Primary Market Area (PMA). The resulting number is expressed as a percentage to show the dealer's sales penetration.

*4 14. The dealer's sales penetration is then compared as a ratio to the sales penetration of the entire Nissan region, to determine the dealer's RSE.

15. A simple expression of the RSE formula is: Dealer's Sales Penetration ÷ Region Sales Penetration. Breaking down each of these into their component parts, the RSE calculation would be:

$(\text{Dealer's sales anywhere} \div \text{Competitive Registrations in the Dealer's PMA}) \div (\text{Combined Sales of all Region Dealers} \div \text{Competitive Registrations in the Region})$

16. A dealer who reaches 100 percent RSE is performing at an average level, which is a "C" level of performance.

17. Although the terminology and calculations may vary slightly, RSE or sales penetration is the industry standard method used to measure dealer sales performance.

18. RSE is a fair method of evaluating dealer performance with conservative expectations because no dealer is expected to perform above an average level and because the dealer gets credit for sales anywhere, while only being held responsible for the sales opportunities within its PMA.

19. Approximately 60 percent of dealers in the Nissan's Southeast Region, within which Hampton is located, meet or exceed the "average" sales penetration of 100 percent RSE.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

20. Nissan has been using RSE as its standard to measure dealer sales performance for over 30 years.
21. This evaluation method is communicated to dealers not only in the Dealer Agreement, but also in contacts and visits with the dealer and correspondence.
22. Hampton's owner admits that he knew Nissan was evaluating the dealership's sales performance using RSE.
23. RSE is a reasonable criterion to measure dealer sales performance and it was reasonable for Nissan to evaluate Hampton's sales performance using RSE.
24. At the Final Hearing, Hampton argued that it should be evaluated based on market penetration rather than sales penetration. Market penetration is the ratio of Nissan registrations in a dealer's PMA, no matter what dealer sold the vehicle, to competitive registrations in the PMA, which is then compared to Region average.
25. Because market penetration looks at registrations in the market by any dealer, it does not measure the efforts or sales performance of the dealer in the market. Using market penetration as a measure artificially increases the perception of the sales effectiveness of an underperforming dealer because that dealer would get credit for sales made by other dealers through no effort of the underperforming dealer.
26. Using the market penetration calculation, a dealer could sell no vehicles, yet reach 100 percent (or more) of region average base upon sales by other dealers to customers in its PMA.
27. The market penetration within Hampton's PMA for years 2008 through 2010 was higher than Hampton's sales penetration within that PMA, indicating that consumers within Hampton's PMA desired Nissan's products, but not so much from Hampton.
- *5 28. Neither Nissan nor any other manufacturer uses market penetration to measure the sales performance of a dealer.
29. Market penetration is not a reasonable criterion to measure Hampton's performance under the Dealer Agreement.
30. Section 3H of the Dealer Agreement provides that Nissan will "periodically evaluate" Dealer's performance of its sales responsibilities and discuss these evaluations with the dealer. The dealer agrees to correct any deficiencies.
31. Nissan evaluates its dealers and provides feedback on their performance in several ways. First, Nissan has District Operations Managers (DOMs) who call on dealers routinely to discuss various areas of performance, and to review reports that outline the dealer's RSE performance and other information pertinent to dealer operations. Various department and training managers from Nissan may also assist a dealer. Nissan's senior management often notifies a dealer of violations of the Dealer Agreement, including poor sales performance.
32. Nissan DOMs have extensive industry experience and have had the opportunity to work with top-performing dealers, as well as poor-performing dealers. DOMs provide advice and counsel and share best practices with dealers on things that can impact sales, including items such as customer service, product training, inventory management, and other areas. DOMs also share data with dealers to help identify areas of opportunity to grow and improve.
33. Nissan counseled with Hampton and its owner for a number of years regarding Hampton's poor sales performance and operational deficiencies prior to the December 2010 Notice of Termination.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

34. Since becoming a Nissan dealer in 1998, Hampton has performed poorly from a sales perspective. In 2002 and 2003, Nissan issued several notices of default to Hampton based on their unsatisfactory sales performance and related operational deficiencies. On November 3, 2003, Nissan issued Hampton a notice of termination for poor sales performance.

35. Around the same time, Nissan conducted a nationwide audit of dealer PMAs. As part of that audit, Nissan instituted a new rule limiting the size of a PMA to 25 miles. As a result of this new rule, Hampton's PMA was reduced in size. Because Hampton was responsible for a smaller area, its sales penetration increased to 80 percent of average. Although this performance was still poor because it was 20 percent less than average, it was not among the worst in the state, and Nissan withdrew the NOT.

36. After Nissan withdrew its NOT, Hampton's operations did not change, and its RSE drifted back towards the bottom of the state, even in its reduced PMA. For the next few years, Nissan continued counseling with Hampton regarding its declining sales penetration, poor customer service scores, lack of training for its employees, and other problems at the dealership.

37. During this time, Hampton experienced significant management turnover. Article Fourth of the Dealer Agreement, stresses the importance of "qualified management" for the dealer and requires Hampton to provide a qualified executive manager with "full managerial authority for [Hampton's operations], ... [who] shall continually provide his or her personal services in operating the dealership and [who] will be physically present at the Dealership Facilities."

*6 38. The lack of a qualified executive manager was an ongoing problem at Hampton. Nissan continuously counseled with Hampton concerning this issue.

39. Ben Bondi was the last approved executive manager at the dealership.² Following his departure in 2005, Hampton had a number of managers in a few short years. In mid-2005, after Ben Bondi was let go, Carl Roscitti became general manager for about five months. By November 2005, Mr. Roscitti was gone, and Rick Himmel was the manager for two months. Following Mr. Himmel's departure, in February 2006, Al Brockett served as manager for about three months. Alan Reese replaced him for three months beginning in April 2006. Brent Joy took over for Mr. Reese in August 2006 for a month. In September 2006, Tom Buckley took over for two or three months. None of these individuals were provided with the level of authority or decision-making ability expected of an executive manager.

40. Throughout this period of management turnover, Hampton's sales performance was declining. By the end of 2006, Hampton's RSE, even in its new PMA, had fallen to 75.41 percent, which ranked it 132/154 dealers in the Southeast Region, 50/58 dealers in the State of Florida, and last among the 15 dealers in Hampton's district.

41. In 2007, Rusty Chambers and Jeff Kagan served as the management team at Hampton. Although neither of these individuals served as executive manager, they provided some consistency at the dealership, and they had more authority than prior managers. Operations improved somewhat under their management. For the first time in its history, Hampton reached region average in 2007, at 102.7 percent.

42. In February 2008, after reaching region average RSE in 2007, Mr. Hampton intentionally put his dealership on finance credit hold so it could not order any more vehicles. This cancelled all vehicle orders and prevented the dealership from purchasing inventory. By taking this action, Hampton not only reduced its present inventory, but also lowered its sales rate, impacting future allocations.

43. Upon learning that Hampton was on finance hold, Nissan notified Mr. Hampton of the drastic impact this would have on sales performance, incentives, and future allocations. During a meeting with the DOM, Mr. Hampton said that he had too much inventory and that he planned to force his sales staff to sell what they had before ordering any more.

44. On March 6, 2008, with the finance hold still in place, Nissan personnel sent a letter to Hampton and met with its owner to discuss the situation. Although the flooring line had been suspended for over a month, the owner said he "planned to leave

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

[the suspension] in place and force the staff to sell what they currently had available." When told that this was a violation of the Dealer Agreement, Mr. Hampton stated that "he did not care about the agreement because Nissan had already tried to get him once and they could not get him."

*7 45. Having a dealership put itself on finance hold is extremely unusual, and Nissan personnel had never seen any other dealership take this type of action. Even Hampton's own expert agreed he would not recommend it. This operational decision had a direct impact on Hampton's sales performance in 2008 and beyond.

46. After Hampton put itself on finance hold, its inventory dropped from 160 vehicles to 60, and its sales penetration began to drop immediately.

47. By mid-2008, Mr. Hampton had fired the management team of Rusty Chambers and Jeff Kagan, and the management turnover resumed. Following their departure, Ralph Harris served as sales manager at the store, and there was no executive or general manager. Nissan continued to counsel with Hampton throughout 2008 concerning sales performance, the lack of an executive manager, and operational deficiencies.

48. During meetings with the dealership, the DOM reviewed empirical data and discussed areas of opportunity for the dealership. Rather than discussing ways to implement the suggestions and improve performance, Hampton's owner accused the DOM of being critical, and would try to change the subject to irrelevant matters whenever the DOM asked a challenging question about dealership operations.

49. Hampton's performance continued to decline. In July 2008, Nissan's DOM contacted Hampton's owner to discuss the dramatic drop in sales, poor customer service performance, and what steps the dealership planned to take to turn the business around. Rather than provide an action plan, Mr. Hampton stated that he had nothing further to discuss and did not see the point of meeting with the DOM. At this point, Mr. Hampton decided he no longer wanted to meet with the DOM or Nissan personnel to discuss dealership business, despite the negative impact this could have on sales performance.

50. By October 2008, the dealership had no executive manager, general manager, sales manager or finance and inventory manager. On several occasions, Nissan personnel attempted unsuccessfully to contact Mr. Hampton to discuss the situation.

51. At the end of October, Carl Stark took over as sales manager at Hampton. Although he claimed to have authority over the store's operations, he was not an executive manager. He did not have authority over parts, service, pay plans, advertising budget, used vehicle appraisals, or many other facets of the dealership operations.

52. From October 2008 to May 2010, Mr. Stark remained the sales manager, but there was no general manager, executive manager or, even an executive manager candidate at Hampton. Although he promoted Mr. Stark and left him in a management position for an extended period of time, Mr. Hampton said he was not effective and was "extremely slow."

53. By the end of 2008, Hampton's RSE had dropped to 67.1 percent, which ranked 140/155 dealers in the Southeast Region and 53/58 dealers in the State of Florida.

54. On January 14, 2009, Nissan's Region Vice President sent a letter to Hampton expressing concern at the declining RSE performance, and asking him to submit a plan for improvement. No plan was ever submitted.

*8 55. Throughout 2009, Mr. Hampton refused to meet with the Nissan DOM, and there was no executive manager at the store. Although Mr. Hampton refused to meet with her, the DOM provided all relevant monthly reports to him by e-mail, expressed concern over the continuing decline in RSE, identified areas of opportunity, suggested best practices that could help the dealership improve, and offered to meet any time to discuss dealership business. Mr. Hampton never responded to any of these overtures.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

56. In October 2009, the Region Vice President sent additional letters to Mr. Hampton, expressing concern over the lack of an executive manager at the dealership, the continuing and alarming decline in RSE performance, and the poor owner loyalty that was contributing to this decline. He reminded the dealer of its obligations under the Dealer Agreement and requested that immediate steps be taken to turn things around.

57. By the end of 2009, Hampton's RSE had dropped to 58.4 percent, which ranked 227/245 dealers in the Region and 56/58 dealers in the State of Florida.

58. In January 2010, Nissan's fixed operations manager spoke with Mr. Hampton on the phone concerning an available program to help recapture service customers, improve marketing efforts, and increase customer traffic. Mr. Hampton was originally interested in the program, but later called back to decline the program because, according to Mr. Hampton, if it brought in more customers, he would have to hire additional staff, which would drive up expenses.

59. On February 3, 2010, Nick Reese, Nissan's Area General Manager (AGM), took his whole team to Fort Walton Beach to meet with Mr. Hampton and to express Nissan's serious concerns over the dealership's declining RSE and lack of an executive manager. They discussed the dealership's poor sales performance, now ranked at the bottom of the state, and asked how the dealership planned to improve. Although Mr. Hampton agreed they were not delivering, he would not identify any plan to improve. Instead, he tried to change the subject to some unrelated business deal he was working on and to Hyundai's launch of a new Sonata. He failed to focus on Nissan sales and expressed no sense of urgency to correct the problems.

60. During this same meeting, Hampton's sales manager stated that they could not improve sales with the dealership's existing advertising budget. Advertising was a problem and a major contributor to the lack of traffic at the dealership. Total advertising for the dealership in 2009 had fallen to one-fourth of its 2007 levels — from over \$1 million in 2007 to \$242,058 in 2009.

61. Following the meeting, Mr. Reese sent a letter to Hampton concerning the poor RSE and owner loyalty at the store. He asked the dealer to take immediate action to improve, but this was never done.

62. On April 27, 2010, Nissan's DOM met with Carl Stark, the acting manager, to discuss the continuing decline in RSE, which had fallen to 45.5 percent, 240/244 in the Region and 57/58 in the state. Mr. Stark again expressed concern about the lack of advertising and stated that all advertising was being directed by Mr. Hampton's staff in Lafayette.

*9 63. On May 4, 2010, Mr. Reese called Mr. Hampton to follow-up on their February meeting. He informed Mr. Hampton that there had been no change in performance, and the dealer would receive a notice of default. During this call, Mr. Hampton admitted he could not manage the store from 300 miles away and stated that it was his entire fault and that he would do the same thing as Nissan since the store is not performing. Mr. Hampton also claimed he had hired a "heavy hitter" to serve as general sales manager and wanted to see if he could turn things around. This new general sales manager never came to work at Hampton in Fort Walton.

64. On May 20, 2010, Nissan issued a notice of default (NOD) to Hampton based on the dealership's unsatisfactory sales performance and continued lack of an executive manager. The NOD provided Hampton with 180 days to cure the default, and it specifically warned that failure to cure the breaches set forth in the NOD would result in termination.

65. The NOD outlined the many discussions Nissan had with the dealer over the course of several years regarding its declining sales performance, and it outlined numerous operational deficiencies that contributed to this performance, including lack of an executive manager, poor customer service, failure to market and effectively advertise, failure to maintain inventory, and lack of capitalization. Mr. Adcock, Nissan's Region Vice President, hoped that issuing the NOD would get the dealership's attention, notify Mr. Hampton of the seriousness of the situation, and give Hampton time to improve performance.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

66. By May 2010, when the NOD was issued, Hampton's RSE had dropped to 47.3 percent, which ranked 56/58 dealers in the state of Florida.

67. On May 22, 2010, Mr. Hampton contacted Mr. Reese to advise him that he hired Kevin Dryc as the general manager of Hampton. He acknowledged that the store had been mismanaged and said that Mr. Dryc would be his final attempt and, if it did not work out, he was going to sell the store. Mr. Dryc lasted about a month as general manager and was gone by mid-June.

68. On June 24, 2010, the DOM met with Mr. Hampton, as Mr. Dryc was gone and the store had no general manager. During this contact, the DOM discussed Hampton's low RSE and the effect that constant management changes, lack of training, minimal advertising, and other operational problems were having on the dealership. Mr. Hampton acknowledged the issues, but did not outline a plan for improvement.

69. On June 28, 2010, Mr. Reese contacted Mr. Hampton and asked about his plans for a manager at the store since Mr. Dryc had left. Mr. Hampton stated that he was bringing over a young, aggressive general manager from his Lafayette Toyota store and Nissan would be seeing good things soon. Following this call, Mr. Hampton did not move a general manager to the Fort Walton Beach store for at least two more months.

70. On August 25, 2010, the AGM and DOM again traveled to Fort Walton Beach to meet with Mr. Hampton and discuss the performance problems at the dealership. The cure period was more than halfway over, and there had been no improvement in the Hampton's sales performance. The AGM advised Mr. Hampton that the NOD would turn into a notice of termination if there was no improvement. Rather than providing a plan to improve, Mr. Hampton responded by stating that Florida is a dealer-friendly state and that Nissan would not terminate him. He showed no intention of trying to improve and no concern about the NOD cure period. Other than claiming that he had hired yet another new general manager, who had not relocated to Fort Walton Beach, Mr. Hampton outlined no plan to improve.

*10 71. On September 3, 2010, Mr. Reese again contacted Mr. Hampton to discuss the RSE and operational problems at the dealership. Rather than discussing dealership business, Mr. Hampton tried to change the subject to talk about unrelated matters. He also stated that he had purchased 100 used Nissans from an auto auction for the dealership to sell. This was a big concern for Nissan, as it would shift the focus of salespeople to used cars, which would not improve Hampton's RSE. At the time of this contact, the new manager still had not relocated to Fort Walton, and nobody was on-site managing the store.

72. In September 2010, Hampton's new manager, Don Moyers, finally relocated to Fort Walton Beach, four months into the NOD period. Mr. Moyers, however, was still responsible for the management of Hampton Toyota in Lafayette, and he bounced back and forth between the two stores for the remainder of the NOD cure period.

73. At the Final Hearing, Mr. Moyers described the state of the dealership when he arrived four months into the cure period. He stated that the dealership was disorganized, there was no accountability, they were not following procedures, they lacked training, they lacked leadership, there were no checks and balances, there were no systems in place for traffic control, and they were not consistently counting customers, or doing follow-up calls. He admitted the dealership was performing poorly in all areas — sales, service, parts, and finance and insurance (F&I).

74. Despite repeated requests from Nissan for several years, Hampton never provided a plan to improve performance or demonstrated a sense of urgency. Mr. Hampton admits that he never called the Nissan's Regional Vice President, never went to meet with him, never responded to any of the letters Nissan wrote during the NOD period, and never prepared any specific plan to address the deficiencies. In fact, Mr. Hampton did not even tell his manager, Mr. Moyers, that the store had been issued an NOD or that the dealership had a limited cure period to improve its sales performance.

75. Based on the continuing poor performance of the store, its lack of improvement and lack of any commitment to improve, Mr. Adcock began the process for requesting a notice of termination.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

76. By early December, the cure period had expired, and there had been no improvement in RSE. The dealership's RSE had declined from 102.7 percent in 2007 to 66.55 percent in 2008, 56.83 percent in 2009, and 49.73 percent through September 2010. This ranked Hampton 56th of the 58 dealers in Florida. From May 2010 to September 2010, RSE had barely changed, from 47 percent to 49 percent.

77. As of early December, Nissan knew Hampton's sales numbers for October and November, which were 22 and 13 respectively. This was less than half of what the dealer needed to sell to reach region average, and Nissan knew the RSE had actually declined from September to November. The November RSE data confirmed that sales penetration through November 2010 actually declined to 48.5 percent RSE.

*11 78. On December 7, 2010, Mr. Adcock made the final decision that Hampton's dealership should be terminated and Nissan issued a notice of termination (NOT) to Hampton for unsatisfactory sales performance.

79. At trial, neither party disputed that Hampton's sales performance was extremely poor. However, each party offered different explanations for this poor performance.

80. Hampton argued that the economy, the real estate bubble, and unemployment in Fort Walton Beach caused its poor sales performance. The evidence does not support this.

81. The RSE calculation takes into account the state of the economy in a particular PMA. If the economy slows for any reason in a PMA, it would affect every brand of vehicle, and the competitive registrations would be lower. This would lower the sales expectation for Hampton, as it is only expected to gain an average share of competitive registrations.

82. The unemployment rate in Fort Walton Beach was far lower than the rest of Florida. If rising unemployment did affect RSE, it would impact other Florida dealers in PMAs with higher unemployment rates to a far greater degree than Hampton, thus improving Hampton's relative performance. That expectation however, did not happen. The unemployment rate in nearby PMAs was much higher than Fort Walton Beach, yet those dealers exceeded region average RSE. This would not occur if the economy and unemployment rate was the cause of Hampton's low RSE.

83. Hampton's arguments regarding economic conditions are further undercut by Mr. Hampton's own statements. In June 2010, he told Mr. Reese there was a lot of growth in the area because it had not been hit by the oil spill and the military base was expanding.

84. Hampton also blamed its poor performance on a large military population in its PMA and the lack of Nissan military incentives. The evidence does not support this.

85. The military population in Fort Walton Beach declined from 2007 to 2010. If a higher military population was hurting Hampton's RSE, its performance would have improved during this period, but it declined substantially. In addition, Nissan dealers with the largest military populations in their PMAs on average exceeded 100 percent RSE, including other dealers in the Florida Panhandle.

86. Hampton's own expert stated that the lack of military incentives probably did not have a big effect on Hampton's sales performance. He further stated that if lack of military incentives were a problem, it would possibly be something that Hampton would want to discuss with a Nissan representative. Hampton, however, never mentioned to Nissan that lack of military incentives was a problem.

87. Hampton also argued at the final hearing that Hampton had 27 competitors in its PMA, which was too many to reach RSE. The evidence does not support this.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

88. Hampton did not explain how it managed to reach 102.7 percent of Region average in 2007 despite having 28 competitors at that time. Hampton's own expert analysis showed that a dealership with 27 competitors in its PMA should be expected to hit 99.6 percent of average, whereas Hampton reached only 48.5 percent through November 2010. Every other Nissan dealership in the entire state of Florida with 27 or more competitors performed at a higher level than Hampton. Dealerships with a similar number of competitors in the Nissan Southeast Region on average reached 110 percent RSE.

*12 89. Hampton also argued that the PMA was not drawn correctly. Hampton's expert, however, admitted he had no dispute with how the dealership's PMA is drawn and that he would draw it the same way.

90. Hampton implied that the 2010 census may change the PMA and argued that if Nissan added a dealer in its PMA, this would reduce its size and increase Hampton's RSE (assuming its sales do not change).

91. Although Hampton's PMA was reduced after the 2000 census, this was not because of the census results, but because Nissan limited its PMA to a 25-mile radius. There was no evidence that Hampton's PMA would be significantly altered by the 2010 census.

92. As with other manufacturers, Nissan assigns a PMA primarily based on proximity to the Nissan dealership, because a customer generally will buy from the most convenient dealer. The actual census tract of the population closest to Hampton is larger than the 25-mile radius assigned to Hampton. Because its PMA is smaller than the census tract of the closest population, Hampton's RSE is enhanced because Hampton can sell into nearby unassigned areas, but Hampton is not held responsible for the competitive registrations within those unassigned areas. If Hampton's PMA were constructed on a pure proximity of population to dealership basis, including areas beyond the 25-mile limitation, Hampton's RSE would be even lower.

93. Although Hampton argued that adding a new dealer would reduce the size of its PMA, it never suggested that Nissan add a new dealer, and its expert denied that another dealer was needed in the PMA.

94. To affirm that the PMA definition had no impact on Hampton's performance, Nissan's expert analyzed Hampton based on sales by distance, without regard to PMA boundaries. This confirmed that Hampton's performance was far below that of other Panhandle dealers. In a 0-4-mile radius, Hampton penetrated the market at 38.3 percent RSE versus 112.8 percent for nearby Nissan dealers. The results were similar at 4-8 miles, 8-12 miles, and beyond, confirming that the PMA definition did not cause Hampton's poor RSE.

95. Hampton further argued that its sales performance was caused by a lack of available inventory and that it did not receive enough vehicles during the cure period to reach 100 percent RSE. This argument ignores the application of Nissan's uniform allocation system, Hampton's long history of declining vehicles and reducing inventory levels, and its ability to obtain additional vehicles by working within the allocation system and taking advantage of supplemental vehicles that were available.

96. Nissan's allocation system is based on the relative "days' supply" of each dealer, and it fairly and equitably distributes vehicles to the dealers who need them the most. "Days' supply" is the industry standard measurement of dealership inventory. A dealer's days' supply is the number of days their current inventory would last based on their sales rate. For example, if a dealer sells one car per day (30 per month) and has 60 vehicles in inventory, that dealer would have a 60-days' supply. If the dealer sells 3 cars per day (90 per month) with the same inventory, the dealer would have only a 20-days' supply.

*13 97. The system is responsive to a dealer's sales rate and inventory levels. As a dealer increases its sales rate by selling its inventory faster, this also lowers its days' supply, allowing the dealer to earn more vehicles.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

98. Both Hampton's owner and general manager admitted that Hampton earned vehicles under the allocation system the same as every other dealer. Mr. Hampton also admitted that other dealers have more inventory because they have a higher sales rate and lower days' supply.

99. Hampton's claims of insufficient inventory are undercut by its own actions in the time frame prior to the NOT. For a period of several years, the dealership declined a substantial number of vehicles that it had been allocated. From April 2007 to November 2010, Hampton declined over 1400 vehicles. Hampton's practice was to decline the majority of product offered and "dealer trade" for what it needed. This strategy was repeatedly invoked by various managers at the dealership, even though Nissan personnel counseled against it because it limited vehicle availability at the dealership.

100. Mr. Hampton admitted it was his strategy, even in 2010, to intentionally keep a low inventory of only the fastest moving vehicles and to dealer trade for any other vehicles. He testified that he does not care how many vehicles are in inventory, as long as they do not have any aged units. This strategy is reflected in the dealership's pay plan, which reduces the manager's pay if he orders inventory that does not sell within 90 days.

101. The financial hold to reduce inventory levels which Mr. Hampton instituted at the dealership in 2008 served as a clear demarcation for the dealership's inventory levels. Hampton's inventory levels dropped from 120 vehicles to a range of 60-80 vehicles, and its sales rate was soon cut in half.

102. Hampton does not claim that it lacked inventory overall, but claims only that it did not receive enough of certain "hot models" in late 2010. Hampton's inventory levels in these "hot models," however, were consistent with the rest of the Southeast Region.

103. In addition, Hampton's sales were poor in almost every segment, showing that it was not a lack of certain "hot models" that caused its poor sales performance. For example, although it had access to plenty of Titans, Pathfinders, and Armadas, Hampton penetrated those segments at only 64 percent, 33 percent, and 16 percent of region average, respectively.

104. Nissan personnel explained the allocation system in detail to various managers at Hampton over the years. As Nissan personnel explained, the best way to earn more vehicles under the allocation system is to increase the sales rate by selling the vehicles you have faster.

105. During the cure period from May to November 2010, Hampton was offered 166 vehicles in the allocation system, even though it sold only 123. Thus, its inventory on the ground went up during this time period, although its sales penetration did not change. If Hampton had increased its sales rate during the cure period, it would have earned more vehicles under the allocation system.

*14 106. Hampton also had the opportunity to obtain additional vehicles from the "Pass Two" turndown list. "Pass Two" vehicles are specified and equipped by the region with the most popular equipment to sell quickly. If any dealer in the district declines or fails to affirmatively accept any Pass Two vehicles offered in allocation, the DOM offers these to dealers within his district. During the cure period, the DOM offered Hampton first cut at the entire Pass Two turndown list each month before offering them to any other dealer. When the DOM provided the list (often including over 150 vehicles) to Hampton each month, he either got no response or Hampton accepted only a few vehicles.

107. Hampton also suggested that there was a market issue that affected its sales. Hampton argued that, because the successors to two other terminated dealers (Love Nissan and Classic Nissan) performed poorly after termination, this must mean the problems those dealers and Hampton faced were the result of some unidentified market issue, rather than their own operations. The evidence did not support this.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

108. Hampton's expert admitted that he did not analyze the operations of those other two terminated dealerships, and that he could not tell one way or the other whether the performance at those dealerships was based on operational rather than market issues.

109. After the initial final hearing was completed on February 16, 2012, Hampton argued that incentive variations were an additional cause of its poor performance. As a result of that argument and the granting of a motion on that issue filed by Hampton, the record was reopened and the parties were permitted to obtain additional discovery and present additional evidence on this issue, the findings on which are detailed below.

110. Beginning in May 2009, Nissan began to vary incentives offered on a few specific models depending on where the customer resided. On these few select models, customers residing in Florida were offered more favorable lease incentives, and customers residing in the rest of the Southeast Region were offered more favorable purchase incentives.

111. Hampton argued that it was harmed by the incentive variations because Fort Walton Beach has a lower leasing rate than the State of Florida or the Southeast Region as a whole. Hampton's expert, however, could not quantify the impact, if any, this had on Hampton Nissan's sales performance, and he did not analyze any PMA other than Fort Walton Beach. Both sales and leases count as a retail transaction for purposes of calculating sales penetration.

112. It is very common in the automobile industry to vary incentive offers based on customer residency. The mere fact that incentive variances existed does not show a negative impact on Hampton or any other dealer. To determine if there was any impact, it is necessary to analyze the sales and registration data.

113. Prior to mid-2009, the incentive programs for customers located in Florida and in the rest of the Southeast Region were identical. Thus, incentive variations did not trigger Hampton's sales performance decline, which began in 2007 and declined most dramatically from 2007 to 2008.

*15 114. If incentive variations benefited Florida dealers located in areas where leasing was more prevalent, as Hampton argues, Hampton's sales performance in 2009 would have declined more when compared to the rest of the state than when compared to the Southeast Region. However, Hampton's sales performance decline is similar regardless of whether a state or region benchmark is used.

115. Sales penetration can be adjusted to account for the leasing rates in a particular area by separating lease and purchase data and adjusting the expectation accordingly. After adjusting for the lower leasing rates in the Fort Walton Beach PMA, Hampton's sales penetration during the cure period from June through November 2010, was only 45.9 percent of the region average, showing that low leasing rates in the market had very little impact, if any, on Hampton's sales performance.

116. The incentive variations beginning in mid-2009 impacted only four models — Sentra, Maxima, Rogue, and Murano. Both before and after the incentive variations began, these models accounted for only 25 percent of Hampton's sales. If the incentive variations had caused Hampton's poor performance, its sales decline should have been greater in these models, but Hampton's sales performance decline was consistent among both impacted and non-impacted models.

117. Hampton's expert testified that advertising better purchase incentives on one model could bring in customers who ultimately purchase a different model. He did not know, however, if this actually happened, and there is no evidence that Hampton changed their advertising in any way based on the available incentives.

118. On a few other models — Pathfinder, Armada, Z, and Frontier — a Florida customer was eligible for the same purchase incentive as a customer in the rest of the Region, but also was eligible for a more beneficial lease incentive than customers in the rest of the Region. Because the incentives offered to Florida customers on both lease and purchase were equal to or better

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

than incentives offered outside Florida, the incentives on these models could not have negatively impacted Hampton or any other dealer in Florida.

119. Although industry lease levels in the Fort Walton Beach PMA were lower than the State of Florida as a whole, leasing was more prevalent in Fort Walton Beach than in the other three West Panhandle PMAs — Panama City, Pensacola, and Marianna (5.9 percent leasing rate compared to 7.1 percent in Fort Walton Beach). If the incentive variations negatively impacted Florida dealers in low leasing areas, these dealers should perform worse than Hampton after the lease variations began, yet all three exceeded region average sales penetration.

120. If the incentives offered to customers in the Fort Walton Beach PMA were uncompetitive because of low leasing preferences, the brand performance in the PMA would have declined after the incentive variations began. However, the data shows that the Nissan brand actually performed better in the Fort Walton Beach PMA after the incentive variations began.

*16 121. While Nissan brand penetration increased in the PMA, Hampton's contribution declined, meaning that customers in Hampton's PMA were purchasing (or leasing) Nissan vehicles at higher rates, yet not from the Hampton dealership. This reflects an operational problem at the dealership.

122. Ultimately, the leasing rates for a brand in a particular market are impacted by the methodology and sales processes of the dealer in the market. Hampton's own expert conceded that advertising, dealer operations, sales strategy, pricing, management, sales staff ability, sales training, and the number of sales people influence both sales performance and whether a customer decides to buy or lease a vehicle.

123. Although industry leasing in the Fort Walton Beach PMA was 7.1 percent, Nissan brand leasing was only 5.9 percent. By comparison, Nissan leasing in the other West Panhandle PMAs was 12 percent, more than double the industry-leasing rate. This reflects a lack of effort by Hampton. According to its financial statements, Hampton made only one Nissan lease from 2006-2010. Had it captured the available lease opportunity at the same rate as other district dealers, it would have made an additional 22 to 45 retail transactions per year.

124. Although not asserted as an excuse for its poor performance, Hampton argued that Nissan acted in bad faith because (1) the termination was secretly based on Hampton's decision not to enroll in Nissan's facility program; and (2) Nissan offered to provide financial assistance to a potential buyer of the store. The evidence does not support Hampton's argument.

125. Nissan's facility program is similar to those used by other manufacturers, and it is voluntary. Nissan offered the program to Hampton, as it did to its other dealers. Nissan's market study suggested that conversion of Hampton to an image facility devoted exclusively to sales of Nissan products would be successful in Hampton's location. Although Nissan recommended that Hampton consider converting to an imaged facility, it was not required. Although it may have contributed to the poor sales performance, Hampton's decision to decline participation in the facility program had no bearing on the decision to issue the NOD or NOT.

126. Nissan's offer to provide financial assistance to a potential buyer of the store also does not evidence any bad faith. Mr. Hampton's own broker referred the potential buyer to Nissan. Prior to engaging in any substantive discussions with this potential buyer, Nissan personnel obtained Mr. Hampton's permission. The price Mr. Hampton sought for the dealership was very high, and Nissan offered financial assistance to help bridge the gap. This offer would allow Mr. Hampton to get a higher price for his dealership, and provide Nissan with a proven performer.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

Reasons for Hampton's Poor Performance

a) Lack of Executive Manager

127. It is critically important for a dealership to have an authorized on-site executive manager to provide leadership and direction. Without this, it is difficult for Nissan's field team to work with anyone at the dealership to help a dealer improve sales.

*17 128. Mr. Hampton admitted that the number one reason for the poor sales performance at the store was his failure to have qualified management on-site. He admitted that he made all the management-hiring decisions and that Nissan sent him many written notifications about the failure to have qualified management at the store.

129. Management turnover and lack of an executive manager was a continuing problem at Hampton. Hampton had between 10-12 general managers or management candidates from 2006-2010. Even when the dealership had someone serving as general manager, he did not have the authority of an executive manager.

130. Most dealership decisions and functions were run out of Hampton's headquarters in Lafayette, including accounts payable, parts and service statements, payroll, financial statements, inventory logging, and floorplan redemptions. The team in Lafayette also made the decisions regarding all manager pay plans and most employee pay plans, set the advertising budget, and reappraised every used vehicle traded in at the dealership.

131. A number of Hampton's managers expressed frustration over their lack of authority over the dealership operations, with everything being controlled out of Lafayette and their hands being tied regarding advertising, vehicle appraisals, and other day-to-day operational issues.

132. At the Final Hearing, Hampton argued that the lack of an executive manager at the dealership was Nissan's fault because they did not help Hampton hire a good executive manager. However, Nissan had no system to identify or recommend potential employees for its dealers, who are independent businesses responsible for making their own hiring and firing decisions.

b) Capitalization

133. Mr. Hampton is the 100 percent owner of Hampton Automotive Group and 13 other entities. The Hampton organization pulled significant amounts of money out of the Fort Walton Beach dealership through owner's salary, institutional advertising (which consisted of "talent fees" paid to Mr. Hampton to star in commercials), outside services, rent, and management fees. In these five categories alone, \$6.3 million was pulled out of the dealership's balance sheet in five years.

134. Hampton argued that the removal of capital was irrelevant because there was money available for the dealership from the Hampton organization. Even if this money was available, it was never invested in the dealership. The financial statements reveal that, because of various "costs" paid to the Hampton organization, the Fort Walton Beach store lost over \$1 million per year in 2008 and 2009. In addition, the Fort Walton Beach dealership lost capital by paying off millions of dollars in loans to other Hampton entities in 2008-2010, further lowering its capital levels. These losses and the withdrawal of capital correlate to the declining sales performance at the dealership.

135. In meetings with Nissan, Mr. Hampton stated that he kept the dealership because he personally made \$10 million from it in five years. He also stated that owners' salaries, management fees, institutional advertising, and other entries on the financial statement were "fluff that went directly to him," and that, although the dealership showed a loss, it provided him with plenty of profit.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

(c) Advertising

*18 136. In 2006 and 2007, the dealership spent over \$1 million on advertising. In 2008, Hampton cut its advertising budget in half, to \$526,355. In 2009, Hampton cut its advertising budget in half again, to \$242,058. Despite the issuance of an NOD, Hampton's advertising expenditures remained low in 2010, at \$284,430. During this same time period, sales performance steadily declined, from 102.7 percent in 2007 to 67.1 percent in 2008, to 58.4 percent in 2009, to 48.5 percent through November 2010. While the dealership advertising was cut in half in 2008 and again in 2009, the owners' salary stayed consistent at \$480,000.

137. There is a direct correlation between investment in advertising and sales volume. The less a dealership advertises, the less traffic it attracts, and the less it sells. Nissan DOMs noted that advertising was a major problem at the dealership and the limited ad budget hurt the dealership's sales performance. Even in 2010, Hampton's managers complained that their "options were limited based on [the] meager advertising budget" and their "hands are tied due to the limit[ed] amount of resources allocated to advertise in the community." Though advertising had been cut by 75 percent from 2007 levels, Hampton did not increase its advertising budget during the NOD period.

138. Several experts analyzed Hampton's advertising trend and noticed the same decline on a relative basis that is reflected on an actual basis in the financial statements. On a per-new-unit (vehicle) basis, advertising dropped from an above average \$500-\$600 per unit in 2006-2008 to 20 percent below average at less than \$400 per unit in 2009-2010. Hampton also spent less of its gross profit to advertise than other dealers in the region. Hampton's advertising per expected sale fell from a high of \$620 in 2007 to \$263 in 2010.

d) Sales Staff

139. From 2007 to 2010, Hampton cut its sales staff in half, from 13 in 2007 to 6 in 2010. Hampton's general manager testified that, when he arrived in August 2010, they only had seven salespeople, and they needed 10 just based on the traffic they had at that time. The pay plan for managers discouraged hiring salespeople by lowering management pay if salesperson compensation increased.

140. Successful dealers have a trained and certified sales staff, as product knowledge is a key element in selling. Hampton failed to have training programs in place and failed to take advantage of Nissan's offers of training. Hampton refused to send any of its staff to off-site training offered by Nissan. Hampton's own manager admitted that sales personnel lacked sufficient training as late as August 2010.

141. Other than in 2007, when Hampton performed at average, the dealership lacked a sales force that was dedicated to the Nissan brand. Having a dedicated sales staff can make a great impact on sales performance, as they have better product knowledge and are vested in the sale of Nissan products.

*19 142. At the Final Hearing, Mr. Hampton testified that one of the reasons Nissan sales suffered is that the sales force focused more on Hyundai sales.

(e) Lack of Focus on Sales Performance

143. At the Final Hearing, Mr. Hampton admitted that he was focused on personal profitability rather than sales numbers or adequate representation of the Nissan brand. He testified that he was proud of how the dealership performed in 2007-2010 because it was profitable, despite its poor sales performance.

144. Hampton's pay plan for General Managers was not based on sales performance, but instead on gross profit, even during the NOD period. In addition, salespeople at Hampton are paid based on gross profit, and they had no incentive to focus on a particular brand, even during the NOD period.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

145. Hampton did not take advantage of programs and incentives offered to improve sales performance. The dealership never participated in any tactical incentive programs offered by Nissan, which provide employees with trips, cash, and other incentives directly from Nissan to help drive sales. Mr. Hampton advised his staff not to try to hit retro bonuses, which provide a great monetary incentive to make a certain number of sales. He decided that making the sales necessary to hit a retro would just open them up to an audit.

146. Hampton was one of only two or three dealers in the entire region that refused to participate in a truck retro where Nissan offered up to \$10,000 in incentives on each Titan sale.

Nissan's Treatment of Other Dealers

147. Section 12(B)(1) of the Dealer Agreement allows Nissan to terminate the Agreement if a dealer fails to substantially fulfill its sales responsibilities. Due to the complexities involved, Nissan evaluates potential dealer terminations on a case-by-case basis. Both Hampton's expert and Nissan's expert agreed that it would be unreasonable to apply a bright-line test for termination, because circumstances affecting sales penetration must be considered. Consistent with this opinion, Nissan first considers the dealer's sales penetration and then reviews any circumstances that might affect sales penetration or warrant delaying the termination.

148. Nissan does not terminate every dealer who falls below 100 percent RSE, because a dealer that is just slightly below average would not be considered to be in substantial and material breach of the Dealer Agreement.

149. Nissan's starting point for considering a sales performance termination is the dealer's RSE, and those dealers near the bottom of the state in terms of performance may be considered in substantial breach warranting termination.

150. Next, in making the determination of whether to issue a notice of default or termination, Nissan considers the materiality of the RSE deficiency, the ranking among other dealers in the state, the effectiveness and turnover in management, ineffective or insufficient advertising, and other factors that might contribute to the success or failure of a dealer. Nissan also considers whether the dealer has come forth with a meaningful plan to improve and turn things around. Each of these factors is applied consistently and uniformly to any dealer facing potential termination.

*20 151. After considering Hampton's extremely poor performance, its steady decline in RSE, its long history of management turnover and operational deficiencies that continued during the NOD period, and its lack of a plan or even a willingness to take the steps necessary to improve, Nissan determined it was necessary and appropriate to terminate Hampton.

152. Hampton's counsel specifically identified three other dealers that he believed must be terminated before Hampton to uniformly apply the grounds for termination: Ocala Nissan, Celebrity Nissan, and Crystal Nissan. Notably, Hampton's expert report reflects that the PMAs of all three of these dealers performed better than Hampton in Registration Effectiveness, Hampton's preferred measure of performance.

153. With respect to RSE, Hampton's expert analysis shows that Ocala Nissan's average sales performance from 2008-2010 was better than Hampton's, with an average RSE of 65.8 percent compared to 59.6 percent for Hampton. Like Hampton, Ocala was issued a notice of default. Unlike Hampton, Ocala immediately called the Region Vice President to schedule a meeting after receiving the notice of default, came to the Region office with a plan to provide qualified management at all levels, and implemented a plan to overhaul the dealership operations with a substantial increase in advertising. While any one of these actions alone may not have been enough to delay a notice of termination, the action plan convinced Nissan that the dealer was taking the necessary steps to improve performance, and they delayed the issuance of a notice of termination to provide Ocala with a limited time to implement the plan and improve performance. While not stellar, Ocala's RSE performance was better than Hampton's at the time the NOT was issued to Hampton.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

154. Celebrity Nissan was a replacement dealer for Classic Nissan, a dealer who was issued a notice of termination, but sold the dealership while appealing the Department's decision approving the termination. Upon purchasing the dealership, Celebrity had to operate from the same substandard facility as the terminated dealer and had to overcome the prior dealer's history of poor performance in the market. When Celebrity failed to significantly improve performance at the store, Nissan issued a notice of default. In response, Celebrity notified Nissan that Celebrity was going to sell the dealership and requested Nissan to provide a buyer's assistance letter. Once Celebrity was in active negotiation with the buyer, Nissan saw no benefit in seeking termination and, instead, gave the dealer time to move forward with the sale. The dealer who purchased Celebrity began performing well.

155. Like Celebrity, Crystal Nissan was a replacement for a terminated dealer who sold the dealership while appealing the Department's decision approving the termination. Crystal had to share a facility with the prior dealer's Honda store until it could build its own facility. Crystal's predecessor had been a 20-year poor performer, and Crystal was tasked with essentially creating the market. According to Hampton's own expert, Crystal's "average" performance from 2008-2010 was higher than Hampton's. In addition, Crystal, with an 80 percent RSE at the end of 2009, was performing far better than Hampton and remained over 15 points higher than Hampton at the time the NOT was issued to Hampton in December 2010.

CONCLUSIONS OF LAW

*21 156. The Division of Administrative hearings has jurisdiction over the subject matter and the parties to this proceeding, in accordance with sections 120.569, 120.57(1), 320.641, and 320.699, Florida Statutes.³

157. Under section 320.641, which governs the termination of a motor vehicle dealer's franchise agreement, Nissan bears the burden of establishing that termination of Hampton's franchise agreement is fair and not prohibited.

158. Nissan's burden of proof is by a preponderance of the evidence. § 120.57 (1) (j), Fla. Stat. ("Findings of fact shall be based upon a preponderance of the evidence, except in penal or licensure proceedings or except as otherwise provided by statute and shall be based exclusively on the evidence of record and on matters officially recognized.").

159. Section 320.641(3) provides:

A discontinuation, cancellation, or nonrenewal of a franchise agreement is unfair if it is not clearly permitted by the franchise agreement; is not undertaken in good faith; is not undertaken for good cause; or is based on an alleged breach of the franchise agreement which is not in fact a material and substantial breach; or, if the grounds relied upon for termination, cancellation, or nonrenewal have not been applied in a uniform and consistent manner by the licensee. If the notice of discontinuation, cancellation, or nonrenewal relates to an alleged failure of the new motor vehicle dealer's sales or service performance obligations under the franchise agreement, the new motor vehicle dealer must first be provided with at least 180 days to correct the alleged failure before a licensee may send the notice of discontinuation, cancellation, or nonrenewal.

160. The evidence demonstrated that Nissan provided the required cure period. On May 20, 2010, Nissan issued a Notice of Default, which specifically outlined the dealer's sales performance deficiencies and provided the opportunity to correct these failures. The Notice of Termination was issued on December 7, 2010, more than 180 days after the Notice of Default. At the time Nissan issued the NOT, it knew that the dealership's RSE through the end of November (the cure period) was below 50 percent of average and among the worst in the entire State.

161. Nothing in section 320.641(3) requires that the opportunity to correct sales-performance failures take any specific form. Prior to issuance of the NOD, Nissan had been counseling Hampton regarding its poor performance for an extended period of time, going back to 2008 for its most recent performance decline. In letters and meetings, Nissan outlined Hampton's performance deficiencies and provided them the opportunity to correct the failures. These letters and meetings also provided Hampton with a cure period of much longer than 180 days prior to the NOT.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

162. “The Dealer Agreement establishes the terms of the business relationship between [a manufacturer] and a dealer.” *Stella Chevrolet, Inc. v. Roberts Chevrolet, Inc.*, Case No. 88-3099, ¶ 15 (Fla. DOAH Jan. 30, 1990; HSMV May 4, 1990). As noted in *Love Nissan, Inc. v. Nissan N. Am., Inc.*, Case No. 04-2247, ¶ 100 (Fla. DOAH July 14, 2005; HSMV April 12, 2006):

*22 The Florida Legislature could have mandated ... the methodology by which manufacturers evaluate dealer sales performance or could have imposed minimum sales performance standards for termination, but it chose to leave those matters up to the agreement between the parties.

163. The Dealer Agreement requires that Hampton “actively and effectively promote” the retail sale of Nissan vehicles, and it specifically provides that Nissan can choose any reasonable method to evaluate Hampton's performance of its sales obligations. Nissan used the industry standard method, RSE, which is also outlined as an example of reasonable criteria in the Dealer Agreement. *Love*, ¶ 98.

164. Nissan's use of RSE has been found to be reasonable in previous administrative decisions under section 320.641. See, e.g., *Classic Nissan, Inc. v. Nissan N. Am., Inc.*, Case No. 05-2426, ¶¶ 12, 14 (Fla. DOAH Mar. 20, 2007; HSMV Oct. 31, 2007); *Love*, ¶¶ 20, 98. Hampton was aware that its sales performance was being evaluated using RSE, and the use of RSE to measure Hampton's performance of its sales obligations is reasonable.

165. Section 12(B) (1) (A) of the Dealer Agreement clearly permits Nissan to terminate a dealer where, as here, the dealer has failed to substantially fulfill its sales responsibilities. Based on Nissan's evaluations of its sales performance, the evidence showed that Petitioner failed to actively and effectively promote the sale of new Nissan vehicles, and, as a result, it experienced a substantial decline in sales penetration to among the worst in the entire state.

166. Hampton's argument that the Dealer Agreement does not impose any sales obligation on the dealer, but rather, only a “marketing” obligation is contradicted by the plain language of the Dealer Agreement and has been rejected by the Department. See e.g., *Love*, ¶¶ 96-97. Even if a dealer is actively promoting the sale of vehicles, it is not effectively promoting them if the promotion does not result in a reasonable level of sales performance. *Id.*

167. Nissan's termination of Hampton's Dealer Agreement was undertaken in good faith based on Hampton's extremely poor sales performance, its operational decisions which led to such performance, and its unwillingness or inability to take the steps necessary to improve.

168. Nissan provided appropriate and continuing notice to Hampton of its declining sales penetration and offered specific recommendations on ways to improve. Hampton ignored these recommendations and often refused to meet with Nissan personnel. See *Love*, ¶ 103 (providing notice of poor performance and recommendations to dealer shows good faith); accord *Classic*, ¶ 167.

169. Nissan's termination of Hampton's Dealer Agreement was for good cause. Hampton was not only a long-time poor performer, but it also experienced a substantial and continuing decline in sales penetration to among the worst performers in the entire state of Florida. See *Classic*, ¶ 170 (finding poor sales performance to be good cause for termination); accord *Love*, ¶ 104.

*23 170. While Hampton is free to make its own operational decisions, it is contractually obligated to effectively represent the Nissan brand and to fulfill its sales performance obligations. Its failure to do so provided good cause for termination.

171. Hampton's poor sales performance was due to operational problems at the dealership, including issues related to management, advertising, customer relations, lack of training, and capitalization. Hampton's owner even admitted that the management turnover and lack of a qualified, on-site Executive Manager for many years is the primary cause of its poor performance. See *Classic*, ¶¶ 171-172 (lack of executive manager relevant to good cause). These operational decisions had an immediate and continuing impact on the dealer's sales performance.

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

172. A dealership's failure to achieve reasonable market share is a material and substantial breach. "Because franchise dealers are the major outlet the manufacturer has for the sale of new automobiles, it is essential that minimum levels of sales performance are achieved on a regular basis. Failure to meet the minimum sales performance over the term of this agreement by [the dealer] is a material and substantial breach of the contract." Bill Gallman Pontiac GMC Truck, Inc. v. GMC, Case No. 89-0505, ¶ 17 (Fla. DOAH June 29, 1990; HSMV Aug. 19, 1994).

173. Every slight failure to achieve average sales penetration may not be a material and substantial breach warranting termination. "The magnitude of the short-fall must be considered in determining whether a dealer's performance is so ineffective as to warrant termination." Love, ¶ 105; accord Classic, ¶¶ 178-179.

174. Hampton did not merely fail to achieve average RSE; its performance was significantly below average. By November 2010, Hampton was performing at 48.5 percent of average, among the worst performers in the state and the region. Hampton's lack of any substantive effort to improve its sales performance also evidences the materiality of its breach. Classic, ¶ 179. Hampton's breach of its sales obligations in the Dealer Agreement is material and substantial.

175. The "uniform and consistent" requirement of section 320.641(3) does not require that a manufacturer treat every under-performing dealer "identically," issuing the same number of NODs, or terminating the dealer only after the exact same length of poor performance. Rather, the uniform and consistent requirement requires the manufacturer to show that it has "treated similarly-situated dealers in a uniform and consistent manner, and that it has not singled out any particular dealer for disparate treatment," using criteria not applied to other dealers. Love, ¶ 108.

176. The evidence showed that Nissan uniformly and consistently applied the same performance standard and considerations to all dealers, including Hampton, and that Hampton was not singled out for disparate treatment. Although Hampton identified other dealers whose performance was poor at some period of time, Nissan explained the circumstances surrounding these dealers, who either improved performance, sold their dealership rather than face potential termination, or came forward with a specific action plan to improve after receiving an NOD. None of these dealers are similarly situated to Hampton, and Nissan applied the grounds for termination in a uniform and consistent manner.

*24 177. The manufacturer may take into account each particular dealer's circumstances, including factors beyond the dealer's control that may have prevented the dealer from reaching its sales penetration obligation, as well as the efforts of the dealers to effectively address the poor performance. Love, ¶¶ 106-109 (holding that manufacturer may take into account all appropriate dealer circumstances); Classic, ¶¶ 182-183 (lack of plan or willingness to improve differentiated dealer from other poor performers).

RECOMMENDATION

Based on the foregoing Findings of Fact and Conclusions of Law, it is RECOMMENDED that the Department of Highway Safety and Motor Vehicles enter a final order dismissing Petitioner's protest and approving the December 7, 2010, Notice of Termination.

DONE AND ENTERED this 12th day of September, 2012, in Tallahassee, Leon County, Florida.

JAMES H. PETERSON, III
Administrative Law Judge
Division of Administrative Hearings
The DeSoto Building
1230 Apalachee Parkway

Attachment 2

HAMPTON AUTOMOTIVE GROUP, INC. D/B/A HAMPTON..., 2012 WL 5305152...

Tallahassee, Florida 32399-3060

Filed with the Clerk of the Division of Administrative Hearings this 12th day of September, 2012.

Footnotes

- 1 Petitioner, Hampton Automotive Group, Inc. d/b/a Hampton Nissan filed exceptions to the Recommended Order. These exceptions are ruled on in the Appendix to this Order. Respondent Nissan North America, Inc., filed responses to the exceptions.
- 1 The Dealer Agreement identifies Hampton Automotive Group, Inc. as a Florida corporation. The purchase by Hampton Automotive Group, Inc., included the Nissan, Hyundai, Mitsubishi, and Volvo dealership in Fort Walton Beach, Florida, at the location where Hampton Automotive Group currently operates Hampton Nissan (Hampton), Hampton Hyundai, and Hampton Mitsubishi. Mark Hampton owns other companies with a Mitsubishi dealership, a Toyota dealership, and a used car dealership in Lafayette, Louisiana.
- 2 Article Fourth (b) of the Dealer Agreement obligates Hampton to obtain the written consent of Nissan before changing its executive manager.
- 3 Unless otherwise noted, all references to the Florida Statutes are to the current, 2012 versions, pertinent portions of which have not changed since prior to the occurrence of material facts in this case.

2012 WL 5305152 (Fla.Div.Admin.Hrgs.)

End of Document

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Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

2005 WL 1662263 (Fla.Div.Admin.Hrgs.)

Division of Administrative Hearings

State of Florida

LOVE NISSAN, Petitioner

v.

NISSAN NORTH AMERICA, INC., Respondent

Case No. 04-2247

July 14, 2005

RECOMMENDED ORDER

*1 Upon due notice, a disputed-fact hearing was conducted in this case on March 7-11 and 16-18, 2005, in Tallahassee, Florida, before Ella Jane P. Davis, a duly-assigned Administrative Law Judge of the Division of Administrative Hearings.

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Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

18501 South Figueroa Street
Gardena, California 09248-0191

STATEMENT OF THE ISSUES

Whether Respondent Nissan North America, Inc.'s April 1, 2004, Notice of Termination of the Dealer Sales and Service Agreement between itself and Petitioner Love Nissan, Inc., was undertaken in good faith; undertaken for good cause; clearly permitted by the franchise agreement; and was based on a material and substantial breach of the dealer agreement; and whether the grounds relied upon for termination have been applied in a uniform and consistent manner.

PRELIMINARY STATEMENT

On April 1, 2004, Nissan North America, Inc., (Nissan) issued a Notice of Termination (NOT) of its Dealer Sales and Service Agreement to Love Nissan, Inc., (Love Nissan or Love). Love timely filed a protest with the Florida Department of Highway Safety and Motor Vehicles. The matter was referred to the Division of Administrative Hearings on or about June 25, 2004.

By agreement of the parties, this cause was originally scheduled for a final hearing on the merits on February 7-18, 2005. Ultimately, the case was rescheduled, again at the parties' request, for the dates set forth above.

According to law, and by stipulation of the parties, Nissan bore the duty to go forward and the burden of proof by a preponderance of the evidence of all statutory elements. All concerned acknowledge that, regardless of the style of these proceedings, the Florida Department of Highway Safety and Motor Vehicles is the agency which will enter the final order herein.

Nissan presented the testimony of Jonathan Finkel, Andrew Delbrueck, Patrick Doody, Herbert Walter, and James Anderson. Nissan's Exhibits 9, 11, 14, 16-38, 40-46, 72, 91, 95-98, and 100-112, were admitted in evidence.

Love presented the testimony of Joseph Roesner, Robert (Bob) Halleen, Chad Halleen, and Robert Dilmore. Love's Exhibits 10, 14, 17, 23, 39, 45, 52, 54-57, 59-60, and 60A were admitted in evidence. Love's Exhibits 10A and 61 were not admitted in evidence, but were proffered, along with related testimony.

*2 Some exhibits constitute depositions of additional witnesses.

In the course of hearing, the undersigned made the following evidentiary rulings, among others:

(1) In this franchise termination proceeding, the 2001 amendment to Section 320.641, Florida Statutes, requiring that a manufacturer's grounds for termination be applied by it in a "uniform and consistent manner" applies to this action from June 8, 2001, the amendment's effective date, through the issuance of NISSAN'S Notice of Termination to the franchisee/dealer, LOVE.

(2) All evidence between June 8, 2001, and April 1, 2004, the Notice of Termination date, is relevant to determine whether or not NISSAN has satisfied this requirement.

(3) Dissimilar treatment of other dealers which occurred after the Notice of Termination, if any such dissimilar treatment occurred, is irrelevant to the issues of this cause.¹

A Transcript of 14 volumes was filed on April 1, 2005. The parties filed their respective Proposed Recommended Orders timely, in accord with their stipulation. Both proposals have been considered in preparation of this Recommended Order.

FINDINGS OF FACT

10/1/05

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

1. Nissan is a "licensee" as defined by Section 320.60(8), Florida Statutes.
2. Love is a "motor vehicle dealer," in relationship with Nissan, as defined by Section 320.60(11)(a)1., Florida Statutes.
3. At all times material, Love Nissan's principals have been retailers of both Nissan and Honda automobiles in Homosassa Springs, Citrus County, Florida. The Honda dealership is called, "Love Honda." (See Finding of Fact 11.) Honda is a competitor of Nissan.
4. Nissan and Love are parties to a Dealer Sales and Service Agreement, which is a "franchise agreement" as defined by Section 320.60(1), Florida Statutes, and which is referred to herein as "the dealer agreement."
5. This is an automobile dealer termination case, arising from Nissan's April 1, 2004, Notice of Intent to Terminate the Dealer Sales and Service Agreement.
6. Love's dealer agreement with Nissan, executed March 4, 1999, is the acknowledged contract between the parties. Nissan drafted it.
7. Charles Halleen purchased Love Nissan on July 23, 1990. At all times material, Charles Halleen had a long and successful history in the automotive sales and service industry. From the time Charles Halleen purchased the dealership, his son, Robert Halleen, worked at the dealership. Robert also has been involved in the automotive sales and service industry most of his life. When Charles Halleen acquired Love, Robert took control over most dealership operations, other than sales. Robert Halleen's duties increased as he began to oversee used car sales. Chad Halleen, Charles Halleen's grandson and Robert Halleen's son, also worked part-time or full-time at the dealership from 1990 through the date of hearing.
8. However, until 1994, a non-family member served as Love's executive manager and was responsible for new vehicle sales, advertising, and ordering from Nissan of the vehicles to be sold by Love.
- *3 9. From 1994 to 1999, Charles Halleen owned the Love dealership and served as its dealer principal. During the same period, Robert Halleen served as Love's general manager. Since 1994, Love has been a poor performer saleswise.
10. Effective March 4, 1999, Nissan approved Charles Halleen's transfer of ownership of Love Nissan to Robert Halleen, and to Robert's son, Chad Halleen. Robert Halleen became 90 percent owner of the dealership, and Chad Halleen received the remaining 10 percent ownership. At the same time, Robert Halleen and Chad Halleen entered into the dealer agreement with Nissan that is at issue in these proceedings. Pursuant to that dealer agreement, Robert Halleen became Love's dealer principal and Chad Halleen became Love's executive manager.
11. Robert and Chad Halleen also own Love Honda, which is located adjacent to Love Nissan. The Nissan and Honda dealerships have separate showrooms, display areas, and parking areas, but they share a service facility which is located behind the Love Nissan showroom.
12. Section 320.645, Florida Statutes, prohibits a manufacturer from owning a motor vehicle dealership that sells the cars it manufactures directly to the public. Nissan cannot sell cars at retail in Florida and therefore must rely on its dealers to sell cars to the ultimate consumers. Accordingly, Nissan's agreements with its dealers contain provisions to help ensure that dealers achieve and maintain sufficient and satisfactory levels of sales performance.
13. Within the dealer agreement, Love is referred to as "dealer," and Nissan is referred to as "seller."
14. The following provisions of the dealer agreement impact this case:
Section 3: Vehicle Sales Responsibilities of Dealer.

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

3.A. General Obligations of Dealer. Dealer shall actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and if Dealer elects, the leasing and rental) of Nissan Vehicles to customers located within Dealer's Primary Market Area. Dealer's Primary Market Area is a geographic area which Seller uses as a tool to evaluate Dealer's performance of its sales obligations hereunder. Dealer agrees: that it has no right or property interest in any such geographic area which Seller may designate; that, subject to Section 4 of this Agreement, Seller may add, relocate or replace dealers in Dealer's Primary Market Area; and that Seller may, in its reasonable discretion, change Dealer's Primary Market Area from time to time.

3.B. Sales of Nissan Cars and Nissan Trucks. Dealer's performance of its sales responsibility for Nissan Cars and Nissan Trucks will be evaluated by Seller on the basis of such reasonable criteria as Seller may develop from time to time, including for example:

3.B.1. Achievement of reasonable sales objectives which may be established from time to time by Seller for Dealer as standards for performance.

3.B.2. Dealer's sales of Nissan Cars and Nissan Trucks in Dealer's Primary Market Area and/or the metropolitan area in which Dealer is located, as applicable, or Dealer's sales as a percentage of:

*4 3.B.2.(i) registrations of Nissan Cars and Trucks;

3.B.2.(ii) registrations of Competitive Vehicles;

3.B.2.(iii) registrations of Industry Cars;

3.B.2.(iv) registrations of vehicles in the Competitive Truck Segment;

3.B.3. A comparison of Dealer's sales and/or registrations to sales and/or registrations of all other Authorized Nissan Dealers combined in Seller's Sales Region and District in which Dealer is located and, where Section 3.C applies, for all other Authorized Nissan Dealers combined in the metropolitan area in which Dealer is located; and

3.B.4. A comparison of sales and/or registrations achieved by Dealer to the sales or registrations of Dealer's competitors.

The sales and registration data referred to in Section 3 shall be those utilized in Seller's records or in reports furnished to Seller by independent sources selected by it and generally available for such purpose in the automotive industry. If such reports of registration and/or sales are not generally available, Seller may rely on such other registration and/or sales data as can be reasonably obtained by Seller.

3.C. Metropolitan Markets.

If Dealer is located in a metropolitan or other marketing area where there are located one or more Authorized Nissan Dealers other than Dealer, the combined sales performance of all Nissan Dealers in such metropolitan or other marketing area may be evaluated as indicated in Sections 3.B.2 and 3.B.3 above, and Dealer's sales performance may also be evaluated on the basis of the proportion of sales and potential sales of Nissan Vehicles in the metropolitan or other marketing area in which Dealer is located for which Dealer fairly may be held responsible.

3.D. Additional Factors for Consideration.

Where appropriate in evaluating Dealer's sales performance, Seller will take into account such reasonable criteria as Seller may determine from time to time, including, for example, the following: the Dealership Location; the general shopping habits

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

of the public in such market area; the availability of Nissan Vehicles to Dealer and to other Authorized Nissan Dealers; any special local marketing conditions that would affect Dealer's sales performance differently from the sales performance of other Authorized Nissan Dealers; the recent and long term trends in Dealer's sales performance; the manner in which Dealer has conducted its sales operations (including advertising, sales promotion, and treatment of customers); and the other factors, if any, directly affecting Dealer's sales opportunities and performance.

* * *

3.G. Assistance Provided by Seller.

3.G.1. Sales Training Courses.

Seller will offer from time to time sales training courses for Dealer sales personnel. Based on its need thereof, Dealer shall, without expense to Seller, have members of Dealer's sales organization attend such training courses and Dealer shall cooperate in such courses as may from time to time be offered by Seller.

*5 3.G.2. Sales Personnel.

To further assist Dealer, Seller will provide to Dealer advice and counsel on matters relating to new vehicle sales, sales personnel training and management, merchandising, and facilities used for Dealer's vehicle sales operations.

3.H. Evaluation of Dealer's Sales Performance.

Seller will periodically evaluate Dealer's performance of its responsibilities under this Section 3. Evaluations prepared pursuant to this Section 3. Evaluations prepared pursuant to this Section 3.H. will be discussed with and provided to Dealer, and Dealer shall have an opportunity to comment, in writing, on such evaluations. Dealer shall promptly take such action as may be required to correct any deficiencies in Dealer's performance of its responsibilities under this Section 3.

* * *

Section 12. Termination.

* * *

12.B. Termination by Seller for Non-Performance by Dealer.

12.B.1. If, based upon the evaluations thereof made by Seller, Dealer shall fail to substantially fulfill its responsibilities with respect to:

12.B.1.a. Sales of new Nissan Vehicles and the other responsibilities of Dealer set forth in Section 3 of this Agreement;

12.B.1.b. Maintenance of the Dealership Facilities and the Dealership Location set forth in Section 2 of this Agreement;

12.B.1.c. Service of Nissan Vehicles and sale and service of Genuine Nissan Parts and Accessories and the other responsibilities of Dealer set forth in Section 5 of this Agreement;

12.B.1.d. The other responsibilities assumed by Dealer in this Agreement including, without limitation, Dealer's failure to:

* * *

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

12.B.1.d.(i) Timely submit accurate sales, service and financial information concerning its Dealership Operations, ownership or management and related supporting data, as required under this Agreement or as may be reasonably requested by Seller;

12.B.1.d.(ii) Permit Seller to make an examination or audit of Dealer's accounts and records concerning its Dealership Operations after receipt of notice from Seller requesting such permission or information;

12.B.1.d.(iii) Pay Seller for any Nissan Products or any other products or services purchased by Dealer from Seller, in accordance with the terms and conditions of sale; or

12.B.1.d.(iv) Maintain net worth and working capital substantially in accordance with Seller's Guides therefore; or

12.B.2. In the event that any of the following occur:

12.B.2.(i) any dispute, disagreement or controversy between or among Dealer and any third party or between or among the owners or management personnel of Dealer relating to the management or ownership of Dealer develops or exists which, in the reasonable opinion of Seller, tends to adversely affect the conduct of the Dealership Operations or the interests of Dealer or Seller, or

12.B.2.(ii) any other act or activity of Dealer, or any of its owners or management occurs, which substantially impairs the reputation or financial standing of Dealer or of any of its management subsequent to the execution of this Agreement:

*6 Seller will notify Dealer of such failure and will review with Dealer the nature and extent of such failure and the reasons which, in Seller's or Dealer's opinion, account for such failure.

Thereafter, Seller will provide Dealer with a reasonable opportunity to correct the failure. If Dealer fails to make substantial progress towards remedying such failure before the expiration of such period, Seller may terminate this Agreement by giving Dealer notice of termination, such termination to be effective at least ninety (90) days after such notice is given.

During such period Dealer will commence such actions as may be necessary so that the termination obligations of Seller and Dealer set forth in this Agreement may be fulfilled as promptly as practicable.

15. Therefore, it may be said that Love and Nissan have agreed and contracted that Love will "actively and effectively promote the sale at retail" of new Nissan vehicles; that Love will be evaluated by Nissan on Love's sales performance within its designated Primary Market Area (PMA); and that Nissan may evaluate Love's "performance of... sales responsibility... on the basis of such reasonable criteria as [Nissan] may develop from time to time."

16. At all times material, Love's PMA has included all of Citrus County and parts of Levy and Hernando Counties, although during the critical period of time, Nissan twice adjusted Love's PMA boundaries as described below.

17. At all times material, Robert and Chad Halleen knew that Nissan makes periodic evaluations of Love's sales performance, and that pursuant to the dealer agreement, Nissan could terminate Love for failure to "substantially fulfill its responsibilities with respect to sales of new Nissan vehicles."

18. Nissan, in fact, used the criteria set forth in Section 3.B.2.(ii), of the dealer agreement to evaluate Love, that is: Love's percentage of competitive vehicle registrations, compared to the "sales and/or registrations of all other Authorized Nissan Dealers combined in [Love's] sales region." It is undisputed that the dealer agreement outlines the "sales penetration" calculation Nissan is permitted to use, and did use, to evaluate Love and all other Nissan dealers' sales performance.

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

19. This is a statistically dense case, and accordingly, the weight and credibility of testimony in the respective experts' various fields has been analyzed and considered in arriving at the following factual analysis of those statistics, but it is unrefuted that Love's sales performance on Nissan automobiles has always been below Nissan's southeast region average by every standard used to evaluate Love's performance.

20. Nissan has consistently used sales penetration to evaluate the sales performance of all Nissan dealers, not just Love. Sales penetration is calculated by dividing a dealer's total new vehicle sales by the number of competitive new vehicles registered in a dealer's PMA. The resultant quotient is expressed as a percentage, to show the dealer's sales penetration. Each dealer's sales penetration is then compared as a ratio to Nissan's sales penetration throughout the region, to determine whether the dealer being analyzed is penetrating its PMA below, at, or above the average for all Nissan dealers in the region. Historically, by case law, and by expert testimony in the instant proceeding, it is found that Nissan's method for evaluating its dealers' sales performances is a reasonable, industry-accepted practice for evaluating new car dealers.²

*7 21. Furthermore, this methodology has "built-in" benefits for the dealers being analyzed. Because all sales are included in the denominator of the calculation, and not just those sales from the geographical market areas assigned to the respective dealers, the total region penetration figure is lowered, thus helping more dealers demonstrate at least average penetration.

22. Nissan advises dealers who are in trouble saleswise, or who are likely to get in trouble saleswise, before it is too late to salvage the dealership. Among other means of doing this is Nissan's practice of sending dealers who rank in the bottom 10 of the sales penetration rankings a quarterly letter expressing Nissan's concern with the dealership's sales performance. From 1997 to 2004, Love Nissan received many such letters. The first such letter arrived in 1997, before Robert and Chad Halleen took over the running of Love Nissan. Robert Halleen claims that in 1997, upon receipt of Love's first "bottom 10" letter, Nissan's District Operations Manager (DOM) told him that bottom 10 letters were a mere formality and that he should not worry about receiving them. While this unrefuted testimony is credible, it does not excuse Love's later failure to respond to requests and advice from Nissan; failure to respond to bottom 10 letters; or failure to respond to notices of default (NODs), by bringing Love's sales penetration into line with the region average for the next six-plus years.³

23. From 1997 to April 1, 2004, in addition to bottom 10 letters, Nissan repeatedly notified Love of its evaluations on the basis of Love's sales penetration as compared to the region average and Love's ranking among Nissan dealers; notified Love that it was not meeting Nissan's expected level of sales; and offered advice and counsel, through its DOM, on increasing sales, as more specifically described below.

24. On November 29, 1999, nine months into Robert and Chad Halleen's ownership and administration of Love, Love received Nissan's certified bottom 10 letter, stating that Love needed to improve its sales penetration to meet the region average. As of that date, Love's penetration was 33 percent of the region average.

25. On November 21, 2000, Nissan sent Love an NOD, advising that Love was in default on several provisions of the dealer agreement. The letter notes that it is the third such notice.

26. Love had unilaterally, and without Nissan's prior approval as required by the dealer agreement, added the Daewoo car line to Love's dealership. Daewoo is another import competitor of Nissan. Although Love's showroom for Daewoo was located elsewhere, some Daewoo automotive service was conducted at the Love Nissan service facility, which already was shared with Love Honda. Nissan cited this situation as one of the four elements of a default by Love, along with Love's failure to maintain its facilities, insufficient capitalization, and poor sales performance/penetration.

*8 27. The NOD also advised Love that its sales penetration had been decreasing: 35.5 percent of region average in 1998, which was 390 units short of the region average units sold that year; 32.0 percent of the region average in 1999; and 28.1

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

percent of region average in 2000, year to date (YTD). Nissan gave Love 90 days to avoid termination by reaching the region's average sales penetration.

28. By year's end, Love was only at 29.5 percent penetration, but Love Nissan's attorney sent an explanation of the Daewoo situation to Nissan on January 9, 2001. His letter stated, in pertinent part:

... as you note in your letter, Mr. Halleen has purchased land adjacent to the dealership facilities and has already moved the Daewoo sales to that land. Also, the rest of the Daewoo related complaints are not an issue as Mr. Halleen has remedied that problem so that Daewoo service or parts is not infringing on any portion of Nissan's use of any of the facilities.

... the numbers that have been provided to you are not accurate or have not been appropriately applied to the situation regarding Love Nissan's Guides for Dealership Facilities. At this time, we believe that Love Nissan is now, and has been in substantial compliance with these Guides. [There follows a discussion of alleged square footage of the facility as Love compared it to the Nissan guidelines.]

... Mr. Halleen... disagrees with the current "planning potential" that has been assessed to Love....

29. On February 1, 2001, Nissan sent Love a follow-up NOD, again advising Love that its current sales penetration was the lowest of the 58 Florida dealers, and again advising that Love must remedy its default of the dealer agreement.

30. On June 29, 2001, Nissan sent Love another certified letter. Nissan again informed Love that it was in breach of the dealer agreement based upon its sales penetration through April 2001, which was only 47.2 percent of region average. Nissan requested a response from Love by July 16, 2001, with a plan to cure its default, but Love did not respond.

31. The effect of this correspondence was additional time beyond the 90 days in which Love could show performance improvement.

32. By a July 16, 2001, NOD, Nissan reiterated the same unauthorized addition of Daewoo to the already shared service department, failure to meet facility guidelines, and unsatisfactory sales performance, and set a 30 days' time limit for Love to come up with a written plan for improvement and a 90 days' deadline for Love to meet the region sales average.

33. The July 16, 2001, NOD also advised Love that, at Love's request, Nissan had reduced the size of Love's PMA and had recalculated sales penetration pursuant to the new PMA, but that Love's sales penetration, as recalculated, was still at only 54 percent of the average region sales penetration.

34. The NODs were jointly signed by W. J. Kirrane, Nissan's Vice-President and General Manager, and Brad Bradshaw, Nissan's then-Southeast Region Vice-President.

*9 35. Love's response to the July 16, 2001, NOD came from Robert Halleen, dated August 10, 2001. It was addressed to Mr. Kirrane, in California, and was copied to Mr. Bradshaw. It read, in pertinent part:

Your letter sent to me July 16, 2001, Notice of Default... shows a total lack of communication within Nissan as well as a total lack of commitment to your dealers. Our DOM's [sic.] have continually worked to adjust our PMA to try to eliminate some of the obstacles in penetrating this market.

Even by your own numbers, our penetration is increasing.... I would appreciate any help you can give me.... We currently have thirty two Nissans in stock (we normally stock 70-80) and had 3 units taken from our last allocation. If Nissan wants me to sell more cars they need to provide them.

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

Regarding your concerns over Daewoo, there is no evidence of Daewoo parts and service in our Nissan facility now or in the past. Daewoo currently resides in a building one mile south of our Nissan facility.

Concerning your facilities question, I do not believe anyone who has ever been to our dealership could call it inadequate. We have more than enough land to adequately display and sell Nissans (approximately 4 acres). Our service department is not running at full capacity, so I must assume that it also is more than adequate for the job.

* * *

Mr. Kirrane, if you are truly interested in Love Nissan improving its penetration, then sit down with me at the upcoming dealer meeting and explain how I can do this.

36. The foregoing letter indicates several troubling things about the Halleens' approach to solving Love's sales penetration problems: a misunderstanding of how a PMA is established; a failure to recognize that Nissan had recently readjusted Love's PMA; and a peculiar belief that the PMA itself somehow inhibited sales, as opposed to being just an evaluation tool. Further, it at least suggests that Robert Halleen misunderstood Nissan's allocation and ordering system as explained by several witnesses. It did not propose any plan for improving sales penetration. The letter also did not re-address, with any specificity, the Nissan facility guidelines by square-footage of each part of the facility, but it did give an owner's reassurance that Daewoo service was no longer being performed in Love's Nissan-Honda facility.⁴

37. Mr. Kirrane, from California, did not meet with Robert Halleen as suggested, or personally respond to the foregoing letter. Nissan's position is that Love was adequately served by its local DOMs and by Nissan's Region Vice-President.

38. On September 5, 2001, a certified letter from Region Vice-President Bradshaw responded to Robert Halleen's August 10, 2001, letter. Mr. Bradshaw's response memorialized a phone conversation between himself and Robert Halleen, which Mr. Bradshaw believed had resolved the PMA issue; offered Love help with allocation of product (inventory); acknowledged Love's relocation of Daewoo service; and cited several visitations by the DOM to assist Love. The Region Vice-President's letter further addressed Love's poor sales penetration and requested that Love propose a plan for achieving the region average. Love did not send Nissan any written plan.

*10 39. On November 26, 2001, Nissan sent another certified letter to Love, advising that, even with Love's new PMA, Love's sales penetration had fallen to 51.1 percent of the region average, and requesting a plan of improvement. No plan was received.

40. Nissan sent a certified letter to Love on March 4, 2002, advising that Love's sales penetration was only 50 percent of region average and requesting a plan for improvement by March 31, 2002. Love did not respond with a plan of correction for improvement of its sales.

41. In October 2002, Nissan's DOM visited Love to discuss sales performance and the need to improve.

42. On March 24, 2003, Nissan sent Love another certified letter, advising that Love's sales penetration percentage had declined in 2002 to 50.6 percent from an already low 50.9 percent the previous year, and that Love was in breach of the dealer agreement.

43. Chad Halleen responded to Nissan's then-Region Vice-President, Patrick Doody, generally stating Love's intent to increase sales via increased advertising and expressing concerns about how Nissan calculates sales penetration versus how Honda calculates sales penetration. He also expressed a concern about getting new Nissan cars/trucks and the desired type of Nissan cars/trucks in time to sell Nissan units in July 2003, based on how few units he currently had on his lot and how few he had on

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

order. This letter also evidenced Chad Halleen's misunderstanding of Nissan's allocation and ordering system, and it proposed no plan of correction.

44. Jon Finkel, Nissan's then-DOM, met with the Halleens on April 11, 2003, at the dealership. Love's then 51.2 YTD percent of region average sales penetration was discussed.

45. On May 23, 2003, Nissan sent Love another certified letter, advising that Love's sales penetration had fallen to 45.9 percent of region average through March 2003, which constituted a decrease from both the previous month and the previous year.

46. On June 24, 2003, DOM Finkel again visited Chad Halleen to assist with new signage, inventory, and "leads" for sales.

47. On June 27, 2003, Nissan issued another NOD to Love, again based on Love's current sales penetration of 46.7 percent and long-term sales penetration deficits. It gave notice of a breach of the dealer agreement and held out to Love the option of curing its breach by increasing sales penetration to reach the region average. At this stage, Love's performance had resulted in 200-plus lost Nissan sales per year, each year since 1999.

48. Mr. Finkel also called on Love in July of 2003 and advised that Love had improved to 48.2 percent of the region average in sales penetration. He also called on August 8, 2003, and advised that Love had climbed to 50.7 percent of average, but reminded Love that under the terms of the current NOD, Love had to attain region average sales penetration by September 2003 or Nissan would terminate the dealer agreement.

49. On August 15, 2003, Nissan sent another bottom ten letter, again advising Love of its deficient sales penetration and requesting that Love submit a plan for improvement to region average by September 15, 2003. Love's response was received by Nissan on September 18, 2003, but it contained no specific plan for the future and mostly related Love's previous July and August 2003 changes in hiring trained personnel in both sales and service areas; discussed compensation incentives already instituted for sales personnel; and stated that Love recently had sometimes lost money on new car deals by pricing them low, just to move Nissan units. These prior changes so far had produced minimal effect and so far had not significantly improved Love's sales penetration figures. Cutting Love's profit margin clearly was not a long-term solution to improve the dealer's sales penetration.

*11 50. On September 24, 2003, Mr. Finkel again met with Love to discuss Love's sales penetration, which was then at 53.1 percent of the region average, through July 2003. He again reminded Love that it needed to meet the region average sales penetration by the end of the month or Nissan would terminate the dealer agreement.

51. However, Love's raw score of new car sales and penetration percentage had modestly increased after the June NOD, and Nissan accordingly extended the NOD as of November 5, 2003.

52. Mr. Finkel met with Love on December 8, 2003, to discuss the October 2003 sales penetration report, which for Love still hovered at only 56.6 percent of region average sales penetration.

53. Mr. Finkel's report memorializes that at that time, Chad Halleen indicated he planned to renovate parts of the facility; Mr. Finkel urged Chad Halleen to "de-dual" with Honda in order to take advantage of the generally improving Nissan market; Mr. Halleen said he did not think he could do that financially, due to Nissan's space requirements; and Mr. Finkel said he would get back to Mr. Halleen about the space requirements. Love did not volunteer capital to build a new facility or to de-dual or offer a comprehensive sales penetration plan.

54. Mr. Finkel also set a sales objective for Love of 400 new Nissan vehicles for 2004. This goal was not a Nissan requirement or an approved Nissan evaluation tool, and the figure has never been used to evaluate Love for active and effective sales

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

performance/penetration. It was Mr. Finkel's own incentive idea. Love contends that an aspirational raw score like this should have been Nissan's requirement all along, yet at no time did Love ever sell 400 new Nissan vehicles in a year.

55. On February 10, 2004, Mr. Finkel again met with Love to discuss that the 2003 year-end data showed that Love had fallen back to a 55.8 percent of region average sales penetration.

56. On April 1, 2004, Nissan issued the NOT which gave rise to the instant case. The NOT was based on Love's historical and continued poor sales performance, as evidenced by statistics and evaluation through December 31, 2003.

57. At the time that the NOT was sent to Love, Nissan did not base the NOT on Love's sales penetration for the first quarter of 2004, which ended March 31, 2004. Due to a nationwide audit, Love's PMA had been inconsequentially changed on March 1, 2004.⁵ However, the figures representing actual sales penetration up to the date of termination, April 1, 2004, including calculations based on the latest PMA, have since been reviewed by Nissan, and these statistics support a finding that through March 2004, Love's sales penetration ranked 147th of the 154 Nissan dealers in the region; 56th of the 57 Nissan dealers then in Florida; and 17th of the 17 Nissan dealers in its district.

58. After five years of a variety of counseling sessions, warnings, NODs, and extensions, and after Nissan's realignment of Love's PMA in 2001, at Love's request, Love still had failed to ever meet the regional sales average and, despite repeated solicitation by Nissan of a comprehensive written plan for improvement of Love's sales penetration, Love had failed to submit such a plan.

*12 59. Nonetheless, the Halleens, father and son, testified that since they took over Love in 1999, they have had a private plan that is best described as "slow, stable growth." This seems to mean, among other things, that they chose not to accept all of Nissan's suggestions simultaneously, but wanted to build and improve Love's sales force first, before increasing its advertising, before ordering/stocking certain new models of Nissan vehicles. The problem with this "plan," apparently first advanced at hearing, is that it has never resulted in Love meeting the region sales penetration average.

60. In attempting to fulfill its obligations under Subpart 3.G.2., of the dealer agreement, Nissan, through its DOMs, Region Vice-Presidents, and other corporate management, at various times during the last five years, has advised Love as set out previously (see Findings of Fact 38, 46, and 53) and has also advised Love to stay open on Sundays; increase advertising; and hire and train competent personnel in both sales and service fields, including getting all Love's service personnel trained and certified by Nissan so that Love could offer customers "certified Nissan used cars and service," thereby engendering customer satisfaction and brand loyalty. Nissan also has suggested that Love maintain a steady workforce, conduct off-site sales, and stock and move new models. Few of these suggestions have been implemented by Love.

61. Love had previously tried staying open on Sundays, but found it not to be cost-effective and decided to stay closed on Sundays, even though staying open would have meant Love would have been the only dealer of any brand open on Sundays in Homosassa and therefore more competitive. The Halleens represented at hearing that they intend to eventually stay open one or more Sundays per month, but they did not clearly indicate this to Nissan prior to the NOT or explain why they would not open on Sundays at that time.

62. Only since late 2003, have the current owners significantly increased their advertising budget and spread out their advertising through several newspapers, billboards, coupon books, two radio stations, mail-delivered print ads, cable television spots, various telephone books, and direct mail. This effort was late, and the amounts spent up to the date of the NOT were well below Nissan's advertising recommendations.

63. Love's sales manager testified that sales staff has been adequate for several years at Love. However, traditionally, Love has maintained that there are not a lot of trained dealership personnel in its local community or its PMA and that there are few persons who are willing to move to Homosassa to work. Love asserts that it is difficult to lure trained sales personnel to Love's

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

rural location, and that larger markets, where income and prestige are more attractive, lure away personnel that Love has trained. Yet the fact remains that other dealers with similar problems are outselling Love. Also, traditionally, Love would not follow Nissan's advice to send its salespeople to training sessions conducted at other Nissan dealerships for fear that its employees would be lured away by that dealership, and Love has frequently not had Nissan certified mechanics in its service department. Since 2003, Chad Halleen works on the premises from opening until after closing. He has created an aggressive recruitment program and sales incentive program. He has instituted daily sales meetings with staff, weekly motivational meetings, and promotional cookouts, but these late efforts did not result in effective sales penetration figures prior to the NOT.

*13 64. Traditionally, Love has resisted holding off-site sales, as recommended by Nissan, but Love pointed out only one location where there might, possibly, be a legal impediment to off-site sales, and offered no other reason for not holding off-site sales.

65. Love's recent reduced pricing to increase unit sales has increased its unit sales while adversely affecting its gross profit margin, but even these extraordinary efforts did not result in reaching region average sales penetration figures before termination. Moreover, this sacrifice has the potential of adversely affecting Love's capitalization and long term success.

66. The parties have each formed the opinion that Love's problems with Nissan new car/truck inventory impacted its sales penetration. Love maintains that it could not get the amount and variety of Nissan inventory it needed. Nissan suggests that the Halleens did not understand how to use the Nissan allocation of product and ordering system to their advantage.

67. Nissan established that, over time, Love sometimes failed to confirm its allocations, so that Nissan had to contact Love directly; that over time, Love sometimes declined vehicles offered under Nissan's current production order system; and that over time, Love frequently declined to take "pass 2" vehicle offerings, believing them to be somehow inferior or having been repeatedly rejected by other Nissan dealers, neither of which perceptions is accurate. Nissan further established that on occasion, its DOM intervened to provide units when Nissan complained about availability.

68. The totality of the evidence also shows that there was an on-going discussion between Love and Nissan's successive DOMs to the effect that Nissan repeatedly recommended that Love should stock more cars, in more or different models, in more colors, with more optional packages, in order to make more sales, and that, for a long period of time, the Halleens' concept of slow and steady growth caused them to resist the varietal approach suggested by Nissan. This was because the Halleens believed they knew their potential clientele, up close (see Findings of Fact 59 and 71), better than did Nissan, at a distance, and the Halleens perceived that they might be "stuck" with new Nissan models they believed they could not turn over in a reasonable amount of time. However, Love's inventory regularly stayed at 60-90 days supply,⁶ which was the level the Halleens wanted, and Love's inventory sometimes exceeded 90 days' supply, the level advocated by Nissan's representative. Therefore, it is clear that Love got its ordered inventory; had the inventory mix it selected; and that same inventory did not penetrate Love's PMA adequately and never reached the region average sales penetration.

69. Love was responsible for selecting and ordering its own inventory for its potential clientele both by quantity and variety. No fault in this regard has been credibly attached to Nissan.

*14 70. Pursuant to 3.D. of the dealer agreement, there are additional factors beyond just sales penetration/performance that Nissan is obligated to consider in the termination of a dealer.

71. Herein, one of the factors identified by Love as unique is that 32 percent of the residents of Love's PMA as constituted at any time were retirees, the majority of whom are over 65 years of age and who wanted to pay cash, without taking advantage of the several new car financing plans and packages which are the financial lifeblood of most dealerships and which would benefit Love's gross profit margin, capitalization, and cash flow, while Nissan's targeted customer demographic is 29 to 54 years of age. However, the financing issue is a capitalization problem, which periodically has been a concern voiced by Nissan. Likewise, the segmentation analysis, which is part of Nissan's regional evaluations and rankings, divides competitive registrations into

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

separate types or "segments" of vehicles sold in a market. The dealer is evaluated only on its expected penetration for each segment. If one segment does not perform well in a certain PMA, the dealer is held to a lower sales expectation for that type of vehicle. Even adjusting for segments, Love's sales penetration figures do not pass muster.

72. Another unique factor alleged by Love is that there is no significant retail activity in Homosassa or Crystal River to draw consumers to Love from other parts of its PMA. That said, Nissan credibly represented that its sales penetration methodology took into account the local marketing conditions, area, shopping habits of the public, traffic patterns, natural and man-made boundaries, and other relevant issues concerning the Homosassa market when it performed a market study in Love's area and when it twice re-evaluated and altered Love's PMA.⁷

73. Love identified commuting patterns in its PMA to be going away from Love's location to other PMAs and claims this factor exposes commuters to more advertising by other dealers than to Love's advertising, as well as exposing them to the presence of those other dealers in and outside Love's PMA, but this would seem to be a problem with Love's advertising, if anything. Finally, even Love ultimately conceded that this is not a phenomenon unique to Love Nissan but is faced by all dealers near Love experiencing sales into the PMA by competing same line dealers.

74. Demographic factors are a built-in component of the assigned PMA. Region average sales penetration is achievable, regardless of metropolitan or more rural location. Sales penetration by non-metropolitan dealers (as defined by Nissan) in Florida for March 2004 YTD was 98.3 percent versus 98.6 percent for metropolitan dealers (as defined by Nissan). While Florida dealerships are not the comparison required by the dealership agreement, this statistic is meaningful in the present case, because of Love's approach to the issue. More to the point, however, is the fact that each analysis of the region and the PMA found Love lacking in sales and provided a fair comparison with all other dealers.

*15 75. Love complained that its sales penetration success was impeded because there are more domestic car dealerships in its PMA than import dealerships in its PMA, but how this renders Love's situation different from other Nissan dealers in the same region was not clearly enunciated and no nexus between this factor and Love's lack of sales success was clearly established.⁸

76. Love claims, as another unique factor, that dealers in larger communities tend to stock more inventory than dealers in smaller communities and that greater variety can be a reason for potential car buyers to travel further to a larger dealer. Once again, this factor would seem to have been a problem solvable by Love's stocking a larger inventory and a more varied inventory, but it does not render Love's situation unique. (See Findings of Fact 59 and 66-69.)

77. Also, Love asserts that consumers on the periphery of Love's PMA are physically closer to dealers in other PMAs, but this is clearly a factor common to almost every PMA in the nation.

78. Love submits that it should only be required to sell in, and be evaluated on, its sales based on Citrus County, its home county, because Citrus County is the only area Love can "reasonably be expected to serve," but Love offered no credible reason why it should be singled out to be assigned such a limited territory. Robert and Chad Halleen knew the size and extent of Love's PMA when they assumed control of Love in 1999, and the dealership agreement is clear as to how Love's sales were to be evaluated by Nissan. Nissan re-evaluated and adjusted Love's PMA once at Love's request and once pursuant to a national audit of PMAs. A reduction of the PMA to one county was not demonstrated to be a reasonable measuring technique.⁹ Even Love's expert, Mr. Roesner, admitted that Love's PMA was properly drawn and that none of the areas included in Love's PMA should be assigned to other dealers.

79. All the foregoing allegedly "unique factors" raised by Love amount to Love's dissatisfaction with its inventory, PMA, or capitalization. As previously stated, Love largely controlled and intentionally limited its own inventory. Capitalization was also under Love's control. Love's PMA is a creation of Nissan, but one which reasonably measures demographics and sales. The PMA adjustments have been previously discussed.

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

80. Finally, Love contends that Nissan has not treated Love in “a uniform and consistent” manner with other specifically named dealerships that have also, in some years, not met their region sales average. These are: Nissan of Melbourne, which did not meet its region sales average for four years and which had worse results than Love in 2001 and 2003; Alan Jay Nissan, which did not meet its region sales average for four years and had worse results than Love for 2001, 2002, and 2003; Hampton Nissan and Hill Nissan, each of which did not meet the region average for four years and each of which was worse than Love in 2002 and 2003; Nissan of Lakeland/Jenkins Nissan, which did not meet the region sales average for four years; and Lake Nissan, which was worse than Love in 2002.

*16 81. Nissan readily admitted that any individual circumstances considered for one dealer should be considered for all dealers, but in fact, each of the foregoing dealerships presented a unique situation very different than Love's situation. Obviously, the degree of Nissan corporate knowledge about each dealer on the date of Love's April 1, 2004, NOT is pivotal.¹⁰

82. Nissan of Melbourne experienced two ownership changes between 2001 and April 1, 2004. Its sales penetration improved with the new dealer in 2001, but it was sold again. After the second sale, Nissan also gave the second new dealer a chance to improve sales penetration. After the second sale, Melbourne's sales penetration was still higher than Love's for each of the first three months of 2004, but Nissan would not have known the whole of that quarter's statistics for either dealer on April 1, 2004.

83. Alan Jay Nissan's dealer principal recognized that his dealership was in trouble and personally sought out Nissan's current Southeast Region Vice-President, Patrick Doody, to lobby a comprehensive Nissan sales improvement plan which included relocation and construction of a new, exclusive Nissan dealership separate from Alan Jay's existing Toyota dealership. The dealer presented a detailed marketing plan, personnel changes, changes in compensation, and a plan for increased capitalization. The capitalization of the project was initially raised by the dealer, and he made a “dramatic investment” in Nissan inventory before Nissan committed to his plan. Alan Jay's plan was implemented in 2003. Love had been offered several chances to submit a comprehensive improvement plan to Nissan, but did not. Nissan management perceived Love's principals as not involved and uncooperative in sales improvement; they perceived Alan Jay's principal as implementing a practical plan for success and gave him an opportunity to succeed. Although the first quarter of 2004 figures were not available when Love was terminated, they ultimately showed that, by the time Nissan issued the NOT to Love, Alan Jay's sales penetration had gone from 48.09 percent in 2003, to 88.61 percent of the region sales penetration through March 2004.

84. Hampton Nissan was on the road to termination at one point. After study, Nissan adjusted Hampton's PMA, effective March 1, 2004, as part of a nationwide revision of PMAs. Love's PMA was adjusted at the same time, but was not substantially altered. (See Finding of Fact 57.) Prior to proceeding to termination, Nissan gave Hampton an opportunity to be evaluated upon its new PMA, much as it had given Love the same opportunity in 2001. Nissan had not compiled and analyzed the March 2004 results of its regional evaluations, including the new 2004 PMAs, when it terminated Love on April 1, 2004, but the sales already made by both dealers ultimately showed that Hampton was performing far better than Love by April 1, 2004. When the compiled and analyzed first quarter 2004 sales penetration figures became available shortly after April 1, 2004, they demonstrated that Hampton's penetration had risen to 95.74 percent of the region in March. Neither in 2001, nor 2004, did changes to Love's PMA meaningfully improve Love's sales penetration performance.

*17 85. Sales penetration by Hill Nissan had been adversely affected by the re-routing of a major thoroughfare away from that dealership. Hill responded to Nissan's complaints about Hill's declining sales penetration by requesting to relocate and construct an improved facility, but before Nissan committed to this, Hill demonstrated a dramatic improvement in sales.

86. Nissan of Lakeland was sold to a new dealer and renamed “Jenkins Nissan” in 2003. The new owner instituted a plan to relocate the dealership in order to improve its sales penetration up to the region average, but within a year and even before the move to the new location, there had been significant improvement. As of March 2004, Jenkins had reached sales penetration at 81.68 percent of the region average.

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

87. The access road in front of Lake Nissan was rerouted and closed for an extended period due to construction. Lake created a plan of correction which included constructing a new facility to attract customers and agreed with Nissan that if Lake did not meet region average sales penetration by June 2005, Lake would sell the dealership, presumably to a retailer who could meet the desired average.

88. Love has not demonstrated that any road construction, sale of the dealership, or any other problem beyond its control affected Love's poor sales penetration.

89. Love also ascribes lack of good faith to Nissan's business decisions to not terminate these other struggling dealers who were confronted with conditions largely beyond their control and who offered Nissan detailed plans to overcome their disadvantages, but Love has not presented any persuasive evidence to that effect. Love only has presented evidence that after Hill, Lake, and Lakeland/Jenkins committed their finances to building new facilities to take advantage of Nissan's growth in the industry, Nissan gave some additional money toward those goals up to amounts consistent with the maximum amounts in Nissan's dealer assistance program for such projects. Nissan will provide assistance money up to \$420,000.00 for major facility changes but requires that the dealer submit a plan and/or demonstrate improved performance first. An additional \$80,000.00 can be "earned" by the dealer based on improved performance. However, there is no indication that Love has ever considered building a new facility, let alone offered to build a new facility, or has asked for financing from Nissan for such a project. Basically, Love has never offered Nissan any tangible plan of correction or substantial improvement of its penetration percentage, as have the other named dealers.

90. Love demonstrated that Nissan has suggested to Love that it build a new facility and let its Honda dealership go so as to take advantage of the improving Nissan market, but Love was free to reject that suggestion along with all the other Nissan suggestions it rejected. The penetration figures are the result of Love's choices, not Nissan's coercion.

*18 91. Love also has suggested that the NOT herein is related to Nissan's 2001 objection to Love's adding a Daewoo dealership and due to Love's continuing association with Honda. Neither suggestion was proven. Indeed, there was no mention of the Daewoo connection by either party after 2001, and mention of the Honda connection was reasonable in the context it came up. (See Findings of Fact 38 and 53.)

CONCLUSIONS OF LAW

92. The Division of Administrative Hearings has jurisdiction of the subject matter and the parties to this proceeding, in accordance with Sections 120.569 and 120.57(1), Florida Statutes.

93. This cause is governed by Chapter 320, Florida Statutes, including but not limited to Section 320.641(3), Florida Statutes. This section was most recently amended on June 8, 2001, to include a provision requiring "uniform and consistent application of the grounds for termination." The dealer agreement between Love and Nissan was executed on March 4, 1999, and has not been amended since its execution. However, the amendments to Section 320.641(3) apply to this action from their effective date, June 8, 2001, until April 1, 2004, the date of the Notice of Termination herein.

94. Section 320.641(3), Florida Statutes, provides:

Any motor vehicle dealer who receives a notice of intent to discontinue, cancel, not renew, modify, or replace may within 90-day notice period, file a petition or complaint for a determination of whether such action is an unfair or prohibited discontinuation, cancellation, nonrenewal, modification, or replacement. Agreements and certificates of appointment shall continue in effect until final determination of the issues raised in such petition or complaint by the motor vehicle dealer. A discontinuation, cancellation, or nonrenewal of a franchise agreement is unfair if it is not clearly permitted by the franchise agreement; is not undertaken in good faith; is not undertaken for good cause; or is based on an alleged breach of the franchise agreement which is not in fact a material and substantial breach; or, if the grounds relied upon for

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

termination, cancellation, or nonrenewal have not been applied in a uniform and consistent manner by the licensee. A modification or replacement is unfair if it is not clearly permitted by the franchise agreement; is not undertaken in good faith; or is not undertaken for good cause. The applicant or licensee shall have the burden of proof that such action is fair and not prohibited.

95. The duty to go forward and the burden to prove, by a preponderance of the evidence, Nissan's compliance with Section 320.641(3), Florida Statutes, is upon Respondent Licensee, Nissan.

96. The thrust of Love's defense in this cause has been (1) that Love's only obligation, pursuant to the dealer agreement, was to "actively and effectively promote the sale at retail" of Nissan vehicles within its PMA, and (2) that Nissan inequitably terminated Love, while permitting other equally, or more egregiously, unsuccessful Nissan dealers to continue to operate. More specifically, Love asserts that, because Nissan could have imposed, but did not from the beginning impose, upon Love a specific, objective performance obligation, such as requiring the sale of a given number of new cars which Nissan expected Love to sell in a specified period of time, there is no clear criteria for measuring Love's "active and effective" promotion of Nissan sales. Love argues that the dealer agreement does not require that Love achieve a particular level of sales penetration or exceed the level of sales penetration of other Nissan dealers. Love suggests, instead, that Nissan is free to use as an evaluation tool Love's level of sales penetration, as compared to the region average and the sales penetration of other dealers, but that Love's failure to meet the region average or to perform above the bottom of the dealer ranking is not, in and of itself, a valid basis for termination of the dealer agreement. While acknowledging that it is a low volume sales performer, Love suggests that Love's failure to meet the regional sales average is an improper measuring guide when the term or terms, "average" or "average sales," are not specifically used in the dealer agreement as a measurement of "active and effective promotion of sales." Rather, Love asserts that the threshold issue is whether, in light of problems "unique" to its PMA, Love's sales activities satisfy the "active and effective" obligation established in the dealer agreement. Love also maintains that, to the extent the obligations imposed by the dealer agreement upon Love are ambiguous, such ambiguity should be resolved in Love's favor, because Nissan was the drafter of the agreement. See *Homestead v. Johnson*, 760 So. 2d 80 (Fla. 2000).

*19 97. In addressing Love's arguments generally, it can be said that Love may have actively promoted Nissan sales, but Love did not meet the conjunctive requirement of effectively promoting Nissan sales. The NOT specifically cites Love Nissan's historical performance and its sales penetration in the calendar years 2001, 2002, and 2003. Although sales performance in 2004 is mentioned, this was not a basis for termination. Even if the first quarter of 2004 is considered, it affords Love no comfort. The evidence is clear that Love's performance has always been below the region average pursuant to an evaluation methodology which is generally accepted in the industry and which is a reasonable one. It is a methodology Nissan has consistently used to evaluate all its dealers, not just Love. Love's principals knew of, and agreed to, the evaluation method used, and the PMAs upon which it was sequentially based from the inception of the dealer agreement. The PMA was adjusted once, at Love's request. Pursuant to their contract, Nissan advised Love periodically of the jeopardy of the dealership arising from Love's poor sales penetration and offered advice on how to improve sales penetration. Love deliberately chose not to implement most of Nissan's suggestions. Love identified other dealers who ranked below or near Love during one time period or another but no dealer whose performance was as consistently poor and long-standing as Love's at the time of Love's termination.

98. The dealer agreement permits Nissan to select its methodology for evaluating its dealers' sales performance. One commonly-accepted, industry-wide methodology for measuring "effectiveness" of a dealership is the methodology employed by Nissan. Nissan demonstrated, and it is undisputed, that sales penetration is an industry-wide accepted standard for evaluation of dealers, and therefore falls within the scope of "reasonable criteria," as permitted by the dealer agreement. Nissan has used this methodology for a minimum of the preceding five years, including the period since the most recent statutory amendments in 2001. Love did not demonstrate that Nissan has used any other dealer evaluation methodology in the preceding five years or since the statutory amendments in 2001. While competing statistics may be slippery things, there is no dispute that Nissan's statistical analysis has correctly measured Love's results and has correctly compared those results with the other dealers in the

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, ..., 2005 WL 1662263...

PMA. While Love correctly asserts that statistics should not be “conclusive,” they are permitted by the franchise agreement and persuasive here.

99. The dealer agreement establishes the terms of the business relationship between [a manufacturer] and a dealer. Stella Chevrolet Inc., et al. v. Roberts Chevrolet Inc., et al., DOAH Case No. 88-3099 (Administrative Law Judge Sartin, RO January 30, 1990; FO May 4, 1990).

100. The Florida Legislature could have mandated, in its amendments, the methodology by which manufacturers evaluate dealer sales performance or could have imposed minimum sales performance standards for termination, but it chose to leave those matters up to the agreement between the parties. Section 3.A. of the dealer agreement in this case clearly obligated Love to “actively and effectively promote the sale at retail” of Nissan vehicles within its PMA. Love accepted and agreed to this obligation, yet Love's sales performance was chronically poor. Nissan demonstrated that by a commonly recognized methodology within the industry, Love consistently ranked sales at only about half the rate of an average dealer in Love's region. Section 3.B. of the dealer agreement clearly permits Nissan to evaluate Love's sales performance utilizing reasonable criteria. Sales penetration is specifically set forth in Section 3.B. of the dealer agreement as an acceptable dealer evaluation methodology. Nissan has consistently used region average sales penetration as its evaluation standard. This standard has not been hidden from Love and has been repeatedly disclosed to Love. Indeed, pursuant to Section 3.H. of the dealer agreement, Nissan has repeatedly advised Love of its failure to achieve and maintain region average and that continued failure in this regard was grounds for termination of the dealer agreement. Section 12.B.1.a. of the dealer agreement also clearly permits Nissan to terminate a dealer when that dealer has failed to substantially fulfill its responsibilities with respect to sales of new Nissan vehicles. Therefore, it is concluded that Love's termination was clearly permitted by the franchise agreement between the parties.

*20 101. It is likewise concluded that Nissan undertook the April 1, 2004, termination due to a material and substantial breach of the dealer agreement, in good faith, and for good cause.

102. Love introduced no evidence proving any ulterior motive or lack of good faith for the termination. The evidence shows that Nissan terminated Love solely for its poor sales performance. Love's poor sales performance dates back to at least 1994, a total of 10 years. Since 1999, Nissan has sent eight or more certified letters to Love, reiterating that Nissan uses sales penetration to evaluate dealer performance and that Love remained substantially below region average. The undersigned has considered the “miscue” of one Nissan DOM to Mr. Robert Hallecn (see Finding of Fact 22) and that Nissan has been influenced by extensively detailed action plan(s) submitted by another dealer or dealers (see Findings of Fact 80-87), but the material and substantial fact remains that each time Nissan requested from Love a response and action plan to cure Love's deficiencies, Love failed to provide one.

103. Additionally, Nissan's DOMs repeatedly visited Love's dealership to advise and assist Love in improving its sales performance. Love rarely followed their suggestions and ultimately little effect was felt. See Bill Gallman Pontiac GMC Truck Inc. v. General Motors Corp., DOAH Case No. 89-0505 (Administrative Law Judge Donnelly, RO June 28, 1990; FO February 28, 1991), finding termination undertaken in good faith by manufacturer and for good cause where the manufacturer “continuously encouraged the dealer to meet sales performance standards and has worked with [the dealer] in an effort to achieve this goal.” Cf- Nolette Motors Inc. v. Mazda Motors of America Inc., DOAH Case Nos. 98-1457 and 98-2596 (Administrative Law Judge Adams, RO May 12, 1999; FO August 13, 1999), finding lack of good faith where manufacturer failed to notify the dealer of alleged breaches, but the result turned upon abandonment of the franchise. Nissan demonstrated good faith by, at Love's request, reevaluating and reducing Love's PMA in 2001. Nissan demonstrated good faith by providing Love multiple opportunities to cure its default of sales obligations prior to issuing the NOT. Nissan issued to Love four separate NODs between 2000 and 2003. In each NOD, Nissan clearly advised Love of its deficiencies and allowed Love at least 90 days to cure the deficiencies. Even when Love did not timely cure its deficiencies, Nissan granted Love more time, including a final extension in November of 2003. Nissan was within its rights to terminate Love on the basis of sales penetration figures through December of 2003, which penetration figures it had as of the date of the April 1, 2004, NOT. See Broward Truck and Equipment Company v. Navistar International Transportation Corp., DOAH Case No. 93-5966 (Administrative Law Judge Harrell, RO April 29, 1994;

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA,...., 2005 WL 1662263...

FO August 19, 1994) vacated on other grounds by In Re Broward Truck and Equipment, Case No. 94-21195 (S.D. Florida Bankruptcy Court, October 4, 1994), finding that termination was undertaken in good faith where manufacturer gave dealer six months' notice and opportunity to cure, but the case also discusses capitalization problems more explicitly; and Rick Starr Lincoln-Mercury Inc., v. Nissan Motor Corp., DOAH Case No. 92-5187 (Administrative Law Judge Rigot, RO June 10, 1993; FO August 5, 1993), finding good faith where manufacturer acted in "consistent, honest, and forthright manner" with its dealer and even offered to extend deadlines for compliance on several occasions, but the case also discusses an exclusive facility contract clause more explicitly. On April 1, 2004, Nissan had additional figures for the quarter immediately preceding, January-March, 2004. Those figures were not fully compiled and analyzed until after the NOT had been sent. Those compiled figures, when analyzed in accordance with the standard sales penetration methodology that Nissan had appropriately and consistently used, showed that Love's sales penetration had further declined each of those first three months of 2004, which immediately preceded the NOT.

*21 104. Love has been a chronically poor new sales performer for Nissan. In 1999, Love received 32.0 percent of the average sales penetration achieved by dealers in the region. In 2000, Love achieved 29.5 percent of the region average new car sales. In 2001, following Nissan's reduction of Love's PMA, Love achieved 50.9 percent of region average. In 2002, Love's region average was 50.6 percent. In 2003, Love achieved 55.8 percent of the region average. While Love demonstrated improvement in its percentage scores between 1999 and the end of 2003, if the Nissan sales penetration region average is comparable to a passing grade of "C," Love's average sales penetration, at best, in 2003, rated only a little more than half of an average "C" grade. Love's poor sales performance has resulted in substantial lost sales opportunity for the manufacturer Nissan in the Homosassa, Florida, market. Nissan has met its burden of showing good cause for termination of its dealer agreement with Love. See Broward Truck and Equipment Company v. Navistar International Transportation Corp., and Bill Gallman Pontiac GMC Truck Inc., v. General Motors Corp., both supra, finding dealer's failure to achieve reasonable share of market to be substantial and material breach of contract and good cause for termination.

105. Not every failure to achieve the manufacturer's region average sales penetration standard will constitute a material and substantial breach of the agreement warranting termination. The magnitude of the short-fall must be considered in determining whether the dealer's performance is so ineffective as to warrant termination. Unfortunately, herein, Love has materially and substantially failed to meet its sales obligations under its dealer's agreement with Nissan. Love has never achieved Nissan's region average sales penetration standard, and at least since 1999, Love's yearly sales penetration has ranged only between 29.5 percent and 55.8 percent of that achieved by the average dealer in Nissan's region. Consequently, Nissan has established that its loss of the new sales market occasioned by continuing to work through the Love dealership has been so material and substantial as to go directly to the core of the business relationship between Nissan and Love. Nissan has met its burden of showing that Love's breach of sales performance obligations constitutes a material and substantial breach of the dealer agreement. See Broward Truck and Equipment Company v. Navistar International Transportation Corporation, and Bill Gallman Pontiac GMC Truck Inc. v. General Motors Corp., both supra.

106. This brings us to the last test, that is, whether or not Nissan has applied the grounds for termination in a "uniform and consistent" manner. Love puts forth that no matter how it is described, at least one-half of the dealers in Nissan's Southeast Region will not achieve the regional average sales penetration. This is certainly true, simply because mathematical averaging principles work that way. However, Love's premise that to terminate Love without terminating all other dealers who fall below average or below Love is to behave inconsistently or without uniformity is unreasonable and contrary to the statute's intent. Love referred to six other dealers whom Love implied were not "treated the same" as Love. Nissan presented evidence that it had applied the same performance penetration evaluation standards to all dealers, and then took into account all appropriate individual dealer circumstances. Nissan then distinguished Love's circumstances from those of the other six dealers. Most of these dealers received some sort of extension, much as Love had received in 2001 (see Finding of Fact 33) and in 2003 (see Finding of Fact 51), causing some overlapping of statistical reporting periods. One received an extension based on a PMA change, but experienced significant sales penetration after its PMA was revised; some of the other six dealers performed better than Love historically; some improved their performance dramatically by the time Love was terminated; some performed poorly but not for the extended length of time that Love performed poorly; some went through recent ownership changes and

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

demonstrated subsequent improvement; and some had poor performance caused by road construction and other outside elements but instituted plans of corrective action that impressed corporate Nissan.

*22 107. As to whether Nissan's giving those other dealers time extensions, financing, or plan approval based on their de-dualling with Nissan competitors, or based on their building new facilities partly financed by Nissan, constituted lack of good faith by Nissan toward Love is concerned, Nissan provided adequate commercial reasons, including a changed PMA; improved performance; aggressive, affirmative proposals; dramatic investment in Nissan inventory; and new facility capitalization initiated by the dealers, as reasons for those corporate decisions. Love was not similar to these dealers in any of those respects.

108. A free marketplace mandates that a manufacturer be free to consider particular dealer circumstances affecting a dealer's sales performance prior to terminating that dealer. It is the essence of a free economy that industry executives be able to use their expertise in granting reasonable exceptions to contractual dealers in order to help those dealers improve their performance, thus making a profit for both the franchisor and the franchisee. An example of this may be found in Nissan's repeated grants of extensions of time for improvement to Love. To interpret the amended Section 320.641(3), Florida Statutes, to require that a manufacturer treat every dealer "identically" as opposed to "uniformly and consistently" would be to abrogate the clear language of the statute. Rather, the "uniform and consistent" requirement of Section 320.641(3), Florida Statutes, is here interpreted to impose upon a manufacturer the burden of showing that it has treated similarly-situated dealers in a uniform and consistent manner, and that it has not singled out any particular dealer for disparate treatment. This case is complicated by monthly and quarterly statistical analysis by Nissan, but there is no contractual or statutory requirement that Nissan select a particular day, week, month, or year, and terminate only the dealer whose sales performance is numerically "worse" or "worst" at the selected time, nor is there any contractual or statutory provision which requires that no accommodation be made for any dealer, and that only sales penetration figures be applied to invoke termination in every case of poor performance. Indeed, to read such requirements into the statute, when the statute has not specifically established them, would be counter-productive to manufacturer-dealer relations and would inhibit sales within the entire automotive industry. If a manufacturer's patience and efforts in favor of helping a failing dealer elevate that dealer from a "worse" or "poor" performer to a "better" performer and the manufacturer is thereby deemed to have forfeited its right to pursue termination if that dealer fails to succeed, it is doubtful that any manufacturer would dare to devote substantial time and effort to help dealers improve. Dealers in Love's situation would be the worse for such an interpretation. Indeed, under such an interpretation, Love would probably not have received several extensions or its requested change of PMA.

*23 109. Herein, the evidence shows that Nissan applied the same performance/penetration evaluation standards to each of its dealers, and then took into account all appropriate individual dealer circumstances related to each individual dealer's performance, and that those individual circumstances were considered on a case-by-case basis, but none of those individual circumstances which applied to the six other dealers were applicable to Love. Love's sales penetration has ranked consistently among the very worst in the state of Florida and throughout the entire southeast region longer than any other named dealer. Accordingly, it is concluded that Nissan has met its burden of showing uniform and consistent application of the grounds relied upon in this case for termination of Love.

110. Nissan has established all statutory grounds for termination.

RECOMMENDATION

Based on the foregoing Findings of Facts and Conclusions of Law, it is

RECOMMENDED: that a final order be entered, dismissing Love's Protest/Petition and ratifying the April 1, 2004, Notice of Termination by Nissan.

DONE AND ENTERED this 14th day of July, 2005, in Tallahassee, Leon County, Florida.

RECEIVED

Attachment 2

LOVE NISSAN, Petitioner v. NISSAN NORTH AMERICA, INC., 2005 WL 1662263...

ELLA JANE P. DAVIS
 Administrative Law Judge
 Division of Administrative Hearings
 The DeSoto Building
 1230 Apalachec Parkway
 Tallahassee, Florida 32399-3060

Filed with the Clerk of the Division of Administrative Hearings this 14th day of July, 2005.

ENDNOTES

NOTICE OF RIGHT TO SUBMIT EXCEPTIONS

*24 All parties have the right to submit written exceptions within 15 days from the date of this Recommended Order. Any exceptions to this Recommended Order should be filed with the agency that will issue the final order in this case.

Footnotes

- 1 This ruling did not preclude the use, by either party, of performance data for the period of January through March, 2004, even though such information had not been evaluated by Nissan as of April 1, 2004, the date of the Notice of Termination. The fact that this "quarter year" data was not relied upon by Nissan as a basis for Love's termination does not alter its validity for use as evidence by either party in examining the performance of the franchisee, Love, up to the date of termination, April 1, 2004. (See Findings of Fact 56-57. Cf-Finding of Fact 81 and n. 10.).
- 2 Even Love's witness, Mr. Roesner, who was accepted as an expert in "local automobile industry and dealer performance analysis," conceded that Nissan's evaluation of sales penetration practice was not an unreasonable methodology for evaluating dealers' performance. He described it as "typical."
- 3 It is noted that the NOT herein addresses Love's sales penetration failures in 2001, 2002, and 2003, by chart only, and addresses Love's historical sales penetration and Love's lack of cooperation within the worded text of the letter.
- 4 It is noted that the letter's representation that "there is no evidence" of Daewoo's presence is arguably an avoidance of the admission made previously in Love's lawyer's letter that Daewoo service and parts were in the same facility but were not "infringing" on any portion of Nissan's use of the facility.
- 5 This PMA change was the result of a year-long study and nationwide PMA audit which also adjusted Hampton Nissan's PMA. (See Finding of Fact 84.) This change in PMA did not affect Love's location in the largest shopping area in the PMA and did not significantly affect Love's penetration problem prior to termination.
- 6 "Days supply" is a commonly used term and calculation in the industry, which refers to the number of days it would take the dealer to sell all of the cars in its inventory if the dealer continued to sell at its current rate without obtaining any new vehicles. For example, a dealer who has 30 vehicles and sells one per day will have a 30 "days supply of vehicles," as will a dealer who has 90 vehicles if that dealer sells three vehicles per day. By using a "days supply" calculation, one is able to more accurately compare relative inventories.
- 7 See Findings of Fact 33 and 57, and n. 5.
- 8 Even Love's expert admitted this comparison would not provide a clear picture, because the competition contains both domestic and imported cars. Furthermore, removing domestic cars or import cars from the mix is unrealistic and offers no fair comparison.
- 9 Only such an apples-to-oranges comparison benefits Love statistically. Love's 2003 sales of 29 new Nissan cars/trucks compared with Citrus County average sales penetration of 384 cars/trucks shows an average or better than average penetration, i.e., seventy-five percent.
- 10 See n. 1 and Findings of Fact 55-56, on use of first quarter 2004 YTD figures and when these figures were available.

2005 WL 1662263 (Fla.Div.Admin.Hrgs.)

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

2007 WL 841365 (Fla.Div.Admin.Hrgs.)

Division of Administrative Hearings

State of Florida

CLASSIC NISSAN, INC., Petitioner

v.

NISSAN NORTH AMERICA, INC., Respondent

Case No. 05-2426

March 20, 2007

RECOMMENDED ORDER

*1 On August 7 through 11, 14 through 18, and 21 through 23, 2006, a formal administrative hearing in this case was held in Tallahassee, Florida, before William F. Quattlebaum, Administrative Law Judge, Division of Administrative Hearings.

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Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

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STATEMENT OF THE ISSUES

Pursuant to Subsection 320.641(3), Florida Statutes (2006),¹ the issues in the case are whether Nissan North America, Inc.'s (Respondent), proposed termination of the dealer agreement with Classic Nissan, Inc. (Petitioner), was clearly permitted by the franchise agreement, undertaken in good faith, undertaken for good cause, and based on material and substantial breach of the dealer agreement; and whether the grounds relied upon for termination have been applied in a uniform and consistent manner.

PRELIMINARY STATEMENT

By Notice of Intent dated April 6, 2005, the Respondent advised the Petitioner that the dealer agreement entered into by the parties was being terminated. The Petitioner disputed the termination and filed a Petition for Hearing with the Florida Department of Highway Safety and Motor Vehicles, which forwarded the Petition to the Division of Administrative Hearings. The final hearing was scheduled and then re-scheduled several times upon various motions, finally commencing on August 7, 2006.

At the hearing, the Petitioner presented the testimony of Darren Hutchinson, John Sekula, Scott O'Brien, and Ernest Manuel. Petitioner's Exhibits numbered 15, 26, 27, 47, 58, 79, 80, 100, 102, 104, 107, 117, 126, 129 through 132, 136, 159, 170 through 176, 180, 183 through 188, 193, 195, 214, 217 through 248, 359, 368, 369, 381, 383, 385, 388, 391, 398, 400, 404, 406, 411 through 413, 475, 478, 480, 483, and 488 were admitted into evidence.

The Respondent presented the testimony of Timothy Pierson, Andrew Delbrueck, William Hayes, Douglas Kirchoff, Dawn Mitchell, Joseph Stancato, Herbert Walter, Patrick Doody, and Sharif Farhat. Respondent's Exhibits numbered 1 through 6, 9, 13 through 22, 24 through 33, 36, 38 through 40, 44, 46, 48, 49, 51 through 53, 55 through 57, 59 through 70, 79 through 84, 87, 95 through 99, 101 through 108, 120, 122 through 124, 129, 130, 134, 140, 141, 143 through 148 (including 145A1), 150, and 151 were admitted into evidence.

*2 The 20-volume Transcript of the hearing was filed on September 15, 2006. Both parties filed Proposed Recommended Orders on October 16, 2006, that have been considered in the preparation of this Recommended Order.

FINDINGS OF FACT

1. Pursuant to definitions set forth at Section 320.60, Florida Statutes, the Petitioner is a "motor vehicle dealer" and the Respondent is a "licensee."
2. In 1997, the Petitioner and the Respondent entered into an agreement whereby the Petitioner took control of an already-existing Nissan dealership located in Orlando, Florida.
3. In 1999, the Petitioner and the Respondent entered into a Dealer Sales and Service Agreement (Dealer Agreement), which is a "franchise agreement" as defined at Subsection 320.60(1), Florida Statutes. The Respondent's proposed termination of the 1999 Dealer Agreement is at issue in this proceeding.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

4. At all times material to this case, the dealership has been owned by Classic Holding Company. Classic Holding Company is owned by four members of the Holler family. Christopher A. Holler is identified in the Dealer Agreement as the principal owner and the executive manager of the dealership. The family owns a number of other dealerships, representing a variety of auto manufacturers.

5. The Respondent does not sell cars at retail to individual purchasers. Standard Provision Section 3.A. of the Dealer Agreement requires that the Petitioner "actively and effectively promote" vehicle sales to individual retail purchasers.

6. Standard Provision Section 3.B. of the Dealer Agreement permits the Respondent to develop and select the criteria by which sales are measured, as long as the measurement criteria is reasonable.

7. Standard Provision Section 12.B.1.a. of the Dealer Agreement permits the Respondent to terminate a dealership when a dealer fails to substantially meet its vehicle sales obligation.

8. The Dealer Agreement includes examples of various criteria that may be used to measure dealer performance. Specifically included among the examples is the calculation of a dealer's "sales penetration" within a defined geographic "Primary Market Area" (PMA) around the dealership as compared to other local and regional dealers.

9. Sales penetration is calculated by dividing a dealer's total new vehicle sales by the number of competitive new vehicles registered in the dealer's PMA.

10. Data related to vehicle registration was compiled by R. L. Polk (Polk), a nationally recognized organization commonly relied upon in the auto industry for such information. There was no evidence offered to suggest the Polk data was incorrect.

11. The dealer's sales penetration is compared to Nissan's regional sales penetration to determine the dealer's sales performance as measured against other Nissan dealer's in the region. A dealer performing at 100 percent of the regional average is performing at an "average" level. Otherwise stated, an average dealer is performing at a "C" level.

*3 12. The use of sales penetration calculations as a measurement of dealer performance is common in the automotive industry.

13. The Respondent has used sales penetration as a measurement of dealer sales performance for more than 20 years.

14. The Respondent's use of sales penetration as a measurement of dealer performance was reasonable or was permitted by the specific terms of the Dealer Agreement.

15. The Respondent's use of the sales penetration measurements was widely communicated to dealers, who were advised on a routine basis as to the performance of their dealerships compared to local dealers and on a regional basis.

16. The Petitioner knew, or should have known, that sales penetration was being used to measure the Petitioner's sales performance.

17. There was no credible evidence presented at the hearing that the Respondent calculated sales penetration in order to disadvantage the Petitioner relative to other Nissan dealers in the region.

18. At the hearing, the Petitioner suggested alternative standards by which sales performance should be reviewed, including consideration of total sales volume. The use of sales volume to measure retail effectiveness would penalize dealerships in smaller markets and fail to reflect the market opportunity available to each dealer.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

19. There was no credible evidence presented at the hearing that total sales volume more accurately measured the Petitioner's sales performance than did sales penetration.

20. The Petitioner suggested that the use of sales penetration to substantiate the proposed termination of the Dealer Agreement at issue in this case was unreasonable and unfair because approximately half of Nissan's dealerships will be performing below 100 percent of the regional average at any given time, yet the Petitioner has not proposed termination of dealership agreements with half of its dealer network; however, the proposed termination at issue in this case is not based merely on the Petitioner's sales penetration.

21. In 2002, the Petitioner's sales penetration was 110.5 percent, well above the regional average. At that time, the Respondent was preparing to introduce a number of new vehicles to the market. Some of the new vehicles were revisions of previous models, while others were intended to compete with products against which Nissan had not previously competed.

22. Nissan representatives believed that the new models would substantially expand sales opportunities for its dealerships, and they encouraged their dealer network to prepare for the new environment. Some dealers responded by increasing staff levels and modernizing, or constructing new facilities. The Petitioner failed to take any substantive action to prepare for the new model lineup.

23. Beginning in 2003, and continuing throughout the relevant period of this proceeding, the Petitioner's regional sales penetration went into decline. From 2002 to 2003, the Petitioner's annualized sales penetration fell more than 30 points to 85.13 in 2003. The Petitioner's sales penetration for 2004 was 65.08 percent. The Petitioner's sales penetration for the first quarter of 2005 was 61.78 percent.

*4 24. Following the introduction of the new models and during the relevant period of this proceeding, regional Nissan sales increased by about 40 percent. By 2004, the average Nissan dealer in the Petitioner's region had a sales penetration of 108.8 percent of the regional average. Through the first quarter of 2005, the average dealer in the region had a sales penetration of 108.6 percent of the regional average.

25. Compared to all other Florida Nissan dealers during the relevant period of this proceeding, the Petitioner was ranked, at its best, 54th of the 57 Florida Nissan dealerships and was ranked lowest in the state by January 2005.

26. Every Florida Nissan dealership, other than the Petitioner, sold more new cars in 2004 than in 2002. The Petitioner sold 200 fewer vehicles in 2004 than it had two years earlier.

27. The three other Orlando-area Nissan dealers experienced significant sales growth at the same time the Petitioner's performance declined.

28. The Petitioner has suggested that the Respondent failed to provide the information to appropriate management of the dealership. The Dealer Agreement indicated that Christopher A. Holler was the executive manager of the dealership; however, his address was located in Winter Park, Florida, and he did not maintain an office in the dealership.

29. The Respondent's representatives most often met with managers at the dealership, who testified that they communicated with Mr. Holler. On several occasions as set forth herein, Nissan representatives met with Mr. Holler for discussions and corresponded with him.

30. There was no credible evidence presented at the hearing that the Petitioner was unaware that its sales penetration results were declining or that the Petitioner was unaware that the Respondent was concerned with the severity of the decline.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

31. The Respondent communicated with the Petitioner on a routine basis as it did with all dealers. As the Petitioner's sales performance declined, the Respondent communicated the monthly sales report information to the Petitioner, and the topic of declining sales was the subject of a continuing series of discussions between the parties.

32. In February 2003, Tim Pierson, the Respondent's district operations manager (DOM), met with the Petitioner's on-site manager, John Sekula, and discussed the dealership's declining sales penetration. Mr. Sekula was subsequently transferred by the ownership group to another auto manufacturer's dealership.

33. In August 2003, Mr. Pierson met with the Petitioner's new manager, Darren Hutchinson, as well as with a representative from the ownership group, to discuss the continuing decline in sales penetration, as well as an alleged undercapitalization of the dealership and the lack of an on-site executive manager with authority to control dealership operations.

34. On October 1, 2003, the Respondent issued a Notice of Default (NOD) charging that the Petitioner was in default of the Dealer Agreement for the failure to "retain a qualified executive manager" and insufficient capitalization of the dealership.

*5 35. In December 2003, Mr. Pierson met with Christopher A. Holler to discuss the dealership's problems.

36. By the time of the meeting, Mr. Hutchinson had been designated as the executive manager, although Mr. Hutchinson's decision-making authority does not appear to have extended to financial operations.

37. During that meeting, based on the Petitioner's failure to meet the capitalization requirements and respond to the deterioration in sales, Mr. Pierson inquired as to whether the Petitioner was interested in selling the dealership, but Mr. Pierson testified without contradiction that Mr. Holler responded "no." Mr. Hutchinson explained at the hearing that he asked the question because there was little apparent effort being made to address the deficiencies at the dealership, and he was attempting to ascertain the Petitioner's intentions.

38. Mr. Hutchinson was directed to prepare a plan to address the Petitioner's customer service rating, which had fallen to the lowest in the area.

39. Based on an apparent belief that the ownership group was going to remedy the Respondent's concerns about capitalization, the Respondent extended the compliance deadline set forth in the NOD, but the extended deadline passed without any alteration of the dealership's capitalization.

40. A letter to the Respondent dated March 25, 2004, allegedly from Mr. Holler, noted that sales and customer service scores had improved; however, there was no credible evidence presented during the hearing to support the claimed improvement in either sales or customer service. The letter also stated that the capitalization of the dealership would be increased in April 2004 and that new vehicle orders were being reduced.

41. On March 19, 2004, Mr. Pierson spoke with Mr. Holler and believed, based on the conversation, that a meeting would be scheduled to discuss the sales and capitalization issues. In anticipation of the meeting, Pierson sent the sales penetration reports directly to Mr. Holler, but the meeting did not occur. There was no additional capital placed into the dealership during April 2004.

42. In April 2004, Andy Delbrueck, a new DOM for the area, met with Mr. Hutchinson to discuss the continuing decline in sales penetration through the end of March 2004. Other dealers in the area were experiencing increased sales at this time, but the Petitioner's regional sales penetration continued to decline and was below the region for almost all Nissan models. Mr. Hutchinson advised that he was hiring additional staff and had sufficient advertising funds to return the regional sales penetration averages by June.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

43. In early May 2004, Mr. Delbrueck and a Nissan vice president, Patrick Doody, sent a letter about the Petitioner's declining sales performance to Mr. Holler and requested that the Petitioner prepare a plan to address the problem.

44. On May 18, 2004, Mr. Delbrueck again met with Mr. Hutchinson and discussed the decline in sales performance and customer service scores, as well as the issue of the dealership's undercapitalization.

*6 45. A May 25, 2004, letter to the Respondent, allegedly from Mr. Holler, noted that the dealership's sales penetration had improved, that additional staff had been hired, and that the Petitioner anticipated reaching or exceeding the regional sales penetration average by the end of the third quarter of 2004. The Petitioner never reached regional sales penetration averages following this letter, and, at the time it was written, there had been no material improvement in the dealership's sales penetration.

46. On June 17, 2004, Mr. Delbrueck met with Mr. Holler to discuss the continuing decline in the Petitioner's sales performance. Mr. Delbrueck believed, based on the meeting, that Mr. Holler was aware of the problem and would make the changes necessary to improve sales, including employing additional sales staff.

47. On July 7, 2004, the Respondent issued an Amended NOD, citing the continuing decline in the Petitioner's sales performance as grounds for the default, in addition to the previous concerns related to capitalization that were identified in the earlier NOD. The Amended NOD established a deadline of November 29, 2004, by which time the cited deficiencies were to be remedied.

48. One day later, Mr. Delbrueck met with Mr. Hutchinson, discussed the Amended NOD, and made various suggestions as to how the Petitioner could improve the dealership's sales, including marketing and staffing changes. Mr. Delbrueck also offered to send in a trained Nissan representative, William Hayes, to review dealership operations and provide suggestions to improve conditions at the facility and ultimately to increase car sales. Mr. Hutchinson accepted the offer.

49. A letter to the Respondent dated July 23, 2004, allegedly from Christopher A. Holler, noted that staffing levels had increased as had sales for the month of July; however, there was no credible evidence presented at the hearing that any substantive increase in staffing had occurred or that the Petitioner's sales penetration had increased. The letter contained no specific plan for remedying the problems cited in the Amended NOD.

50. In late July 2004, a Nissan training representative, William Hayes, performed a focused review of the Petitioner's operations and provided a list of specific recommendations intended to improve the Petitioner's sales performance. He met with Mr. Hutchinson at the dealership and discussed the list of recommendations. At that time, Mr. Hutchinson stated that he believed the recommendations were useful.

51. On September 10, 2004, Nissan Vice President Doody sent another letter to Mr. Holler referencing the Petitioner's declining sales performance and, again, requesting that the Petitioner prepare a plan to address the issue.

52. A September 30, 2004, letter to the Respondent, allegedly from Mr. Holler, noted that staffing levels had been increased, a new executive manager (Mr. Hutchinson) had been hired, advertising funds had been increased, and customer service scores had improved. However, by that time, Mr. Hutchinson had been employed at the dealership since at least August of 2003, and there was no credible evidence presented at the hearing that staffing levels, advertising funds, or customer satisfaction scores had been materially increased.

*7 53. On October 18, 2004, Nissan Vice President Doody, sent another letter to Mr. Holler about the Petitioner's declining sales performance, noting that whatever efforts had been made by the Petitioner to improve sales had been unsuccessful. Thereafter, Mr. Doody arranged a meeting with Mr. Delbrueck, Mr. Holler, and another member of the Holler family to discuss the deteriorating situation at the dealership and between the parties.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

54. The meeting occurred on October 26, 2004, during which the Nissan representatives addressed the issues including undercapitalization, declining sales, and customer satisfaction scores. The Nissan representatives noted the Petitioner's failure to respond to any of the continuing problems and advised the Petitioner that, if the situation did not improve, the Respondent could initiate proceedings to terminate the Dealer Agreement.

55. At the hearing, the Nissan representatives testified that the Holler family members in attendance at the October 26th meeting had no response during the discussion and offered no specific plan to resolve the situation. The Petitioner presented no credible evidence to the contrary.

56. Shortly after the meeting, and in the absence of any substantive attempt by the Petitioner to resolve the concerns set forth in the NODs, the Nissan representatives decided to pursue termination of the Dealer Agreement if the Petitioner's sales penetration continued to be unsatisfactory.

57. The Petitioner's regional sales penetration as of November 2004 was 65.69 percent. The year-end sales penetration for 2004 was 64.5 percent of regional average.

58. On January 7, 2005, Mr. Delbrueck met with Mr. Hutchinson to discuss the dealership's sales performance. By that time, more than a year had passed since Mr. Hutchinson's designation as executive manager, yet the dealership's sales performance had not improved.

59. Mr. Delbrueck inquired as to whether the Petitioner would be interested in using an additional Nissan resource (the EDGE program) designed to identify specific deficiencies in the sales process. The EDGE program included an extensive review of the sales process from the customer perspective, including a six-month survey period and four hidden camera "mystery shopper" visits.

60. There was a charge to dealers participating in the EDGE program. Mr. Hutchinson told Mr. Delbrueck that he would have to discuss the program with the owners. The Petitioner subsequently chose not to participate.

61. During the January 7th meeting, Mr. Delbrueck also encouraged Mr. Hutchinson to hire additional sales staff. At the hearing, Mr. Hutchinson testified that at the time of this meeting, he had been "building a sales force" yet by March of 2005, the Petitioner's full-time sales staff was approximately one-half of what it had been in 2003.

62. On February 11, 2005, Mr. Delbrueck met with Mr. Hutchinson and Holler family members to follow up on the NOD and the October 26th meeting, but made no progress towards resolving the problems.

*8 63. On February 23, 2005, Mr. Delbrueck and Mr. Hayes met with Mr. Hutchinson to follow up on the recommendations Mr. Hayes made in July 2004. Mr. Hutchinson continued to state that the recommendations were useful, but very few had been implemented, and he offered no plausible explanation for the delay in implementing others.

64. On February 24, 2005, the Respondent issued a Notice of Termination (NOT) of the Dealer Agreement that set forth the continuing decline in sales penetration as grounds for the action, as well as the alleged undercapitalization.

65. At some point in early 2005, the Petitioner increased the capitalization of the dealership and corrected the deficiency, although it was implied during the hearing that the correction was temporary and that the increased capital was subsequently withdrawn from the dealership. In any event, the Respondent issued a Superceding NOT on April 6, 2005, wherein capitalization was deleted as a specific ground for the proposed termination.

66. The Petitioner's January 2005 sales penetration was 49.3 percent of regional average, the lowest of any Nissan dealer in the State of Florida.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

67. Consumers typically shop various automobile brands, and a consumer dissatisfied with a dealer of one brand will generally shop dealers of competing brands located in the same vicinity, in order to purchase a vehicle at a convenient dealership for ease of obtaining vehicle service.

68. The Respondent asserted that it was harmed by the Petitioner's deteriorating sales performance because Nissan sales were "lost" to other manufacturers due to the Petitioner's failure to appropriately market the Nissan vehicles. The Petitioner asserted that because Nissan's overall sales performance in the Petitioner's PMA was average, no Nissan sales were lost. The Respondent offered testimony suggesting that sales lost to Nissan may not have been lost to the Holler ownership group because the group also owned nearby Mazda and Honda dealerships.

69. The evidence regarding the calculation of lost Nissan sales was sufficiently persuasive to establish that Nissan was harmed by the Petitioner's inadequate vehicle sales volume and by the Petitioner's failure to meet its obligation to "actively and effectively promote" the sale of Nissan vehicles to individual purchasers as required by the Dealer Agreement.

70. The number of sales lost is the difference between what a specific dealer, who met regional sales averages, should have sold compared to what the dealer actually sold.

71. In 2003, the Respondent lost 185 sales based on the Petitioner's poor sales performance. In 2004, the Respondent lost 610 sales based on the Petitioner's poor sales performance, 200 more lost sales than from the next poorest performing Nissan dealer in Florida.

72. The parties offered competing theories for the Petitioner's declining performance, which are addressed separately herein.

73. The greater weight of the evidence presented at the hearing establishes that as set forth herein, the Respondent's analysis of the causes underlying the Petitioner's poor sales performance was persuasive and is accepted.

*9 74. The Respondent asserted that the sales decline was caused by operational problems, including an inadequate facility, inadequate capitalization, poor management, ineffective advertising, inadequate sales staff, and poor customer service.

75. Competing dealerships in the area have constructed improved or new facilities. Customers are more inclined to shop for vehicles at modern dealerships. Upgraded dealerships typically experience increased customer traffic and sales growth.

76. The Petitioner's facility is old and in disrepair. Some dealership employees referred to the facility as the "Pizza Hut" in recognition of the sales building's apparent resemblance to the shape of the restaurant.

77. Nissan representatives discussed the condition of the facility with the Petitioner throughout the period at issue in this proceeding. When the Respondent began preparing for the introduction of new models in 2002, the Respondent began to encourage dealerships including the Petitioner, to participate in the "Nissan Retail Environment Design Initiative" (NREDI), a facility-improvement program.

78. Apparently, the Petitioner was initially interested in the program, and, following a design consultation with the Respondent's architectural consultants, plans for proposed improvements to the Petitioner's facility were created.

79. At the time, the Respondent was encouraging dealers to improve facilities, the Respondent had a specified amount of funding available to assist dealers who chose to participate in the NREDI program, and there were more dealers interested than funds were available. Although funds were initially reserved for the Petitioner's use, the Petitioner declined in June of 2003 to participate in the program, and the funds were reallocated to other dealerships.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

80. The Respondent implied that one of the reasons the Petitioner did not upgrade the dealership facility was a lack of capitalization.

81. The allegedly inadequate capitalization of the dealership was the subject of continuing discussions between the Petitioner and the Respondent for an extended period of time; however, inadequate capitalization was specifically deleted from the grounds for termination set forth in the NOT at issue in this proceeding.

82. Although the evidence indicates that lack of capitalization can limit a dealer's ability to respond to a multitude of problems at a dealership, the evidence is insufficient to establish in this case that an alleged lack of capitalization was the cause for the dealership's failure to upgrade its facility. In a letter to the Respondent dated June 30, 2003, the Petitioner stated only that it was "not feasible" to proceed and indicated an intention only "to proceed in the future," but offered no additional explanation for the lack of feasibility.

83. Similarly, it is not possible, based on the evidence presented during the hearing, to find that Petitioner's failure to respond to the deteriorating operations at the dealership was due to a lack of financial resources.

*10 84. Daily operations at the dealership were hampered by the lack of appropriate management at the dealership location. Although Mr. Holler was identified in the Dealer Agreement as the principal owner and the executive manager of the dealership, his address was located in Winter Park, Florida, and there was no credible evidence presented that he managed the operation on a daily basis.

85. As sales deteriorated, the Respondent began to insist that the Petitioner designate someone located on-site at the facility as executive manager with full control over the day-to-day operations of the dealership.

86. In June 2003, Mr. Sekula was appointed as executive manager, but his authority was limited and his decisions required approval of the ownership group. At the hearing, Mr. Sekula acknowledged that the ownership group was bureaucratic. Shortly after his appointment, he was transferred by the ownership group to another of their competing dealerships.

87. Several months later, Mr. Hutchinson was appointed as executive manager. There was no credible evidence presented to establish that Mr. Hutchinson ran the fiscal operations of the dealership. He prepared budgets for various expenditures and submitted them to the ownership group. The ownership group apparently controlled the "purse strings" of the dealership. There was no credible evidence presented as to the decision-making process within the group; however, decisions on matters such as the dealership's advertising budget required approval of the ownership group.

88. The failure to provide appropriate on-site management can delay routine decisions and negatively affect the ability to manage and motivate sales staff. For example, when Nissan offered Mr. Hutchinson the opportunity to participate in the Nissan EDGE sales program, Mr. Hutchinson was initially unable to respond, because he lacked the ability to commit the financial resources to pay for the program.

89. Mr. Hutchinson testified that the ownership group routinely approved his advertising budget requests. As the Petitioner's sales declined, so did advertising expenditures, from \$694,107 in 2002 to \$534,289 in 2004.

90. The Petitioner's declining advertising expenditures were a contributing factor in deteriorating sales. The Petitioner reduced its total advertising budget while the Orlando market was growing, and the Petitioner's sales penetration declined while competing dealerships sales increased.

91. Additionally, the Petitioner did not monitor the effectiveness of its advertising. The Petitioner's advertising was implemented through "Central Florida Marketing," a separate company owned by the Holler organization. There is no evidence that either the Petitioner or Central Florida Marketing monitored the effectiveness of the advertising.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

92. A substantial number of Nissan buyers within the Petitioner's PMA purchased vehicles from other dealerships, suggesting that the advertising failed to attract buyers to the Petitioner's dealership. Only eight percent of the Petitioner's customers acknowledged seeing the Petitioner's advertising, whereas about 20 percent of car shoppers in the Orlando area admit being influenced by dealer advertising.

*11 93. The Respondent asserted that the Petitioner failed to have sufficient sales staff to handle the increased customer traffic precipitated by the introduction of new Nissan models in 2002 and 2003. The Respondent offered evidence that the average vehicle salesperson sells eight to ten cars monthly, five to six of which are new cars and that, based on sales expectations, the Petitioner's sales force could not sell enough cars to meet the regional averages.

94. Although the evidence establishes that the Petitioner cut sales staff as sales declined at the dealership, there is no credible evidence that customers at the Petitioner's facility were not served. The assertion relies upon an assumption that the Petitioner experienced increased sales traffic upon the introduction of new models and that the sales staff was inadequate to sufficiently service the increased traffic. The evidence failed to establish that the Petitioner experienced an increase in sales traffic such that sales were lost because staff was unavailable to assist customers.

95. However, the Petitioner's sales staff failed to take advantage of customer leads provided to the dealership by the Respondent. The Respondent gathered contact information from various sources including persons who requested vehicle information from the Respondent's internet site, as well as the names of lease customers whose lease terms were expiring. The contact information was provided to dealers without charge through the Respondent's online dealer portal. The Petitioner rarely accessed the data, and it is, therefore, logical to presume that the leads resulted in few closed sales.

96. The Petitioner's customer satisfaction scores also declined during the time period relevant to this proceeding. Poor customer service can eventually influence sales as negative customer "word-of-mouth" dampens the interest of other prospective customers. The Respondent monitored the customer opinions of dealer operations through a survey process, which resulted in "Customer Service Index" (CSI) scores.

97. Prior to 2003, the Petitioner's CSI scores had been satisfactory, and then CSI scores began to decline. By the close of 2003, the CSI scores were substantially below regional scores, and the sales survey score was the lowest in the Petitioner's district.

98. Although the Petitioner asserted on several occasions that CSI scores were increasing, the evidence established that only the March 2004 CSI scores improved and that no other material improvement occurred during the time period relevant to this proceeding.

99. The Petitioner asserted at the hearing that the sales performance decline was caused by a lack of vehicle inventory, the alteration of the Petitioner's PMA, a lack of available financing from Nissan Motors Acceptance Corporation (NMAC), hurricanes, improper advertising by competing dealers, and the death of Roger Holler, Jr.

100. The Petitioner also asserted that this termination action is being prosecuted by the Respondent because the Petitioner declined to participate in the NREDI dealer-facility upgrade program and declined to sell the Respondent's extended service plan product.

*12 101. A number of the suggested causes offered by the Petitioner during the hearing were omitted from the Petitioner's Proposed Recommended Order, but nonetheless are addressed herein.

102. The Petitioner asserted that the Respondent failed to make available marketable inventory sufficient for the Petitioner to meet sales penetration averages. The evidence failed to support the assertion.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

103. Nissan vehicles were distributed according to an allocation system that reflected dealer sales and inventory. The Respondent used a "two-pass" allocation system to distribute 90 percent of each month's vehicle production. The remaining 10 percent were reserved for allocation by Nissan market representatives.

104. Simply stated, dealers earned new vehicles to sell by selling the vehicles they had. New vehicle allocations were based upon each dealer's "days' supply" of cars. The calculation of days' supply is essentially based on the number of vehicles a dealer had available on the lot and the number of vehicles a dealer sold in each month.

105. Through the allocation system, a dealership that failed to sell cars and lower its days' supply would be allocated fewer cars during the following month. More vehicles were made available to dealers with low days' supplies than were available to dealers with higher supplies. It is clearly reasonable for the Respondent to provide a greater supply of vehicles to the dealers who sell more cars.

106. At some point during the period relevant to this proceeding, Nissan removed consideration of sales history from the days' supply-based allocation system calculation; however, there was no credible evidence presented to establish that the elimination of the sales history component from the calculation reduced the vehicle allocation available to the Petitioner.

107. The Respondent applied the same allocation system to all of its dealerships, including the Petitioner. There is no evidence that the Respondent manipulated the allocation system to deny any vehicles to the Petitioner.

108. The Respondent provided current inventory and allocation information to all of its dealerships, including the Petitioner, through a computerized database system. The Petitioner was responsible for managing vehicle inventory and for utilizing the allocation system to acquire cars to sell.

109. Although the Petitioner asserted that the decline in sales was related to a lack of vehicle inventory, there was no evidence that the Petitioner's inventory declined during the period relevant to this proceeding. In fact, the evidence established that the Petitioner's inventory actually increased from 150 vehicles in early 2003 to 300 vehicles in early 2004, at which time the Petitioner reduced vehicle orders and the inventory began to decline.

110. The Petitioner also asserted that it was provided vehicles for sale that were undesirable to the Petitioner's customers, due to expensive or excessive options packages. There was no credible evidence that the Petitioner's sales declines were related to an inventory of undesirable vehicles.

*13 111. Further, there was no evidence that the decline in sales penetration was related to poor supply of any specific vehicle model. Other than two truck models, the Petitioner's sales penetration decline occurred across the full range of Nissan vehicles offered for sale.

112. Every Nissan dealer had the ability to exercise significant control (including color and option package choices) over most of the inventory acquired during the "first pass" allocation.

113. Any inventory deficiencies that may have existed were the result of the Petitioner's mismanagement of inventory. Mr. Hutchinson did not understand the vehicle allocation system or its relationship to the days' supply calculation. The Petitioner routinely declined to order units of Nissan's apparently most marketable vehicles during the allocation process.

114. During 2003, the Petitioner declined 137 vehicles from the "first pass" allocation, including 18 Sentras and 56 Altimas, and declined 225 vehicles from the "second pass" allocation, including 59 Sentras and 59 Altimas. During the first half of 2004, the Petitioner declined 58 vehicles from the "first pass" allocation and 42 vehicles from the "second pass" allocation.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

115. During the hearing, one of the Petitioner's witnesses generally asserted that the Respondent's turn-down records were erroneous; however, the witness was unable to identify any errors of significance, and the testimony of the witness was disregarded.

116. After the two-pass allocation process was completed, there were usually some vehicles remaining for distribution to dealers. Nissan assigned responsibility to DOMs to market these units to dealers. The DOMs used the days' supply calculation to prioritize the order in which they contacted dealers, although the vehicles were available to any dealer. There is no evidence that any DOM manipulated the days' supply-based prioritization of vehicles for denying the Petitioner the opportunity to obtain vehicles to sell.

117. Any vehicles remaining available after the DOM attempts to distribute the vehicles were identified as "Additional Vehicle Requests" (AVR) and were made available to all dealers simultaneously. Dealerships were notified of such availability by simultaneous facsimile transmission or through the Nissan computerized database. There was no evidence that the Petitioner was denied an opportunity to obtain AVR vehicles, and in fact, the Petitioner obtained vehicles through the AVR system.

118. The Petitioner asserted that the Nissan practice of reserving 10 percent of each month's production for allocation by market representatives rewarded some dealers and punished others.

119. Market representative allocations are standard in the industry, and such vehicles are provided to dealerships for various reasons. Nissan market representative allocations were used to supply extra cars to newly opened dealerships or in situations where a dealership was sold to new ownership. Nissan market representative allocations were also provided to dealers who participated in the NREDI facility upgrade program.

*14 120. The provision of additional vehicles by market representatives to new or expanded sales facilities was reasonable because the standard allocation system would not reflect the actual sales capacity of the facility.

121. The Petitioner presented no evidence that the Respondent, or any of its market representatives, manipulated the 10 percent allocation to unfairly reward any of the Petitioner's competitors or to punish the Respondent for not participating in various corporate programs.

122. Prior to 2001, the Respondent had a program of providing additional vehicles to under-performing dealers in an apparent effort to increase sales by increasing inventory; however, the program did not cause an increase in sales and actually resulted in dealers being burdened with excessive unsold inventory and increased floor plan financing costs. The Respondent eliminated the program in 2001, and there is no evidence that any dealership was provided vehicles through this program during the time period relevant to this proceeding. There is no evidence that the Respondent eliminated the program for the purpose of reducing the vehicles allocated or otherwise provided to the Petitioner.

123. The Petitioner asserted that the Respondent altered the Petitioner's assigned PMA in March 2004 and that the alteration negatively affected the Petitioner's sales penetration calculation because the Petitioner's area of sales responsibility changed.

124. Prior to March 2004, the Petitioner's PMA was calculated using information reported by the 1990 United States Census. After completion of the 2000 Census, the Respondent evaluated every Nissan dealer's PMA and made alterations based upon population changes as reflected within the Census.

125. Standard Provision Section 3.A. of the Dealer Agreement provides that the Respondent "may, in its reasonable discretion, change the Dealer's Primary Market Area from time to time."

126. There was no credible evidence presented to establish that the 2000 PMA was invalid or was improperly designated.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

127. There was no evidence that the Respondent's evaluation of the Petitioner's PMA was different from the evaluation of every other PMA in the United States.

128. There was no evidence that the Respondent evaluated or altered the Petitioner's PMA with the intent to negatively affect the Petitioner's ability to sell vehicles or to meet regional sales penetration averages.

129. There was no credible evidence that the 2000 PMA adversely affected the dealership or that the Petitioner's declining sales penetration was related to the change in the PMA. The alteration of the PMA did not sufficiently affect the demographics of the Petitioner's market to account for the decline in sales penetration. Recalculating the Petitioner's sales penetration under the prior PMA did not markedly improve the Petitioner's sales penetration.

130. The Petitioner suggested that the 2000 PMA revision was an impermissible modification or replacement of the Dealer Agreement, but no credible evidence was offered to support the assertion. There was no evidence that the Petitioner did not receive proper notice of the 2000 PMA.

*15 131. At the hearing, the Petitioner implied that the Respondent caused a decline in sales by refusing to make Nissan Motor Acceptance Corporation (NMAC) financing available to the Petitioner's buyers.

132. NMAC is a finance company affiliated with, but separate from, the Respondent. NMAC provides a variety of financing options to dealers and Nissan vehicle purchasers.

133. NMAC relies in lending decisions, as do most lenders, on a "Beacon score" which reflects the relative creditworthiness of a customer's application to finance the purchase of a car. Vehicle financing applications are grouped into four general "tiers" based on Beacon scores. Various interest rates are offered to customers based on Beacon scores.

134. The Petitioner offered data comparing the annual number of NMAC-approved applications submitted in each tier by the Petitioner on behalf of the Petitioner's customers to suggest that the decline in the Petitioner's sales indicated a decision by NMAC to decrease the availability of NMAC credit to the Petitioner's customers.

135. There was no evidence that NMAC treated the Petitioner's customers differently than the customers of competing dealerships or that NMAC-financed buyers received preferential interest rates based upon the dealership from which vehicles were purchased.

136. There was no evidence that the Respondent exercised any control over individual financing decisions made by NMAC.

137. There was no evidence that the Respondent manipulated, or had the ability to manipulate, the availability of NMAC financing for the purpose of negatively affecting the Petitioner's ability to sell vehicles.

138. A number of hurricanes passed through the central Florida region in August and September of 2004. The Petitioner asserted that the dealership's physical plant was damaged by the storms, and that the hurricane-related economic impact on area consumers caused, at least in part, the decline in sales.

139. The evidence failed to establish that the Petitioner's physical plant sustained significant hurricane damage to the extent of preventing vehicle sales from occurring. None of the Petitioner's vehicle inventory sustained hurricane-related damage.

140. There was no evidence presented to indicate that the Petitioner's customers experienced a more significant economic impact than did the customers of competing dealers in the area.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

141. There was no credible evidence that the hurricanes had any material impact on the Petitioner's sales penetration. The Petitioner's sales penetration immediately prior to the hurricanes was 62.8 percent. The Petitioner's sales penetration in August 2004 was 61.6 percent, in September was 61.1 percent, and in October was 62.3 percent.

142. Generally, within 30 to 45 days after a hurricane, customers with damaged vehicles use insurance proceeds to purchase new vehicles. The Petitioner's sales volume increased at this time; although because other dealers in the region also experienced increased sales, there was no change to the Petitioner's sales penetration calculation.

*16 143. The Petitioner asserted that improper advertising of "double rebates" by competing dealers caused declining sales, and offered evidence in the form of newspaper advertisements in support of the assertion; however, the Petitioner's own advertising indicated the availability of such rebates on occasion.

144. There was no evidence presented to establish that the Respondent was responsible for creating or approving advertisements for dealerships. The Respondent has a program whereby dealers who meet certain advertising guidelines can obtain funds to defray advertising costs, but the program is voluntary. The Respondent does not regulate vehicle advertising or retail pricing.

145. There was no evidence that the Petitioner reported any allegedly misleading or illegal advertising with any law enforcement agency having jurisdiction over false advertising or unfair trade practices.

146. Mr. Hutchinson testified that the death of Roger Holler, Jr., in February 2004, negatively affected sales at the dealership, but there was no evidence that Roger Holler, Jr., had any role in managing or operating the dealership. The Petitioner's sales decline commenced prior to his death and continued thereafter. The evidence failed to establish that the death had any impact on the operation of the dealership or the Petitioner's sales performance.

147. The Petitioner asserted that the Respondent's effort to terminate the Dealer Agreement was an attempt to punish the Petitioner for declining to participate in the NREDI program and offered a chronology of events intended to imply that the Respondent's actions in this case were a deliberate plan to force the Petitioner to either build a new facility or sell the dealership. The assertion is speculative and unsupported by credible evidence.

148. During the time period relevant to this proceeding, only one of the four Orlando-area Nissan dealers agreed to participate in the NREDI program. Of the four dealerships, three experienced increased sales activity during the period relevant to this proceeding. The Petitioner was the only one of the four dealerships to experience a decline in sales penetration during this period. The Respondent has taken no action against the two other dealerships that declined to participate in the NREDI program.

149. There was no credible evidence that the Respondent has taken any punitive action against any dealership solely based on a dealership's decision not to participate in the NREDI program.

150. The Petitioner asserted that the Respondent's actions in this case were intended to punish the Petitioner for not selling the Respondent's extended service contract (known as "Security Plus") and for selling a product owned by the Petitioner, but there was no evidence supporting the assertion.

151. A substantial number of dealers in the region did not sell the Security Plus product to new car buyers. There was no evidence that the Respondent has penalized any dealer, including the Petitioner, for refusing to sell the Nissan Security Plus product.

*17 152. During the hearing, the Petitioner identified a number of other troubled Nissan dealerships, ostensibly to establish that other dealerships similarly situated to the Petitioner had not been the subject of Dealer Agreement termination proceedings and that the Respondent had failed to enforce the Dealer Agreement termination provisions fairly.

153. A number of the dealerships cited by the Petitioner are outside the State of Florida and are immaterial to this proceeding.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

154. The Dealer Agreement provides for termination of an agreement if the dealer materially and substantially breaches the agreement. The Dealer Agreement does not require termination of every dealership that fails to achieve average regional sales penetration.

155. Termination of a Dealer Agreement because of sales performance requires a dealer-specific analysis that includes consideration of the factors underlying poor sales and consideration of conditions that may warrant delaying termination proceedings.

156. As to the other Florida Nissan dealers cited by the Petitioner, many had higher sales penetration levels than did the Respondent. When compared to the Florida dealerships, the magnitude of the Petitioner's sales penetration decline exceeded that of all the other dealerships.

157. Many of the cited dealerships had also initiated changes in management, staffing, and facilities to address sale and service deficiencies. Some of the cited dealers had already shown sales and service-related improvements.

158. One dealership, Love Nissan, had already been terminated, even though its sales penetration had exceeded that of the Petitioner.

159. One dealership cited by the Petitioner was Hampton Nissan, against whom the Respondent had initiated termination proceedings in 2003. Changes to Hampton's PMA based on the 2000 PMA resulted in an increase in the dealership's sales penetration eventually to levels exceeding those of the Petitioner, and Nissan has rescinded the action. There was no evidence that the Hampton Nissan PMA was calculated differently than the Petitioner's PMA, or that either PMA was altered purposefully to affect the dealer's sales penetration results.

160. Other dealerships cited by the Petitioner were being monitored by the Respondent to ascertain whether efforts to improve sales performance succeed. The Respondent may ultimately pursue termination proceedings against underperforming dealerships if sales performance fails to improve.

161. There was no credible evidence that, prior to initiating this termination proceeding, the Respondent failed to consider the facts and circumstances underlying the Petitioner's poor sales and the Petitioner's response to the situation. The Petitioner has experienced a substantial and continuing decline in sales penetration and has failed to respond effectively to the deteriorating situation during the period at issue in this proceeding.

CONCLUSIONS OF LAW

162. The Division of Administrative Hearings has jurisdiction over the parties to and subject matter of this proceeding. §§ 120.569 and 120.57(1), Fla. Stat.

*18 163. The Respondent has the burden of proving, by a preponderance of the evidence, that the proposed termination of the Dealer Agreement between the parties was undertaken in good faith, undertaken for good cause, clearly permitted by the franchise agreement, and based on material and substantial breach of the dealer agreement and whether the grounds relied upon for termination have been applied in a uniform and consistent manner. *Love Nissan Inc. v. Nissan North America Inc.*, paragraph 95, Case No. 04-2247 (DOAH July 14, 2005) (Fla. DHSMV April 12, 2006). The Respondent has met the burden.

164. Subsection 320.641(3), Florida Statutes, provides as follows:

Any motor vehicle dealer who receives a notice of intent to discontinue, cancel, not renew, modify, or replace may, within the 90-day notice period, file a petition or complaint for a determination of whether such action is an unfair or prohibited discontinuation, cancellation, nonrenewal, modification, or

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

replacement. Agreements and certificates of appointment shall continue in effect until final determination of the issues raised in such petition or complaint by the motor vehicle dealer. A discontinuation cancellation or nonrenewal of a franchise agreement is unfair if it is not clearly permitted by the franchise agreement is not undertaken in good faith is not undertaken for good cause or is based on an alleged breach of the franchise agreement which is not in fact a material and substantial breach or if the grounds relied upon for termination cancellation or nonrenewal have not been applied in a uniform and consistent manner by the licensee. A modification or replacement is unfair if it is not clearly permitted by the franchise agreement; is not undertaken in good faith; or is not undertaken for good cause. The applicant or licensee shall have the burden of proof that such action is fair and not prohibited. (Emphasis supplied.)

165. Termination of the Dealer Agreement is clearly permitted by the franchise agreement. The Dealer Agreement requires that the Petitioner “actively and effectively promote” the retail sales of Nissan vehicles to retail customers and permits the Respondent to terminate the agreement upon the Petitioner’s failure to meet its sales obligations. The Dealer Agreement specifically provides for measurement of sales performance by use of the dealer’s sales penetration.

166. In this case, the Petitioner failed to actively and effectively promote the sale of new Nissan automobiles and, as a result, experienced a substantial and continuing decline in sales penetration, to the extent that the Petitioner became the lowest ranked dealership in the State of Florida during the period at issue in this proceeding.

167. The Respondent’s termination of the dealership was undertaken in good faith. The Respondent provided appropriate and continuing notice to the Petitioner of the decline in sales penetration and offered specific recommendations intended to improve the Petitioner’s sales performance. It is unknown whether the recommendations would have been successful because the Petitioner implemented very few of the items. The Respondent also suggested utilizing the EDGE program to identify specific sales process deficiencies, but the Petitioner declined to participate.

*19 168. Additionally, the Respondent extended several deadlines for compliance with items identified in the initial NODs based apparently on representations made in communications received from the Petitioner, although the representations appear to be contradicted by fact. The Respondent’s extension of the deadlines is a demonstration of good faith. Rick Starr Nissan Lincoln Mercury Inc. v. Nissan Motor Corp., Case No. 92-5187 (DOAH June 10, 1993) (Fla. DHSMV Aug. 5, 1993).

169. Although the Petitioner asserted the termination was being pursued because the Petitioner declined to participate in the NREDI program, no credible evidence was offered to support the assertion. Other Nissan dealerships have also declined to participate in the NREDI program, and the Respondent has taken no punitive action towards those dealers.

170. The Respondent’s termination of the dealership was undertaken for good cause. As stated previously, the Petitioner experienced a substantial and continuing decline in sales penetration, becoming the lowest ranked dealership in the State of Florida during the period at issue in this proceeding. Every other Nissan dealer in Florida increased sales volume during the period, while the Petitioner’s sales volume declined. The Petitioner made no substantive attempt to resolve the decline in sales.

171. The Petitioner’s declining sales performance was due to operational problems at the dealership including issues related to management, advertising, facility and customer relations.

172. The ineffective management of the Petitioner’s dealership was a source of continuing concern to the Respondent. The Dealership Agreement originally identified Mr. Holler as the executive manager, but there was no credible evidence that he managed the Petitioner on a daily basis.

173. The Petitioner subsequently designated other employees as executive managers, but neither actually had full authority to operate the dealership. Mr. Sekula became the executive manager in June 2003, but he was soon transferred to another dealership

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

by the ownership group. Subsequently, Mr. Hutchinson was appointed as executive manager, but his authority remained limited by the requirement that he obtain approval over budgets and expenditures from the ownership group. Mr. Hutchinson reduced the full-time sales staff and, apparently with approval of the owners, reduced the advertising budget. Further, there was no systematic monitoring of advertising effectiveness, and the Petitioner failed to use active sales leads provided to the Petitioner by the Respondent.

174. The Petitioner asserted that the advertising budget actually increased on the "per unit sold" basis, but the assertion, even if true, fails to establish that the dealership was actively and effectively promoting the sale of vehicles. It is as likely that the "per unit sold" calculation increased because new car sales declined more rapidly than did the advertising budget. A dealership expending a large advertising budget on the sale of a single vehicle would not be regarded as effectively promoting the sale of new vehicles.

*20 175. The Petitioner's sales facility was uninviting and substandard in relation to the sales facilities of competing dealerships in the area, and there were apparently no specific plans to improve the physical plant, save for the Petitioner's vague assurance that it would be "feasible" to "proceed in the future."

176. The Petitioner's customer service scores also declined during the time at issue in this proceeding, to become the lowest in the area. The Petitioner rejected the Respondent's suggestion to implement the EDGE program, which specifically was directed towards reviewing the sales experience from the customer perspective.

177. The result of the Petitioner's failure to actively and effectively market Nissan vehicles to retail customers was that the Respondent lost 185 new car sales in 2003 and 601 new car sales in 2004.

178. The termination is based on material and substantial breach of the Dealer Agreement. The Petitioner's sales penetration decline was substantial, continuing, and occurred during a period of increased sales performance at other Nissan dealerships. The magnitude of the sales shortfall in this case demonstrates the ineffectiveness of the Petitioner's performance. A dealership's failure to achieve reasonable market share is a material and substantial breach of the Dealer Agreement. Bill Gallman Pontiac GMC Truck Inc. v. General Motors Corp., Case 89-0505 (DOAH June 28, 1990) (Fla. DHSMV February 28, 1991).

179. While not every dealer who fails to achieve average sales penetration warrants termination, the evidence fails to establish that the Petitioner made any substantive effort to remedy the sales decline, and the failure to do so further constitutes a material and substantial breach of the dealer's obligation to actively and effectively market the vehicles to retail customers.

180. The Respondent has applied the grounds relied upon for termination in a uniform and consistent manner. Sales penetration statistics were uniformly calculated and provided an accurate identification of dealer performance within each dealer's competitive environment. Primary Market Areas for all dealers are established in a routine manner utilizing a standardized collection of demographic data. The Petitioner presented no credible evidence to the contrary.

181. The Petitioner asserted that the Respondent had not applied the grounds for termination uniformly or consistently because the Respondent allowed other under-performing dealerships to continue operations while initiating termination proceedings against the Petitioner.

182. Many of the cited dealerships responded to sales-related deficiencies with plans to address operational issues, including replacement of management and improvement of facilities. Some may yet face termination proceedings.

183. In contrast, none of the cited dealerships suffered the magnitude of the Petitioner's sales decline; yet the Petitioner made little effort to effectively address the situation.

Attachment 2

CLASSIC NISSAN, INC., Petitioner v. NISSAN NORTH..., 2007 WL 841365 (2007)

*21 184. The evidence failed to establish that the Respondent should have initiated termination proceedings against any of the operating Nissan dealerships cited by the Petitioner prior to pursuing the termination at issue in this case.

RECOMMENDATION

Based on the foregoing Findings of Fact and Conclusions of Law, it is RECOMMENDED that the Department of Highway Safety and Motor Vehicles enter a final order dismissing Petitioner's protest and approving the April 6, 2005, Superceding Notice of Termination.

DONE AND ENTERED this 20th day of March, 2007, in Tallahassee, Leon County, Florida.

WILLIAM F. QUATTLEBAUM
Administrative Law Judge
Division of Administrative Hearings
The DeSoto Building
1230 Apalachee Parkway
Tallahassee, Florida 32399-3060

Filed with the Clerk of the Division of Administrative Hearings this 20th day of March, 2007.

ENDNOTE

NOTICE OF RIGHT TO SUBMIT EXCEPTIONS

All parties have the right to submit written exceptions within 15 days from the date of this Recommended Order. Any exceptions to this Recommended Order should be filed with the agency that will issue the Final Order in this case.

Footnotes

- 1 All references to Florida Statutes are to Florida Statutes (2006), unless otherwise indicated.
2007 WL 841365 (Fla.Div.Admin.Hrgs.)

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

2012 WL 1079719

Only the Westlaw citation is currently available.

United States District Court,
E.D. Michigan,
Southern Division.

SUPERIOR PONTIAC BUICK GMC, INC.,
a Delaware corporation, d/b/a Superior
Nissan and Walter J. Schwartz, Plaintiffs,

v.

NISSAN NORTH AMERICA, INC.,
a California corporation, Defendant.

No. 08-10642. | March 30, 2012.

Attorneys and Law Firms

John C. Kaplansky, Bingham Farms, MI, Robert Y. Weller, Kristen L. Baiardi, Abbott Nicholson, Detroit, MI, for Plaintiffs.

S. Thomas Wiener, Seth D. Gould, Weiner, Gould, Rochester, MI, for Defendant.

OPINION AND ORDER

MARIANNE O. BATTANI, District Judge.

*1 This matter came before the Court for a bench trial on September 7, 2011, and was concluded on November 21, 2011. In their complaint, Plaintiffs Superior Pontiac Buick GMC, Inc. ("Superior") and Walter Schwartz (collectively "Superior") allege that Defendant Nissan North America, Inc. ("Nissan") committed various illegal acts during the course of the parties' dealings and through Nissan's eventual termination of the parties' sales and service agreement. (Compl., Doc. 1.) In their complaint, Plaintiffs seek damages for violations of the Michigan Motor Vehicle Dealers Act, Mich. Comp. Laws § 445.1561 et seq. (MMVDA), the federal Automobile Dealer Day in Court Act, 15 U.S.C. § 1221, et seq. (ADDCA), and for breach of contract.

In support of their relative positions, the Court received numerous documents, including Plaintiffs' Exhibits P 3, P 14, P 19, P 33-P 50, P 52-66, P 69-P 76, P 79, P 92-P 94, P 103-P 116, P 118-P 122, P 125, P 131-P 140, P 142-P 146, P 148-149, P 163-P 187, and Defendants' Exhibits D 1-D 203, D 212-D 214, D 216-D 223, D 225-D 230, D 234, D 238-

D 239, D 244-D 245, D 247-D 248A, D 249A, D 250A, D 251 A, D 252A, D 253A, D 356, D 259-D 260, as well as the parties' closing arguments.

The bench trial was in session on September 7-9, 12-16, 19-21, November 15-18, and November 21, 2011. During the course of trial, the Court heard testimony from Defendant's employees and former employees, Thomas Hushek, retired Regional Vice President of Nissan's North Central Region, Eric Anderson, successor to Hushek, Chad Kirchoff, Regional Sales Operations Manager for the North Central Region, from employees who acted as Dealer Operations Managers (DOMs) during the parties' business relationship, William Shollenberger, Kevin Baumann, and Ray Madugno, and from Joseph Lavrencik, Distribution Manager of the North Central Region. The Court heard testimony from Plaintiff Walter Schwartz and from Superior's employees, George Fowler, the General Manager of the Pontiac-Buick-GMC store, and Michael Cohen, who worked as the General Manager of new car sales. In addition, Defendant offered expert testimony from Herbert Walker, regarding Plaintiffs' financial performance, and Sharif Farhat regarding Plaintiffs' dealer performance. Plaintiff presented expert testimony from Ilhan Geckil, a professional economist, and David Rinker, a Certified Public Accountant.

In general, the Court found all the witnesses knowledgeable and credible. Plaintiffs' witnesses advanced testimony to support Plaintiffs' view that Nissan failed to exercise good faith in its dealings with Superior and imposed unreasonable and unobtainable performance standards. Defendant's witnesses offered testimony to support its view that Superior's sales performance was inadequate.

After considering all the evidence received and the legal arguments of the parties, the Court enters the following Findings of Fact and Conclusions of Law pursuant to Fed.R.Civ.P. 52(a).

I. FINDINGS OF FACT

A. Overview

*2 Nissan distributes new motor vehicles, parts, and accessories throughout the United States to authorized Nissan dealers. Superior has been a party to a sales and service agreement with Nissan since 2001. Schwartz acquired the assets of Dearborn Pontiac Nissan from Bill Perkins for \$3,500,000 through an Asset Purchase Agreement dated October 17, 2000.(D 4). The sale was conditioned on the

Next

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

approval and consent of General Motors and Nissan. (Tr. 9/7/11 at 41).

Nissan consented, and the parties signed the Nissan Dealer Term Sales & Service Agreement (Term Agreement) on January 30, 2001. (D 9). It governed the parties' relationship until they signed the Nissan Dealer Sales and Service Agreement ("Dealer Agreement") on March 10, 2003. (D 48).

Superior Pontiac is part of the Detroit Metro market, which is part of District 12, which, in turn, is part of the North Central Region. The Detroit Metro market includes eight dealerships.

Nissan employs Dealer Operations Managers ("DOMs") to operate on its behalf in the field. (Tr. 9/7/11 at 48–50). DOMs are the contact between Nissan and its dealerships, and typically visit dealerships once or twice a month to review operations and provide assistance and recommendations. (*Id.* at 50). DOMs usually have eight to ten years of industry experience. (*Id.*)

DOMs create dealer contact reports summarizing their visits to a dealership. (Tr. 9/9/11 at 91). The contact reports are internal documents sent to the Nissan regional office in Illinois; they are not shared with the dealers. (Tr. 9/12/11 at 13, 15, 83).

At the time Schwartz began operations, William Shollenberger was the DOM assigned to Superior, and he worked in that capacity until June 2003. (Tr. 9/9/11 at 72–3). Kevin Baumann subsequently became the DOM for District 12, and worked with Superior until Spring 2006. (Tr. 9/13/11 at 58). Ray Modugno succeeded Baumann and worked as the DOM for District 12 from August 2006 until April 2009. (Tr. 9/21/11 at 43).

The DOMs all testified about shortcomings in Superior's performance, including poor sales, poor customer satisfaction, an outdated, poorly maintained facility, and untrained sales people. (*See e.g.* D 54, D 55, D 57, D 83; Tr. 9/7/11 at 92, 96–98, 102–107, 131–132). The DOMs acknowledged that Schwartz claimed lack of product caused his poor sales performance as well as a variety of other causes, including personnel (Tr. 9/12/11 at 95), focus on his GM business (Tr. 9/12/11 at 105), and road construction (D 81).

In 2003, Superior's sales were poor, and on September 26, 2003, Nissan issued a "poor performance" letter. (D 58). At that time, Superior's sales penetration was ranked 187 of 191

dealers in the North Central Region. (D 58). In 2004, its sales penetration fell to the lowest ranking in the North Central Region, Michigan, and the District. (D 85). It was ranked 187 of 187 dealers. (*Id.*) In 2005, Superior was ranked next-to-last in the North Central region. (D 118). In the summer of 2005, North Central Region management conducted an in depth analysis of Superior's sales performance. (D 100). Nissan reviewed correspondence, contract reports and other business reports, and demographic information. (*Id.*; D 116). After completing the analysis, Hushek and Kirchoff advanced a recommendation to national to issue a notice of default for unsatisfactory sales performance. (D 109).

*3 Nissan adopted the recommendation and issued Superior a Notice of Default (NOD) on September 6, 2005. (D 109) Superior had 180 days to improve its sales performance or face termination of the franchise. (*Id.*) In response, Superior maintained that its sales had improved, but sales were hindered by road construction and the dealership location itself, which was near the situs of Ford fleet vehicles and leases. (D 115). These factors should have impacted Nissan's assessment of Superior's sales.

In April 2006, the North Central Region requested an extension to the Notice of Default. (D 133). In August 2006, Superior received notice that Nissan agreed to extend Superior's cure period another 180 days. (D 137). Nissan again extended the cure period 180 days in March 2007.

On December 4, 2007, Nissan issued Superior a Notice of Termination because Superior had "unsatisfactory sales penetration performance." (D 184). Plaintiffs filed this lawsuit two months later, in February 2008. (D 214).

B. Terms of the Governing Agreement

Nissan and Superior entered into a Sales and Service Agreement on March 10, 2003. (D 48). The Dealer Agreement requires Superior to "actively and effectively promote through its own advertising and sales promotion activities the sale at retail ... to customers located within the Dealer's Primary Market Area (PMA)." (*Id.* at § 3.A) A PMA is a group of census tracts assigned to a dealer, generally based upon the dealer's geographic proximity to the census tracts. (Tr. 9/7/11 at 70). Nissan assigns PMAs to its dealers to accommodate measurement of a dealer's performance and to assign a dealer responsibility for a distinct geographic territory in which to market and promote the Nissan brand. (Tr. 9/7/11 at 71). The Dealer Agreement reserved to Nissan

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

the right to reevaluate PMA markets to account for changes in market conditions. (D 48, § 4.A).

When the parties signed the Dealer Agreement, all of the 1990 Census Tracts that made up Superior's PMA were identified. (D 48). Superior's PMA, referred to as the Dearborn PMA, is the most populous in Metro Detroit. (Tr. 11/15/11 at 69). During the course of their relationship, Superior's Primary Market Area increased; however, the PMA identified since August 2001 included the Taylor/Southgate open point, which previously had been unassigned to any dealer. (D 26).

Several provisions in the Dealer Agreement address evaluation of dealer performance. Section 3.B of the Dealer Agreement authorizes Nissan to establish reasonable sales objectives as a percentage of registrations of Nissan cars and trucks, registrations of competitive vehicles, registrations of industry cars in the PMA, the district, or region. (*Id.*)

In addition, because Superior is located in the Detroit metropolitan area, (Tr. 9/8/11 at 75), Section 3.C of the Dealer Agreement is relevant. It provides that if a Dealer is located in a Metropolitan Market, "the combined sales performance of all Nissan Dealers in such metropolitan or other marketing area may be evaluated ... and Dealer's sales performance may also be evaluated on the basis of the proportion of sales and potential sales of Nissan Vehicles in the metropolitan or other marketing area in which Dealer is located for which Dealer fairly may be held responsible." (D 48).

*4 Finally, Section 3.D of the Dealer Agreement provides that, where appropriate, Nissan would consider other reasonable criteria. Items identified include:

the Dealership Location, the general shopping habits of the public in such market area, the availability of Nissan vehicles to Dealer and to other Authorized Nissan dealers, any special local marketing conditions that would affect Dealer's sales performance differently from the sales performance of other Authorized Nissan Dealers, the recent and long term trends in Dealer's sales performance, the manner in which Dealer has conducted its sales operations (including advertising, sales promotion, and treatment of customers), and the other factors, if

any, directly affecting Dealer's sales opportunities and performance.

(D 48).

The Dealer Agreement also establishes Nissan's right to terminate the agreement when its evaluations show that a dealer failed "to substantially fulfill its responsibilities with respect to ... [s]ales of new Nissan vehicles and the other responsibilities" designated to a dealer in Section 3 of the Dealer Agreement. (D 48 § 12.13). The process requires Nissan to notify the dealer, review the nature and extent of the breach, and the reasons for the breach. Further, Nissan is required to afford a dealer "a reasonable opportunity to correct the failure." (D 48, § 12.13). "If dealer fails to make substantial progress towards remedying such failure" in a given time, Nissan may terminated the Dealer Agreement. (*Id.*)

C. Evaluation Process

In 2005, before Nissan issued a Notice of Default, the North Central Region management reviewed Superior's sale performance reports, compared them to other benchmarks, and reviewed a local market analysis of the Ford influence in Superior's PMA. (Tr. 9/8/11 at 52). Hushek and Kirchhoff both recommended the notice be issued. (D 109; Tr. 9/7/11 at 130-32). Nissan issued the written notice of material default on September 6, 2005, advising Superior that it was in material breach of Section 3 of the Dealer Agreement for failure to actively and effectively promote the sale of new Nissan vehicles in the Dearborn PMA. (D 109).

Nissan will no longer tolerate Dealer's substandard sales penetration performance. In order to correct this Notice of Default, Nissan hereby requires Dealer to achieve at least regional average sales penetration of new Nissan Vehicles within one hundred and eighty (180) days from the date of receipt of this Notice of Default. Failure to meet the regional average sales penetration will constitute a material breach of Dealer's Agreement and may result in Nissan issuing a Notice of Termination....

(D 109 at 3)

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

The NOD identifies unsatisfactory sales penetration performance as the breach. Specifically, Superior's calendar year 2004 sales penetration of the combined Competitive Car and Truck Segment was 0.53%, representing only 14.05% of the North Central Regional Average sales penetration of 3.99%. As a result of Superior's poor sales penetration performance, it ranked 185 out of the 186 Nissan dealers in the North Central Region. Had Superior penetrated the market at 100% Regional Sales Effectiveness ("RSE"), which measures sales performance relative to other dealers in a defined region, it would have sold 1,609 vehicles during CY 2004. (D 109). Instead, Superior lost 1,383 sales for this same time period. (*Id.*) Moreover, as of June CYTD 2005, Superior's sales penetration was .86%, which represented 19.98% RSE. (*Id.*) This performance translated to 749 lost sales through CYTD 2005. (D 109).

*5 Nissan also included another reason in the NOD—Superior's failure to meet capitalization guides. Both parties offered testimony regarding the sufficiency of capitalization. Because this reason did not form the basis of the termination, the Court finds Superior either complied with its capitalization requirements or corrected any deficiencies.

The NOD could not have been a surprise to Superior inasmuch as Nissan had sent letters outlining serious concerns about sales penetration performance, DOMs had addressed Superior's ranking throughout 2005, and its decline in performance. (*Id.*). Although Superior emphasized Nissan's failure to place the dealership on a Performance Improvement Program ("PIP"), Hushek testified that PIPs were not used during the 2000–2006 time frame. (Tr. 9/8/11 at 6–10). Because Nissan was using far more experienced DOMs during that time, and the DOMs identified performance issues and offered recommendations for improvement, the DOMs acted akin to a PIP. Hushek also testified that the use of the DOMs, all of whom provided a consistent and unified approach as to how Superior could improve, rendered a formalized tracking report unnecessary. (*Id.*) It is uncontested that during the cure period, DOMs continued to work with Superior to improve its performance. For example, to assist Superior, Nissan provided it with its Edge Sales Process Booklet, priced at \$15,000, free of charge. (D 112).

An August 11, 2006, certified letter gave Superior an extension despite Superior's failure to make any improvement in its sales performance as measured by RSE. (D 137). Nissan then engaged in a local market analysis that covered the 2003 through June 2006 time frame. (D 136). Nissan initiated

this more formal study of the Detroit market to investigate Superior's assertion that Ford dominance in the Primary Market Area skewed its performance. (*Id.*) Nissan reviewed sales in a variety of ways, including Superior's performance when all Ford competitive registrations were eliminated and when all domestic competitive registrations were eliminated. (D 136). Even under these measurements, Superior's sales penetration remained less than half of the average of the Detroit Metro. (*Id.*)

On March 5, 2007, Schwartz received a second extension of the NOD Cure Period. (D 160). In the certified letter, Nissan noted that Superior had failed to make any improvement in its sales performance and still was ranked last in the state and last in the region. (D 160).

On March 21, 2007, Nissan reviewed the results of the 2006–2007 market study and determined that Superior would benefit if it relocated. (D 165). Nissan reviewed the results with dealers in person. (D 163; D 165). Nissan subsequently informed Superior, that if Superior elected to sell or transfer the dealership, Nissan had to approve the sale and could base approval on the buyer's commitment to relocate the dealership. (D 165).

At a June 6, 2007, meeting, Schwartz again stated that Nissan had failed to provide Superior with an adequate supply of vehicles. (D 168). Nissan disagreed with Schwartz's explanation. It attributed poor sales to other issues: vehicle pricing, customer convenience, aged inventory, and failure to implement Nissan's Retail Environmental Design Initiative program (NREDI) to revitalize the Nissan brand and create a consistent, uniform retail experience for consumers. (Tr. 9/9/11 at 134).

*6 In a July 2007 DOM contact report, the issue of sales performance and lack of improvement were raised with Schwartz. (D 175). Superior was ranked last in the state and last in the region. (*Id.*) A July 2007 update of Superior's sales performance showed it again lagged well behind other Metro dealers and the North Central Region. (D 176).

Finally, on December 4, 2007, Nissan issued Superior a Notice of Termination. (D 184). In the Notice, Nissan stated that in the time following the NOD, "Dealer has not taken necessary action to cure the substantial and material breach that led to the NOD. The reason for the termination was "Unsatisfactory Sales Penetration Performance." (*Id.* at 2). Overall, Superior's RSE declined from September 2005

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

to August 2007 from 19.32% to 16.64%. (Tr. 9/14/11 at 120). During the same time, the District 12 market share had increased by close to 50%, and the Detroit Metro import market share had increased from 13% to 20%. (Tr. 9/14/11 at 138). The updated local market analysis showed that Superior's sales performance had not improved even assuming a market devoid of competitive Ford and competitive domestic registrations. (D 176; Tr. 9/8/11 at 122–23). Notably at the time, Superior had been on notice for more than two years that its sales performance needed to improve. The effective date of termination was March 10, 2008. (D 184).

D. Method of Assessment

To assess Superior's performance, Nissan calculated Superior's sales penetration. It measures the dealer's performance relative to an average. (Tr. 9/16/11 at 199). Specifically, Nissan assesses performance of Superior's sales relative to the performance of other Nissan dealers in the North Central Region. (Tr. 9/16/11 at 197). The Regional Sales Effectiveness or RSE shows how a dealer is penetrating its assigned PMA against the average Nissan dealer in the region. The average level of performance achieved by dealers in the region acts as a benchmark. (*Id.* at 198). Nissan

calculates sales penetration for each of its dealers throughout the country in the exact same way. (Tr. 9/16/11 at 203). Many manufacturers use this measure. (*Id.*) In addition, Nissan ranks dealers against dealers within a particular state or district to gauge performance relative to a more localized peer group. (Tr. 9/7/11 at 97–99).

Sales penetration is calculated using the ratio of a dealer's sales of new vehicles to the number of competitive registrations of new vehicles within the dealer's PMA. Competitive registrations include vehicles in segments in which Nissan competes. (Tr. 9/7/11 at 93–94). Nissan determines which vehicles fall into a segment based upon size, price, and utilities. (Tr. 9/16/11 at 207–08). Nissan receives the information about auto sales from a data provider, R.L. Polk and Company ("Polk"). (*Id.*) Polk breaks down the registrations by product segment, such as compact, subcompact, SUV, or pick-up truck. (*Id.* at 96; D 223, App 26).

*7 Exhibit 225, A 89, which is reproduced below, shows Superior's sales penetration relative to District 12, Michigan, and the North Central Region for the years 2003–2007.

YEAR	SUPERIOR	DETROIT (WITHOUT SUPERIOR)	DISTRICT 12	MICHIGAN	NORTH CENTRAL REGION
2003	0.7 %	1.3%	1.2%	1.4%	3.4%
2004	0.5%	1.7%	1.5%	1.7%	4.8%
2005	0.9%	1.9%	1.7%	2.0%	5.5%
2006	0.7%	1.5%	1.4%	1.7%	5.3%
2007	0.8%	1.5%	1.6%	1.8%	5.8%

YEAR	SUPERIOR	DETROIT (WITHOUT SUPERIOR)	DISTRICT 12	MICHIGAN	NORTH CENTRAL REGION
2003	0.7 %	1.3%	1.2%	1.4%	3.4%
2004	0.5%	1.7%	1.5%	1.7%	4.8%
2005	0.9%	1.9%	1.7%	2.0%	5.5%
2006	0.7%	1.5%	1.4%	1.7%	5.3%
2007	0.8%	1.5%	1.6%	1.8%	5.8%

The chart shows that for each of the years the Dealer Agreement governed the relationship until the time the NOT was issued, Superior underperformed Metro Detroit, District 12, the State, and the Region. In most of the years, Superior's average was at most half of the other groups measured. For example, in 2007, Superior's sales penetration rate was 0.8%, and the North Central Region rate was 5.8%. (*Id.*) Superior fared no better when compared to the District rate which was 1.6% or the Michigan rate, which was 1.8%. (*Id.*) In sum, poor performance was not an anomaly. (Tr. 9/19/11 at 35).

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

Nissan applied this method of assessment across the board to its dealers. In addition, the method was applied as specified in the Dealer Agreement.

1. Reasonableness of the Method

Sharif Farhat, who is employed by Urban Science Applications, a consulting and software development company that uses science to answer business questions within the auto industry, testified as an expert on Nissan's behalf. (Tr. 9/16/11 at 173). Nissan asked Farhat to evaluate whether Superior was "actively and effectively" selling Nissan products and whether the requirements Nissan used to make that decision were reasonable or whether the performance was due to factors beyond its control. (*Id.* at 187).

Farhat concluded that "Nissan's methodology and [its] calculations are appropriate. They are the industry standard way of calculating expectation for dealers, and [Nissan's] process of not just calculating the number, but the ranking of the relative performance of dealers, is an appropriate method to make conclusions about ... whether a dealer is active and effectively marketing Nissan products." (Tr. 9/19/11 at 38). The calculation placed Superior last in the region, state, and district. (*Id.* at 40). In reviewing the five calendar years, 2003–2007, low performance was a consistent issue. (*Id.* at 41).

Farhat testified that Nissan methodology comported with the industry standard way of calculating expectation for dealers and that ranking of the relative performance of dealers is an appropriate basis for concluding the effectiveness of a dealer. (Tr. 9/19/11 at 38). Farhat concluded that because the majority of dealers in the North Central Region had sale penetration above the region average, the benchmark is reasonable. (*Id.* at 28). The number of sales needed was not "overwhelming." (*Id.*) Nevertheless, none of the Metro Eight were above the regional average. (*Id.*)

*8 Superior retained Ilhan Geckil, an economist, to analyze its sales performance. (Tr. 11/15/11 at 40–41), and Geckil concluded that the sales criteria employed by Nissan was unfair. To reach RSE, Superior had to sell 1,753 vehicles in 2005, 1,768 vehicles in 2006, and 1,809 vehicles in 2007. (Tr. 9/21/11 at 18). He added that the expectation that Superior should sell more than 1,000 cars in a given year is unreasonable. (Tr. 11/15/11 at 45; 9/21/11 at 18). To the extent that Superior could not sell the number of vehicles necessary to achieve RSE, the Dealer Agreement only

required "substantial improvement." In this case, Superior showed no improvement whatsoever.

To assess Superior's performance, Geckil looked at Superior's raw sales. Geckil relied on compound sales growth to measure Superior's sales performance. Superior experienced 2.6% compound annual sales growth between 2003 and 2007. (P 169). However, Geckil's testimony did not address the fact that other Michigan Nissan dealers, on average, experienced 3.1 % compound sales growth during the same period. (D 260; Tr. 11/22/11 at 113). His analysis failed to offer a basis for relative comparison of dealer performance in a metro area, and his contention that every market is unique does not afford a manufacturer any metric for determining which dealers are effective. Further, an analysis of raw sales ignores the opportunity available to dealers in different sized markets. (Tr. 9/19/11 at 117). For example, five sales in a small market is not the same as five sales in a market one hundred times bigger. (Tr. 9/7/11 at 97–98). Consequently, a manufacturer's failure to assess raw sales as a performance metric is not unreasonable. (Tr. 9/19/11 at 117).

The Court finds that Superior's failure to ever reach RSE, does not compromise the reasonableness of the goal. Nissan used RSE as a performance metric to assess the effectiveness of dealer sales relative to other dealers, and the fact that reaching RSE merely rendered a dealer average does not undercut the reasonableness of the metric. RSE merely constituted the standard by which the industry measured dealer performance. In fact, Schwartz conceded that GM used the same measure, and that it was calculated in the same way. (Tr. 11/18/11 at 87).

Because the Dealer Agreement specified that other reasonable considerations would be factored into performance evaluation, the Court, as finder of fact, examines evidence regarding whether Nissan's assessment was reasonable in light of other criteria listed in the Dealer Agreement that might guide the analysis.

2. Factors Beyond a Dealer's Control

The parties offered evidence on several factors over which a dealer has no control, including assigned PMA, demographics, the influence of the domestic automotive market, and road construction. The Court's findings on each follow.

i. PMA

Next

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

To the extent the PMA is improperly defined, it is an issue beyond the dealer's control. Nissan, not the dealer, determines the size of the PMA geographically.

*9 In 2001, when Nissan conducted a market study, there was an open point in the Taylor–Southgate Area. (Tr. 9/7/11 at 65). An open point is a series of census tracts where there is no existing dealer. The prior Nissan dealer in the Taylor–Southgate area was terminated in 1988. (Tr. 9/14/11 at 23–24; P 142). After the 2001 market study, Nissan decided to close an “open point” located south of Superior, in Southgate/Taylor, Michigan, and the geography associated with the open point went to surrounding Nissan dealers, including Dick Scott Nissan (Canton), Gerwick Nissan (Monroe) and Superior. (Tr. 9/7/11 at 66, 74–75).

The open point encompasses Wayne County, which has the lowest penetration by import vehicles among Wayne, Oakland, and Macomb counties. In contrast, Oakland County is the most import friendly among the three counties because of its population of higher educated people with higher incomes.

Even if the PMA expansion to the south of the dealership's location was less favorable than a PMA expansion to the north into the more import-friendly suburbs, (Tr. 11/15/11 at 63), there is no evidence that the expansion occurred for any reason other than in the ordinary course of business. Nor was the expansion contrary to industry practice. Nissan made changes to PMAs based on changes in dealer network planning and configuration and census changes, which occur every ten years. (Tr. 9/7/11 at 74). Further, the fact that normalizing by restoring Superior's original PMA before the elimination of the Southgate Taylor open point would, at a minimum, double Superior's sales effectiveness, (Tr. 11/17/11 at 28), it is not persuasive evidence that the expansion was unreasonable. The same would be true for any dealership if its PMA were cut in half because it would reduce the number of units required to reach regional average sales penetration. (Tr. 9/20/11 at 83; 9/14/11 at 61).

Superior's PMA was properly assigned based on the air distance, drive distance, and driving time. There is no evidence that Nissan assigned the census tracts to Superior in an unusual or atypical fashion. In fact, Superior was closer to each of the newly assigned census tracts than any other Nissan dealer. Superior's PMA was fourth smallest in terms of square miles. (Tr. 9/21/11 at 19). Its PMA included the open point when it signed the Dealer Agreement in 2003; its PMA was

not altered after the NOD issued, after the extensions of the cure period, or after the NOT.

Similarly, there was no evidence presented to show that Nissan assigned Superior a PMA with a large population for a reason outside the normal course of business. Superior's location, in a metropolitan market required it to serve a very large population. Superior is one of eight Nissan dealers in the Detroit Metro market, a market having more than four million people. Because of its PMA assignment, Superior serves one-fourth of the Detroit Metro market area, approximately 25% of the population and households, in an area that does not have a strong demand for import vehicles. (Tr. 11/15/11 at 62). Because PMA is used in calculating a dealer's sales performance the assignment is important. (Tr. 9/16/11 at 198).

*10 Nissan viewed the size of the PMA as offering a “significant opportunity relative to other PMAs within the state and in the Detroit market” based upon the number of competitive registrations in the Dearborn PMA. (Tr. 9/21 /11 at 24). There was no evidence presented that PMA among metropolitan dealers typically is allotted to equalize population, and the Court rejects Plaintiff's position that because there are eight Nissan dealers in the Detroit Metro area, Superior Nissan should service approximately one-eighth of the population, the size of the population before the PMA expanded. (Tr. 11/15/11 at 81). PMAs are assigned based on physical proximity, not based on population.

The Court recognizes that it took double the population in the Dearborn PMA to achieve an equivalent number of segment registrations as the Troy PMA, a fact reflecting the lower demand for Nissan vehicles in the Dearborn PMA. (Tr. 11/17/11 at 25). Although the absence of demand for the Nissan product could adversely affect the performance metric developed by the manufacturer, the analysis Nissan conducted accounted for this factor. It measured performance by retail registrations, not population, and retail registrations are the most accurate and appropriate way of measuring opportunity within a market area because it tracks actual consumer behavior with respect to new vehicle purchasing. (Tr. 9/19/11 at 95). The advantage of reviewing actual competitive vehicle registrations is that it removes the need to speculate about buyer behavior based upon population or other demographic data. (Tr. 9/19/11 at 95).

ii. Demographics

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

The demographics in Superior's PMA are the worst in the metro Detroit Nissan market. (Tr. 9/9/11 at 59; Tr. 9/21/11 at 77). The PMA has the lowest median household income, the lowest per capita income, and the lowest educational achievement measured by high school dropouts, college, masters, and PhD degrees. (Tr. 11/15/11 at 66). Its population is the least qualified by income and has the lowest number of qualified customers earning fifty to sixty thousand dollars, the segment most likely to be part of the foreign car market. (Tr. 11/15/11 at 66).

In Superior's PMA, the majority of the block groups have median incomes less than \$50,000. The second block group in terms of ranking has median income between \$50,000 and \$74,000. (Tr. 11/16/11 at 31; P 176). Both experts agreed that an annual income of \$35,000 is not representative of typical Nissan buyers. (Tr. 11/16/11 at 79; Tr. 9/19/11 at 89). The median Nissan buyer has a median household income of \$75,000. (Tr. 9/19/11 at 88). Further, expenditure data shows that residents in Superior's PMA spend less on vehicle purchases compared to residents of the other Detroit metro area Nissan dealers' primary market areas. (Tr. 11/16/11 at 35).

In addition, Superior's market is challenged because of the diverse cultures and languages of the population within its PMA. (Tr. 11/15/11 at 74; Tr. 11/21/11 at 15; Tr. 11/21/11 at 144). Without question, the uniqueness of the demographics in Superior's PMA affects the shopping habits of the consumers. (Tr. 11/15/11 at 70–71). And to the extent those difference result in a “difference in the types of vehicles that are popular within the PMA” is beyond the control of the dealer to adjust....” (Tr. 9/19/11 at 19).

*11 The experts differed as to how to account for the demographic and socioeconomic factors such as income and education, the unique market given the domestic influence, and the shopping habits of the consumers. Geckil testified that because every market is unique, comparisons are not “meaningful.” (Tr. 11/16/11 at 52). He did not compare Superior's performance to any other dealer.

Nissan's evaluation accounted for the unique characteristics in a dealer's PMA through segment adjustment, which separates all vehicles models into groups or segments that are similar to each other in terms of size, price, and function, before calculating the expected sales for a dealer in its market. (Tr. 9/7/11 at 93–4). The segment adjustments, or product popularity, account for differences in income, age,

and other demographic factors from one PMA to another. (Tr. 9/19/11 at 23–25). Consequently, Nissan applied an adjusted penetration average when it evaluated Superior's sales performance, which yielded a smaller percentage for Superior to achieve its sales penetration goal. (*Id.*) Superior's performance does not improve based on this calculation. (Tr. 9/19/11 at 32). (see e.g. Exhibit D 222, A–9—the 2007 product popularity in Dearborn PMA versus the North Central Region). Therefore, the Court rejects testimony that the assigned PMA and/or demographics caused Superior's unsatisfactory sales performance.

iii. Domestic Influence

The domestic influence in the Detroit metro area is a special local marketing condition. (Tr. 9/9/11 at 40, 58). The witnesses were in agreement that the Detroit market is dominated by the Big Three, and unique as compared to the other markets in the North Central Region. (Tr. 11/17/11 at 8; 9/20/11 at 25; 9/8/11 at 36, 80; 9/12/11 at 26–27). The auto industry is the predominant industry in Detroit and people are “tied into” the auto industry more so in Detroit than in other areas of the country. (Tr. 9/20/11 at 57). Ford, GM, and Chrysler sell well above average in Detroit, (Tr. 9/20/11 at 55), and there are challenges in the City of Detroit for any auto manufacturer other than GM, Ford, and Chrysler. (Tr. 9/20/11 at 54). For example, in the metro Detroit area, the eight Metro Nissan dealers compete with 41 Ford dealers. (Tr. 9/14/11 at 23; P 142). Seven Ford dealers operate in the Dearborn PMA, (Tr. 9/12/11 at 37, 63), and nearly 38% of the vehicles sold in Superior's PMA are Fords. (Tr. 11/15/11 at 59). The North Central Region's low penetration is due in part to the presence of domestic manufacturers and plants in the Midwest, (Tr. 9/14/11 at 14; 9/20/11 at 24) and the availability of Big 3 employee discounts. (Tr. 11/21/11 at 23–24).

Although the parties concede Ford may be a specialized factor, they disputed how to address the import of Ford Motor Company in the Dearborn PMA. Farhat normalized for Ford registrations by reducing and/or removing the portion of the industry that is considered biased or unavailable. Because the Ford brands achieve higher than state average levels of performance in Dearborn, those sales in excess of an average level are unavailable to any dealer but a Ford dealer. (Tr. 9/19/11 at 64). Therefore, the sales are removed to normalize the level of expectation. (*Id.*) For example, in “Michigan, Ford is 21.8 percent of the competitive set, and that is lower than Ford in Dearborn, [which] is 37.2, so normalization brings the 37.2 down to 21.8.” (Tr. 9/19/11 at 66).

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

*12 The Court finds Farhat's analysis provided a proper basis for assessing Superior's sales performance. Even after normalizing the Ford registrations, Superior's adjusted sales penetration placed it among the worst performers in Michigan. (D 222, A 38-44). In addition, when Farhat eliminated the Ford registrations from the competitive segment registrations, Superior remained a poor performer. (D 225, A 97). Finally, Farhat normalized all domestic registrations in the Dearborn PMA to a level equal to state average, the Superior's adjusted sales penetration remained among the worst. (D 220, A 45-51). Those dealers that performed worse than Superior are no longer Nissan dealers. (Tr. 9/19/11 at 72, 74-81). Moreover, the Domestic Normalized Analysis reveals that other Detroit Metro PMA's have a higher percentage of domestic registrations than the Dearborn PMA, which runs contrary to the argument advanced by Superior throughout this litigation. (See D 220, A 45, Tr. 9/19/11 at 75). Lastly, Farhat performed a sales penetration analysis that completely eliminated domestic brand vehicle registration from the competitive set. (D 225, A 92). Superior's adjusted sales performance was still below Metro, District, and State averages, and Nissan's assessment of Superior's performance was reasonable.

iv. Road Construction

From late 2003 through 2006, major road construction on Michigan Avenue resulted in difficulty entering and leaving the dealership, excessive dirt, and a reduction in Superior's Buick GMC sales of 30%. (Tr. 11/18/11 at 133, 153; 9/22/11 at 33). Schwartz notified Nissan of the road construction, and DOMs were aware of the construction because they visited the dealership. (Tr. 11/18/11 at 144). Schwartz testified that GM offered Superior a special allocation of vehicles to recover from the road construction, but Nissan did not. (Tr. 11/21/11 at 94; 9/16/11 at 37). Although road construction on Michigan Avenue was advanced by Schwartz as a reason for poor sales, Farhat analyzed the average monthly volumes before, during, and after the Michigan Avenue road construction. He testified that although new vehicle sales remained flat, used vehicle sales increased during road construction. (D 222, A 80). The analysis undercuts road construction as a basis for rejecting Nissan's assessment of Superior's sales effectiveness.

3. Allocation

Underlying the claims alleged in their complaint is Plaintiffs' contention that Superior never received enough inventory to meet Nissan's sales standards. The opening allocation of

vehicles is important because it begins the "turn and earn" system by which Nissan supplied vehicles based on the dealer's sales. The opening allocation is essential for a new dealer to establish a travel rate. (Tr. 9/7/11 at 46). Schwartz asserts that without inventory, Superior could not increase sales, and Superior was chronically undersupplied.

Supply was addressed in the Term Agreement, which governed the opening allocation. The parties understood that:

*13 numerous factors [] affect the availability of Nissan Vehicles ... including, without limitation, production capacity, sales potential in Dealer's and other Primary Market Areas, varying consumer demand, weather and transportation conditions, and state and federal government requirements. Since such factors may affect individual dealers differently, Seller reserves to itself sole discretion to distribute Nissan Vehicles in a fair and consistent manner, and its decision in such matters shall be final.

(D 10, § 7.A.1.)

According to Schwartz, Superior acquired thirty-six Nissan vehicles from Perkins; Nissan puts the number at fifty-three. (Tr. 9/15/11 at 144). Although Schwartz expected an opening allocation of 200 to 250 vehicles, and he testified that other newly established Nissan dealers received substantial opening allocations, Schwartz was not opening a newly established Nissan dealership. Nissan had no records dating back to 2001 documenting the vehicles it offered to Superior. (Tr. 9/16/11 at 6). Further, Schwartz conceded that he was not involved in ordering inventory, and Plaintiffs failed to present testimony from the employee that did order inventory. Regardless of the parties' disagreement as to the number of vehicles at opening, it is undisputed that Superior had a seven month supply of vehicles based upon Perkins' prior historical sales rate, a supply in excess of the two month average for other dealers in the North Central Region. (Tr. 9/16/11 at 34).

The Court does not find these numbers indicative of an inadequate opening supply. Notably, Schwartz never complained about his opening allocation until years later, when he received his NOT. In addition, Lavrencik testified that the fifty-one supplemental cars received by Superior

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

during its first six months of operation were part of its opening allocation. (Tr. 9/16/11 at 34). Notably, after Schwartz first raised opening allocation at a June 6, 2007, meeting, Nissan reviewed Superior's distribution complaints and found Superior had received vehicles in accordance with the Nissan distribution system. (D 190, Tr. 9/16/11 at 11–13).

Without question, allocation is an important component of a dealer's ability to meet its sales goals. Nissan uses a "Market Driven Allocation and Production System ("MAPS") that allows dealers to determine their own product need. (Tr. 9/15/11 at 110). Policy Number 109 covers Regional Reserve Vehicles, and it allocates vehicles to the dealer that will run out of vehicles the soonest. (Tr. 9/15/11 at 112–115). Day supply, which is calculated based upon dealer inventory levels and sales history (Tr. 9/15/11 at 110–112), allows large and small dealers to be treated fairly because the system uniformly raises the day supply of all the dealers. (*Id.* at 114).

Under MAPS, dealers have several vehicle ordering opportunities. Pass One takes place preproduction and allows the dealer to customize the vehicle. (Tr. 9/15/11 at 116). Pass Two offers dealers the fastest moving vehicles in aggregate for the region. (*Id.* at 117). Dealers have less flexibility in terms of modification in Pass Two. (*Id.* at 118). Pass Two includes the leftovers from Pass One and additional vehicles. (*Id.* at 119–120). Both Pass One and Pass Two allocations are computer run and generated; Nissan has no ability to "manipulate" the distribution. (Tr. 9/15/11 at 118). Nissan provides dealers with a list of all vehicles available for purchase. (Tr. 9/17/11 at 45; 9/15/11 at 116). A dealer does not have to accept a particular vehicle; he can accept it as is, decline the vehicle, or modify the vehicle to specific market conditions and accept the modified vehicle. (Tr. 9/15/11 at 116). Dealers also have the opportunity to purchase vehicles declined by other Nissan dealers during Pass Two, which the DOMs offer as "Supplemental" vehicles. (Tr. 9/15/11 at 132). Finally, dealers can purchase vehicles from Additional Vehicle Request ("AVR") pools, which include vehicles available from other districts or regions. (Tr. 9/15/11 at 138).

*14 Nissan provided a chart tracking inventory levels and sales from February 2001 through December 2007. (D 190). The chart shows that for the most part, Superior's inventory exceeded its sales rate. (*Id.*) The chart shows that Superior's sales remained flat even when inventory levels rose. (D 190). According to Lavrencik, the inventory trend had a positive slope showing distribution did not hinder sales. (Tr. 9/16/11 at 12).

Lavrencik testified that Superior declined vehicles allocated as Pass One vehicles and Pass Two vehicles. Nissan also offered Superior additional vehicles, which Superior declined. (Tr. 9/13/11 at 36, 39, 40, 103). Nissan presented charts showing how many supplemental vehicles Superior declined throughout 2005–2007. (D 203). It is undisputed that Superior declined offered vehicles in Pass One of the allocation system, as well as Pass Two. It likewise is undisputed that Superior had the ability to purchase vehicles through supplemental and AVP pools during 2005 through 2007. (Tr. 9/16/11 at 21).

Schwartz offered a reasonable explanation for turndowns, and the Court finds no basis to discredit Schwartz' testimony that he could not get all the vehicles he wanted for his market. The record is replete with evidence that throughout the course of their relationship, Schwartz repeatedly asked for additional inventory. (Tr. 9/12/11 at 21, 101; 11/18/11 at 157; 11/21/11 at 13). Superior wanted high demand vehicles above and beyond what it had earned under MAPS. (Tr. 9/16/11 at 11–13). Specifically, Superior wanted more Altimas, its core product. (Tr. 11/21/11 at 13). Throughout the relationship, DOMs worked with Superior to offer high demand vehicles that became available. (Tr. 9/12/11 at 102; 9/13/11).

Schwartz testified that there were many times he only had a few Altima in stock. This was his core product and the vehicles had sixteen variations and six or seven color choices. (Tr. 11/18/11 at 157, 158). Even if Schwartz believed that he was chronically undersupplied, he never participated in training seminars on Nissan's allocation system. There is no record that anyone from Superior participated in the training. (Tr. 9/15/11 at 103). Nor did Schwartz ever access the contact information provided to dealers in the event the dealer had questions. (Tr. 9/15/11 at 109).

Further, there is no evidence that Superior did not receive the cars it earned under the distribution system. Regional sales performance standards play no role in the MAPS allocation. (Tr. 9/15/11 at 114). Allocation systems are "dealer performance driven" not offer systems. (Tr. 9/16/11 at 66). Under the distribution system, dealers with above average days' supply will not receive additional vehicles until other dealers with lower days' supply receive allocations. (Tr. 9/16/11 at 66). Nevertheless, the Dealer Agreement governs allocation: Nissan never promised to provide vehicles as requested by dealers. It reserved discretion to distribute vehicles in a fair and consistent manner, and Nissan did

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

exactly that. Accordingly, the distribution system played no role in Superior's sales performance because its inventory levels were consistently in excess of the standard industry target of sixty day supply. (Tr. 9/21/11; D 222, A 68).

4. Cross-Sell

*15 Nissan expects its dealers to capture a majority of Nissan sales registered in their own market areas. (Tr. 9/8/11 at 96). Typically a majority of consumers purchase vehicles from dealers located closest to them absent a reason to shop elsewhere. Reasons to purchase elsewhere include bad reputation, ineffective marketing, poor customer treatment, and lack of competitive pricing. (Tr. 9/19/11 at 105).

In June 2004, Superior captured only 31 % of the new Nissan vehicles registered in the Dearborn PMA. (D 76). That means that consumers in Nissan's PMA purchased their new vehicles from dealerships other than Superior, a condition referred to as "pump in." Although Superior also sold vehicles to customers outside its assigned PMA, which is referred to as "pump out," Superior's cross-sell percentage was well below the Detroit metro average. (*Id.*) This statistic shows that Superior was not an effective intra-brand competitor, even within its own area of geographic advantage. (D 222, A 73–A 75). In sum, dealers other than Superior, sold more Nissan vehicles in the Dearborn PMA than Superior.

Even though "pump in" and "pump out" sales are common in a metro area, (Tr. 11/16/11 at 70), and expected given the circumstances of Superior's market, (Tr. 11/16/11 at 71–73), it is an important metric. Because cross-sell performance only considers actual Nissan vehicle registrations in the Dearborn PMA, it undermines Superior's contention that poor demographics resulted in poor sales performance. Other operational deficiencies provide possible explanations for this deficiency. (Tr. 9/19/11 at 160). Farhat concluded that the poor performance could be attributed to Superior's advertising, pricing, facility, service approach, personnel, and focus on business other than Nissan new vehicle sales. (Tr. 9/19/11 at 105).

For example, Superior decreased its annual Nissan advertising during 2004 to 2007, from \$226,353 to \$163,267 (D 222, A 81; Tr. 9/19/11 at 108–09), but increased its used vehicle advertising costs from \$216,379 to \$577,076. (*Id.*) In addition, Superior ran Nissan ads below its prominently displayed GM's ads, despite complaints by the DOMs. (Tr. 9/7/11 at 104; 9/9/11 at 133; 9/13/11 at 52; 9/14/11 at 5). According to Schwartz, he had no understanding of PMA

when he purchased the dealership in 2000. He testified that he has a natural market that he tries to reach through advertising. (Tr. 11/18/11 at 136). Although there was evidence presented that Plaintiffs advertised to the Arabic population that resided in the Dearborn PMA, there was no evidence of targeted advertising to consumers in the Taylor/Southgate area. (*Id.*)

Testimony at trial showed that Superior's average gross profit per new retail unit exceeded the average profit for other Detroit Metro Nissan dealers. (D 248A; Tr. 9/19/11 at 110–114; 11/12/11 at 42).

The DOMs testified that Schwartz dragged his feet in accomplishing facility improvements. (Tr. 9/9/11 at 82, 105, D 27–29). Throughout the relationship, Nissan wanted the dealership to conform to the Nissan Retail Environment Design Initiative (NREDI)-its program to implement a consistent facility image for all dealership. (Tr. 9/9/11 at 134). Yet, Schwartz did not offer to complete the NREDI program until October 2007, while the dealership was under the NOT. (P 62). In addition, Nissan customers had to finalize their vehicle purchases at the GM facility. (D 9).

*16 In addition, Superior had a history of poor customer service (D 57; Tr. 9/12/11 at 104) as reflected by the Customer Satisfaction index ("CSI") surveys. Superior also had turnover in its sales manager position and untrained sales staff. (Tr. 9/12/11 at 94; 9/12/11 at 95; 9/12/11 at 124–130, 132–34; D 70, D 81). Finally, Schwartz was focused on business other than Nissan throughout the relationship. He conceded he initially was busy with GM business, and that he turned his focus to used cars in 2004. Schwartz testified that at that time, he dedicated resources to his used car department because it is easier to control used car inventory. He also hired a used car manager. (Tr. 11/17/12 at 118, 142).

5. Relocation

In 2006 Nissan initiated a market study of the Detroit Metro, and the results were reviewed in person with Schwartz in March 2007. (D 163, Tr. 9/15/11 at 61). One of the recommendations was that the preferred location for the dealership was at Telegraph and Michigan Avenue, closer to competitive dealerships. (*Id.*) Nissan followed up the conversation with a letter sent to Superior stating that Nissan had the contractual right to condition approval of any sale or transfer of the dealership on a proposed buyer's or transferee's commitment to upgrade and/or relocate the dealership in conformance with the 2006–2007 market study. (D 165; Tr. 9/15/11 at 59). Under § 15 of the Dealer Agreement:

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

If [Nissan] has recommended, pursuant to a market study conducted in accordance with Section 4.A, that Dealer relocate its Dealership facilities, [Nissan] may offer to the proposed dealer a Term Sales & Service Agreement subject to the condition that its Dealership Facilities shall be relocated within a reasonable time to a location and in facilities acceptable to [Nissan] and in accordance with market study recommendations.

(D 48 § 15.B). In addition, Nissan has sixty days to assess whether to consent to a buy-sell proposal. (*Id.*)

Schwartz testified that this condition rendered his dealership “unsellable.” (Tr. 11/21 /11 at 117–118). Schwartz has not presented any buy-sell agreement to Nissan. (Tr. 9/14/11 at 115). Nor did Plaintiffs present any evidence that the NOT was merely a means for forcing Superior to relocate.

III. CONCLUSIONS OF LAW

A. Michigan Dealer Act

Nissan bears the burden to show that it acted in good faith, that it complied with the notice requirements, and that there was good cause for the termination of the Dealer Agreement.

Under Michigan Compiled Laws § 445.1567(1),

(1) Notwithstanding any agreement, a manufacturer or distributor shall not [terminate] any dealer agreement with a new motor vehicle dealer unless the manufacturer or distributor has complied with all of the following:

- (a) Satisfied the notice requirement of section 10 [445.1570].
- (b) Acted in good faith.
- (c) Has good cause for the cancellation, termination, nonrenewal, or discontinuance.

*17 The facts show that Nissan satisfied the statutory requirements.

1. Notice

Next

The statute requires that the notice of termination be made more than ninety days prior to the effective date of the termination, that it was sent by certified mail, that it contain a statement of intention to terminate; and that it include a statement of the reasons for the termination, and that it specify the date upon which the termination will take effect. Mich. Comp. Laws § 445.1570. Nissan's NOT complied.

First, the NOT identified itself as a “Notice of Termination Pursuant to the Nissan Dealer Term Sales and Service Agreement and Michigan Compiled Laws § 445.1567(3)(a)-(d).” It stated that Nissan was giving notice of its intent to terminate effective March 10, 2008, or ninety days from receipt of the notice, whichever occurred later. (D 184). It was sent by certified mail on December 4, 2007, more than ninety days prior to March 10, 2008. And, lastly, the NOD provided a reason—“failure to actively and effectively promote the sale of new Nissan vehicles in the Dearborn PMA.” (D 184).

2. Good Cause

The Court assesses whether Nissan had good cause for the termination and acted in good faith based on the facts that existed prior to or on the date of the Notice of Termination–December 4, 2007. Superior's performance after that date plays no role in the assessment. The Notice of Termination clearly states that the termination is due to unsatisfactory sales performance.

The good cause provision in § 445.1567(1)(c), is defined in § 445.1567(3):

(3) If the failure by the new motor vehicle dealer to comply with a provision of the dealer agreement relates to the performance of the new motor vehicle dealer in sales or service, good cause shall exist for the purposes of a termination, cancellation, nonrenewal, or discontinuance under subsection (1) when the new motor vehicle dealer fails to effectively carry out the performance provisions of the dealer agreement if all of the following have occurred:

- (a) The new motor vehicle dealer was given written notice by the manufacturer ... of the failure.
- (b) The notification stated that the notice of failure of performance was provided pursuant to this Act.
- (c) The new motor vehicle dealer was afforded a reasonable opportunity to exert good faith efforts to carry out the dealer agreement.

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

(d) The failure continued for more than 180 days after the date notification was given pursuant to subdivision (a).

Here, Nissan satisfied the notice requirements. Further, Nissan has shown by the preponderance of evidence that it had good cause for the termination because Superior failed to carry out its contractual obligation to “actively and effectively promote through its own advertising and sales promotion activities” the sale of Nissan vehicles in the Dearborn PMA. Nissan measured Superior’s sales penetration using a metric employed by many automobile manufacturers. Specifically, Nissan used the North Central Region average as its baseline benchmark for measuring sales penetration effectiveness. Nissan compared Superior’s performance to other dealers in the state and Detroit metro market. Superior’s sales penetration consistently ranked last or second to last among Nissan dealers in the Detroit Metro market, Michigan, District 12, and the North Central Region. The dealers that underperformed Superior are no longer in business.

***18** The Court finds that Nissan’s methodology, although perhaps not perfect, is reasonable. *See Fred Laverly Co. v. Nissan North America, Inc.*, No. 99–76065 at *25–27 (E.D.Mich. Dec. 17, 2007), *aff’d* No. 03–1005, 2004 WL 1041604 (6th Cir. May 4, 2004); *see also Gallo Motor Corp. v. Mazda Motor of America, Inc.*, 204 F.Supp.2d 144, 152 (D.Mass.2002) (noting that the issue was not dependent on raw sales but on dealer performance relative to the business available in its market area). The use of a regional benchmark controls to great extent for economic and marketing conditions and allows segment adjustment for context as to how a dealer is performing. It also accounts for unique consumer characteristics in a particular market. Therefore, although Superior faced challenges in selling Nissan vehicles in a domestic auto market, Nissan considered the domestic influence in assessing Superior’s performance. Further, the reasonableness of the methodology is supported by the fact the assessment is not contradicted by other measurements. For example, cross-sell reports showed a majority of consumers residing in the Dearborn PMA traveled to other dealers to purchase and service their Nissan vehicles. Factors, within Superior’s control impacted its ability to sell cars, including a focus on its GM business and used car sales, pricing, and failure to upgrade the dealership facility to make it competitive with other dealerships in the Dearborn PMA.

The Court does not find that yearly raw sales volume adequately measures performance. That measurement favors

larger dealerships in densely populated urban areas over smaller rural dealerships. Therefore, the Court rejects it as an alternate basis for assessing the existence of good cause.

Next, the Court finds that Nissan gave Superior a reasonable opportunity to carry out its obligations under the Dealer Agreement; it provided Superior a 180–day cure period, in which Superior’s performance declined as measured by RSE. Despite the performance problems, Nissan twice extended the NOD Cure Period for 180 days. Although Superior had over two years to improve its performance, it failed to do so. Superior’s RSE continued to rank at the bottom, a factor that satisfies subsection (d). Accordingly, the Court concludes that Nissan met each and every requirement under § 445.1567(3), and had good cause to terminate Superior.

3. Good Faith

Under the Michigan Dealer Act, “good faith ... means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” Mich. Comp. Laws §§ 445.1567(1), 440.2103. The issue of good faith “is ordinarily ‘a matter of factual weighing’ for the district court in a bench trial.” *Fred Laverly Co.*, 2004 WL 1041604 at *5.

The evidence presented at trial showed that Nissan investigated Superior’s claims of domestic bias; DOMS worked with Superior to improve its performance; and Nissan twice extended the 180–day cure period. During the two year period Superior operated under a NOD, DOMS offered Plaintiffs information as to how to improve operations.

***19** The Court rejects Plaintiffs’ claim that the termination resulted from Nissan’s desire to force a relocation of the dealership. Nissan’s concern with Superior’s performance was ongoing and arose before the NOD. Moreover, the NOD came before the 2006–2007 Market Study relocation recommendation. Although the NOT was issued after the relocation recommendation, the record is clear—Nissan had concerns about Superior’s sales performance as early as 2004, and it gave a consistent message to Superior throughout the parties’ relationship. Superior offered no evidence other than the relocation recommendation itself to suggest an absence of good faith. The relocation recommendation was issued in the ordinary course of business. There is no evidence that “relocation” was part of Nissan’s plan in 2001, inasmuch as the earlier market study merely recommended an upgrade to the facility at the current location.

Next

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

Similarly, there is no basis for concluding that the changes made to Superior's PMA resulted from bad faith. First and foremost, the initial change to the PMA occurred before the parties entered into the operative Dealer Agreement. When Superior signed the Dealer Agreement in 2003, Plaintiffs accepted the obligation to actively and effectively represent Nissan in the expanded Dearborn PMA. There is no evidence showing that Nissan believed that the increased PMA would lead to Superior's downfall. The expansion was not unreasonable. The census tracts were assigned in accordance with business practices.

Therefore, the Court concludes that Nissan acted in good faith during the course of its relationship with Superior. The Court's finding undermines Plaintiffs' claim that Nissan violated other provisions of the Act. Sections 445.1573 and 445.1574 govern prohibited conduct by manufacturers. After reviewing the evidence, the Court finds no violations.

Specifically, the Act prohibits a manufacturer from adopting, changing, establishing or implementing an allocation and distribution system for new motor vehicle dealers that is "arbitrary or capricious or based on unreasonable sales and service standards." Mich. Comp. Laws § 445.1574(1)(a). The Court holds Nissan did not violate this provision.

Nissan complied at all times with its own Sales Distribution Policy and Procedures. At the beginning of the parties' relationship, Nissan provided an opening allocation of vehicles to Superior, and continued to allocate vehicles in accordance with its allocation system throughout the relationship. On numerous occasions, DOMs made the first offer of extra allocation to Superior. Nissan's allocation system provided Superior with an adequate inventory, and Nissan exercised its discretion reasonably. Without question, Nissan worked to assist Superior to achieve substantial improvement in its sales performance.

Plaintiffs' position is that Nissan applied the sales performance standards and allocation system in a way so as to create a pretext for termination. The evidence does not support Plaintiffs' theory, and Nissan's notice to Superior that it failed to achieve RSE was not pretextual. Nissan's demand that Superior achieve RSE was not coercive. Here, the Court rejects Plaintiffs' claim that Nissan's ulterior motive was to terminate Superior's franchise to relocate to the preferred location at Michigan and Telegraph without compensation to Superior. There is no concrete evidence to support this theory.

*20 Although Nissan set high goals for performance, it worked with its dealers to meet those goals. Throughout the relationship, Schwartz placed a higher value on his own experience and beliefs regarding good business practices in his market area than on what Nissan asked Superior to do. His disagreement does not render Nissan's evaluation unreasonable. The fact that Superior could not reach Nissan's target goal for number of sales does not render the goal unreasonable. RSE merely set an average, and many Nissan dealers exceeded RSE and many dealers failed to meet RSE.

In addition, Plaintiffs contend that Nissan violated § 445.1573(g), which prohibits a manufacturer from requiring a dealer to change the location of the dealership or making substantial alterations to the dealership premises if it would be unreasonable to do so. Mich. Comp. Laws § 445.1574(g). Nissan sent the same form letter it sends to any dealer when a market study recommends relocation. The letter reminded Superior that Nissan had the contractual right to condition approval of any sale or transfer of the dealership on a commitment to upgrade or relocate the dealership. The fact that real estate prices in the preferred location are high does not render the requirement unreasonable. This is not the situation where the dealership underwent expensive upgrades only to be instructed to relocate. Nissan met its burden of proof to show its complaints about sales performance were not a pretext to avoid the statutory prohibition against forcing dealers to relocate or unreasonably withholding consent to a sale or unfairly preventing the dealer from receiving reasonable compensation for the value of his dealership. The inclusion of the right in the Dealer Agreement supports an essential, legitimate business objective—to ensure that dealers are located to best serve the public. *Salco Corp. v. General Motors Corp.*, 517 F.2d 567 (10th Cir.1975). Consequently, the recommendation does not violate § 445.1574(1)(m), which prohibits a manufacturer from "[u]nfairly prevent[ing]" a new motor vehicle dealer "from receiving reasonable compensation for the value" of the dealership. In sum, the Court concludes that Nissan complied with state statutory law.

B. Dealer Day in Court Act

An automotive dealer may bring suit under the Dealer Day in Court Act ("DDCA"), 15 U.S.C. § 1222, against "any automobile manufacturer" to recover damages sustained by reason of the manufacturer's failure to act in good faith in performing the terms of the franchise. The Dealer Day in Court Act defines good faith as the duty "to act in a fair and equitable manner ... so as to guarantee the one party

Next

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

freedom from coercion, intimidation, or threats of coercion or intimidation from the other party[.]" 15 U.S.C. § 1221(e). This is "a quite restrictive definition," *Overseas Motors, Inc. v. Import Motors Ltd., Inc.*, 519 F.2d 119, 124 (6th Cir.1975), and, hence, "[i]n the absence of coercion, intimidation, or threats thereof, there can be no recovery." *Fray Chevrolet Sales, Inc. v. General Motors Corp.*, 536 F.3d 683, 685 (6th Cir.1976).

*21 A mere lack of fairness will not satisfy the statute. *Id.* "Coercion must include a wrongful demand which will result in sanctions if not complied with." *Id.* (internal punctuation and citations omitted). Although insistence that the dealer comply with a reasonable obligation imposed by the franchise agreement does not constitute a wrongful demand, "[a] demand is wrongful if it pressures the dealer into taking an action it would not take otherwise, ... or impels the dealer into forfeiting its rights under the dealer agreement [.]" *General Motors Corp. v. New A.C. Chevrolet, Inc.*, 263 F.3d 296, 326 (3d Cir.2001).

Because Nissan has advanced "an objectively valid reason for its actions," Plaintiffs cannot prevail without evidence of an ulterior motive." *Id.* "This is not to say, however, that a manufacturer who chooses to terminate a dealer can immunize itself from DDCA liability by simply pointing to a franchise agreement provision with which the dealer ostensibly failed to comply and assert that such provision was the basis for its severance of the franchise relationship." *Gen. Motors Corp. v. New A.C. Chevrolet, Inc.*, 263 F.3d 296, 326-27 (3d Cir.2001).

Here, Plaintiffs did not meet their burden of proof and cannot prevail under the DDCA. This is not a situation where Nissan's termination was pretextual. It acted in good faith as demonstrated by the facts found by this Court. Plaintiffs' claim goes beyond an assertion that Nissan administered the allocation system in a manner that failed to supply Superior with high demand cars to force termination. Plaintiffs' position is that Nissan applied the sales performance standards and allocation system in a way so as to create a pretext for termination. Nissan's notice to Superior that it failed to achieve RSE was not pretextual. Nissan's demand that Superior achieve RSE was not coercive. Here, the Court rejects Plaintiffs' claim that Nissan's ulterior motive was to terminate Superior's franchise to relocate to the preferred location at Michigan and Telegraph without compensation to Superior. Again, Plaintiffs advanced no concrete evidence to support this theory.

Consequently, Nissan's insistence that Superior adhere to its franchise obligations did not constitute a wrongful, sanction-backed demand for the reasons discussed in the context of good faith relative to the state claim. In sum, the evidence at trial shows that Nissan worked with Superior to improve its sales; that Superior rejected suggestions from the DOMs regarding dealer operations; and that Nissan carefully considered reasons outside dealer operations as they were raised by Superior to justify poor performance. At all times, Nissan complied with the policies regarding market studies. Plaintiffs failed to advance sufficient evidence for the Court to hold that Nissan acted in bad faith in meeting the terms of the parties' agreement.

C. Breach of Contract

On March 10, 2003, the parties executed a standard Nissan Dealer Sales & Service Agreement, which is the operative agreement governing this dispute. Pursuant to 12B.(1)(a) of the Dealer Agreement, Nissan may terminate if Superior "fail[ed] to substantially fulfill its responsibilities with respect to ... [s]ales of new Nissan vehicles and other responsibilities." D48. The Dealer Agreement also covers what happens when a dealer materially breaches its contractual sale performance obligations. The Dealer Agreement requires Superior to demonstrate "substantial progress" during the cure period to avoid Nissan exercising the right to terminate their agreement. (D 48).

*22 Plaintiffs' claim that Nissan breached the Dealer Agreement when it terminated Superior is assessed under California law. Section 17.F of the Dealer Agreement contains a California choice of law provision. (D 48). The essential elements of a breach of contract claim are: "(1) the contract, (2) plaintiff's performance or excuse for nonperformance, (3) defendant's breach, and (4) the resulting damages to plaintiff." *Reichert v. General Ins. Co. of Am.*, 68 Cal.2d 822, 69 Cal.Rptr. 321, 442 P.2d 377, 381 (Cal.1968).

The Court concludes that Superior failed to perform its obligations under the Dealer Agreement, and the excuse for nonperformance is inadequate. Nissan held Superior to the same sales performance standard it held every other dealer. Under the RSE measurement Superior's sales performance lagged behind every other dealer. Nissan complied with its contractual obligations to Superior as set forth in the Dealer Agreement. It also considered the additional criteria, as set forth in Section 3.3D of the Dealer Agreement. Nissan's evaluation took into account the impact of local marketing

Attachment 2

Superior Pontiac Buick GMC, Inc. v. Nissan North America, Inc., Not Reported in...

conditions, general shopping habits of the public, and the availability of vehicles to the dealer. In sum, Nissan afforded Superior every opportunity to meet its obligations under the Dealer Agreement. Superior failed to do so.

For the reasons stated, the Court holds that Nissan did not violate the Michigan Dealer Act or the DDCA. Nor did Nissan breach the Dealer Agreement. Plaintiffs are not entitled to relief on any of their claims.

IT IS SO ORDERED.

IV. CONCLUSION

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Attachment 2

Before The
State Of Wisconsin
DIVISION OF HEARINGS AND APPEALS

In the Matter of Ralph Gentile, Inc., d/b/a Gentile
Nissan,

Complainant

Case No. TR-07-0001

v.

Nissan North America, Inc.,

Respondent

FINAL DECISION

Ralph Gentile, Inc., d/b/a Gentile Nissan, (Gentile Nissan) is a franchised Nissan dealer. On January 3, 2007, Nissan North America, Inc., (Nissan NA) served a termination notice on Gentile Nissan. In the termination notice Nissan NA informed Gentile Nissan that it intended to cancel Gentile Nissan's Nissan franchise. On January 11, 2007, Gentile Nissan filed with the Division of Hearings and Appeals a complaint pursuant to Wis. Stat. § 218.0114(7)(d). The complaint seeks a determination that the proposed termination violates Wis. Stat. § 218.0116(1)(i). A hearing in this matter commenced on April 14 and 15, 2008. After two days of hearing, the parties informed the administrative law judge assigned to hear this matter that they had reached a tentative settlement of the disputed issues and requested that the hearing be suspended to give them an opportunity to finalize the settlement.

The hearing was suspended at that time because of the possibility of a settlement agreement. However, the complainant never executed the settlement agreement. On July 24, 2008, Nissan NA filed a motion to enforce the settlement agreement. After an opportunity for briefing, a ruling denying the motion was issued on November 26, 2008. The hearing was then completed on February 18, 19, and 20, 2009. All five days of hearing were conducted in Madison, Wisconsin. Mark J. Kaiser, Administrative Law Judge (ALJ), presiding. After completion of the hearing, the parties filed post-hearing briefs. The respondent filed its initial brief on April 28, 2009; the complainant filed its response brief on June 17, 2009; and, the respondent filed a reply brief on July 17, 2009.

Attachment 2

Case No. TR-07-0001
Page 2

In accordance with Wis. Stat. §§ 227.47 and 227.53(1)(c), the PARTIES to this proceeding are certified as follows:

Ralph Gentile, Inc., by

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Boardman Law Firm
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Nissan North America, Inc., by

Attorney Steven J. Wells
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The ALJ issued a Proposed Decision in this matter on December 15, 2009. The respondent filed a brief in support of the Proposed Decision on December 30, 2009. The complainant filed objections to the Proposed Decision on December 30, 2009. The respondent requested an opportunity to file a response to the complainant's comments. The request was granted and the respondent filed a response to the complainant's objections on January 12, 2010. In its brief in support of the Proposed Decision, the respondent identified three mistakes in the Findings of fact. None of these mistakes are material to the determination of the relevant findings in this matter. The corrections to the findings in paragraphs number three, nine, and 26 requested by the respondent have been made in the Final Decision.

The complainant primarily objects to two findings in the Proposed Decision. One objection is to the use of sales effectiveness to judge the sales performance of Gentile Nissan. The most common standards manufacturers use to measure their dealers' sales performance are sales effectiveness and registration effectiveness. Logical reasons exist to use either of the standards. Nissan NA, like most manufacturers, has chosen to use sales effectiveness to measure the sales performance of its dealers. The complainant argues that using sales effectiveness is contrary to the terms of the Dealer Agreement because under the provisions of the Dealer Agreement, Nissan dealers are to be evaluated upon their sales performance within their PMA.

As discussed in the Proposed Decision, Nissan NA's Standard Sales and Service Agreement gives Nissan wide latitude to decide how to evaluate the sales performance of its dealers and Nissan NA made it clear to Gentile Nissan that it would be judged on a sales effectiveness standard. It should also be noted that even if registration effectiveness was used, Gentile Nissan would still not be achieving the regional average. In an effort to circumvent this fact, Gentile Nissan advocates the use of a newly created standard. Gentile Nissan argues that it should be judged on the percentage of its sales within its PMA. This standard says nothing about

Attachment 2

Case No. TR-07-0001
Page 3

the number of vehicles a dealer sells, but only looks at where the sales the dealer does make are made.

In its objections to the Proposed Decision, the complainant also renews the arguments it raised in the posthearing briefs that under the provisions of the Term Agreement, it was only obligated to use its “best efforts” to achieve regional averages, not actually achieve them. This argument is adequately addressed in the Proposed Decision and for the reasons set forth in the Proposed Decision Gentile Nissan is obligated to meet regional averages. Sales effectiveness is a reasonable standard for Nissan NA to evaluate Gentile Nissan’s sales performance and based on this standard, Gentile Nissan breached the Dealer Agreement.

Gentile Nissan’s other primary objection to the Proposed Decision is to the finding of an absence of discrimination by Nissan NA against Gentile Nissan compared to its treatment of “similarly situated” dealers. The complainant argues that the Proposed Decision does not properly address the issue of whether Nissan’s termination of Gentile Nissan’s Dealer Agreement was discriminatory. The question for this issue is what constitutes “similarly situated dealers.” As discussed in the Proposed Decision, the phrase “similarly situated dealers” is not defined in the statute. The undersigned administrator is persuaded that the respondent has satisfied its burden to show that the non-Wisconsin Nissan dealers that the complainant has identified as having lower sales effectiveness numbers than Gentile Nissan and who have not had their franchises terminated do not constitute “similarly situated dealers” for purposes of Wis. Stat. § 218.0116(1)(i)1.

The complainant also objects to findings in paragraphs number 22, 25, 27, 29, 30, and 39 as well as statements about Gentile Nissan’s advertising expenditures in paragraphs 32 through 34. The objection to paragraph 22 is that the statement “[f]or a lower volume manufacturer like Nissan, it is mathematically possible for all its dealers to be at or above 100% sales effectiveness” is not documented by any demonstration in the record. The statement in the Proposed Decision is based on the testimony of Nissan NA’s expert. However, to avoid any confusion paragraph 22 has been amended to limit the statement to Mr. Farhat’s actual testimony.

The complainant objects to a statement in paragraph 27. The complainant alleges that paragraph 27 of the Proposed Decision finds that “the ‘economies of scale’ were the same for two Rosen dealerships as for the Gentile dealerships selling different brands.” The Proposed Decision does not contain such a finding. Paragraph 27 of the Proposed Decision only finds that as part of the Gentile Automotive Group Gentile Nissan “also benefits from economies of scale” and identifies some examples of economies of scale enjoyed by Gentile Nissan. The Proposed Decision does not find that the economies of scale enjoyed by Gentile Nissan are the same as those enjoyed by the Rosen Nissan dealerships.

The complainant also objects to findings regarding Gentile Nissan’s advertising expenditures included in paragraphs 32 through 34. The complainant objects to these findings because they do not compare Gentile Nissan’s advertising expenditures per expected sale compared to other Nissan dealer’s advertising per expected sale. The primary purpose of the findings in these paragraphs is to compare Gentile Nissan’s advertising expenditures to Nissan

Attachment 2

Case No. TR-07-0001
Page 4

NA's guidelines, not to the advertising expenditures of other Nissan dealers. The remaining objections of the complainant are adequately rebutted by the respondent in its response to the complainant's objections. As demonstrated by the respondent, those findings are supported by evidence in the record. Other than the amendments listed above, the Proposed Decision is adopted as the Final Decision in this matter.

Issue to be decided

The issue to be decided is whether the respondent has cancelled the Dealer Agreement it entered into with the complainant unfairly, without due regard to the equities, and without just provocation in violation of Wis. Stat. § 218.0116(1)(i).

Applicable law

Wisconsin Stat. § 218.0116(1)(i) provides in relevant part:

1. in this paragraph:

a. "Due regard to the equities" means treatment in enforcing an agreement that is fair and equitable to a motor vehicle dealer or distributor and that is not discriminatory compared to similarly situated dealers or distributors.

b. "Just provocation" means a material breach by a motor vehicle dealer or distributor, due to matters within the dealer's or distributor's control, of a reasonable and necessary provision of an agreement and the breach is not cured within a reasonable time after written notice of the breach has been received from the manufacturer, importer or distributor.

2. Subject to s. 218.0132, being a manufacturer, importer or distributor who has unfairly, without due regard to the equities or without just provocation, directly or indirectly canceled or failed to renew the franchise of any motor vehicle dealer; or being a manufacturer or importer, who has unfairly, without due regard to the equities or without just provocation, directly or indirectly canceled or failed to renew the franchise of any distributor.

Findings of Fact

The administrator finds:

1. Ralph Gentile, Inc., d/b/a Gentile Nissan (Gentile Nissan or the complainant) is a motor vehicle dealer licensed by the Wisconsin Department of Transportation (WisDOT). Gentile Nissan holds a franchise from Nissan North America, Inc., (Nissan NA or the

Attachment 2

Case No. TR-07-0001
Page 5

respondent) granting Gentile Nissan the right to buy, sell, and service Nissan automobiles and light duty trucks.

2. Nissan NA is a California corporation with principal offices located in Nashville, Tennessee. Nissan NA is licensed by WisDOT to engage in business as a motor vehicle manufacturer or distributor in Wisconsin. Nissan NA distributes Nissan automobiles and light duty trucks and parts through a network of dealers in the United States.

3. Gentile Nissan is part of the Gentile Automotive Group. The Gentile Automotive Group operates franchises for various motor vehicle manufacturers. The franchises Gentile Automotive Group currently operates in addition to Nissan include Honda, Toyota, Scion, Subaru, and Hyundai. The principal for the Gentile Automotive Group is Ralph Gentile. Frank Gentile, Inc., was the corporate entity that operated Gentile Nissan until the summer of 2006. At that time Ralph Gentile, Inc., was formed and ownership of Gentile Nissan and Gentile Hyundai was transferred to it. Ralph Gentile also remains the owner of Frank Gentile, Inc.

4. The Gentile Automotive Group purchased the Nissan franchise from Kenosha Nissan for \$800,000 in July of 2002. The dealership facilities of Kenosha Nissan had been located at the intersection of Interstate 94 and State Highway 50 in Kenosha. After purchasing the franchise, the Gentile Automotive Group relocated the dealership facilities to Racine. The Gentile Automotive Group consolidated the Nissan franchise with its other automotive franchises at facilities located at 6802 Washington Avenue in Racine. At that time the Gentile Automotive Group operated Honda, Toyota, Subaru, Oldsmobile, and GMC franchises from that location. Nissan NA approved both the acquisition of the Nissan franchise by the Gentile Automotive Group and the relocation of the dealership facilities to Racine.

5. Nissan NA assigns a primary market area (PMA) to each of its dealers. A PMA is designated as a set of census tracts. Gentile Nissan's PMA is primarily Racine and Kenosha Counties (exh. 11). This is essentially the same PMA that had been assigned to Kenosha Nissan.

6. Gentile Nissan is geographically located in what Nissan NA has delineated as District 4 in the North Central Region. The North Central Region consists of the part of the United States bordered on the east by the Ohio/Pennsylvania border, Kentucky on the south, on the west to parts of Missouri, Iowa, and South and North Dakota, and the Canadian border on the north (testimony of Scott Compton Tr. p. 45). The headquarters for Nissan NA, North Central Region is located in the western suburbs of Chicago. District 4 primarily consists of the Nissan dealers in Wisconsin.

7. On July 24, 2002, Gentile Nissan and Nissan NA executed a term agreement authorizing Frank Gentile, Inc., to operate a Nissan franchise (exh. 204). A term agreement differs from the standard agreement that Nissan NA enters into with its dealers (the standard dealer agreement is referred to as a Nissan Sales and Service Agreement, see exh. 277) in that it has an expiration date. A term agreement also typically includes conditions that the dealer must meet before it will be offered the standard Nissan Sales and Service Agreement (SSA). For purposes of this decision the various term agreements executed by Gentile Nissan and Nissan

Attachment 2

Case No. TR-07-0001
Page 6

NA and the incorporated terms from the SSA will be referred to as the "Dealer Agreement." The initial term agreement executed by Gentile Nissan expired on January 1, 2005.

8. Article Twelfth of the Term Agreement sets forth the conditions which Gentile Nissan must meet before Nissan NA would offer Gentile Nissan a SSA. The initial term agreement also included an Exhibit "A" which amended Article Twelfth paragraph (d). Exhibit "A" provided that Gentile Nissan could operate the Nissan franchise from its dealership facilities at 6801 Washington Avenue along with its Honda, Toyota, Subaru, GMC, and Oldsmobile franchises until December 1, 2004. Exhibit "A" also included a timetable by which Gentile Nissan agreed to construct a stand alone facility for its Nissan franchise. The deadline for the completion of the stand alone facility was December 1, 2004.

9. Gentile Nissan purchased property at 9501 Washington Avenue in Racine for the construction of a stand alone Nissan facility. The property is approximately two miles from the Gentile Automotive Group's other dealership facilities. The design of the dealership facility constructed by Gentile Nissan is one developed by Nissan NA and is referred to as a National Retail Environmental Initiative (NREDI) facility. The Gentile Automotive Group also constructed a standalone Hyundai facility adjacent to the NREDI facility at 9503 Washington Avenue in Racine. Gentile Nissan Properties, LLC, which is not a subsidiary of Gentile Nissan, invested approximately \$3,000,000 for the land and construction of the NREDI facility and the adjoining Hyundai dealership facility. The NREDI facility was completed in November of 2004 and Gentile Nissan moved the Nissan franchise into the NREDI facility in January of 2005. Nissan NA contributed \$500,000 toward the cost of Gentile Nissan's NREDI facility.

10. Effective April 1, 2004, Nissan NA and Gentile Nissan executed Amendment No. 1 to the Term Agreement (exh. 217). Amendment No. 1 to the Term Agreement extended the expiration of the term agreement to January 1, 2005. The reason for the extension was to give Gentile Nissan additional time to complete construction of the NREDI facility.

11. Effective June 24, 2005, Nissan NA and Gentile Nissan executed Amendment No. 2 to the Term Agreement (exh. 244). In this amendment, the expiration of the term agreement was extended to July 1, 2006. The reason for this extension is that Nissan NA was unwilling to enter into a standard SSA with Gentile Nissan because of its unsatisfactory sales performance. The amended term agreement extended the expiration of the term agreement to give Gentile Nissan additional time to "cure [its] substandard performance." (exh. 237) Exhibit A of Amendment No. 2 to the Term Agreement contains two performance standards Gentile Nissan must meet, a sales performance standard and a customer satisfaction index performance standard.

12. The sales performance standard in Article Twelfth of Amendment No. 2 to the Term Agreement provides that Gentile Nissan "agrees that it will use its best efforts to meet or exceed the North Central Region average sales penetration for the Nissan total competitive car and truck segment on or before July 1, 2006 based on data available at that time and at all times thereafter." The customer satisfaction index performance standard provides that Gentile Nissan "agrees to use its best efforts to achieve regional average NSI and NPI levels on or before July 1, 2006 and on an ongoing basis."

Attachment 2

Case No. TR-07-0001
Page 7

13. The “best effort” standards used in Article Twelfth of Amendment No. 2 to the Term Agreement were proposed by Ralph Gentile. The language originally drafted by Nissan NA for the performance standards required Gentile Nissan to meet or exceed regional averages for sales penetration and customer satisfaction scores. After some negotiation, Nissan NA accepted Ralph Gentile’s language. However, in the letter accepting the language, Peter DiPersia, Nissan NA’s Assistant Regional Manager, indicated that “Nissan’s decision to use [Gentile’s] proposed language in no way waives its rights to pursue any remedies or actions as set forth by the Nissan Dealer Sales and Service Agreement. . . . Gentile Nissan’s continued inability to improve its sales penetration could lead to a breach of the Agreement and would then be subject to all subsequent procedures.” (exh. 114)

14. Article Second, paragraph (b) of the various Term Agreements entered into between Gentile Nissan and Nissan NA provides that it is the Dealer’s responsibility to “actively and effectively promot[e] the sale at retail of Nissan Vehicles within Dealer’s Primary Market Area in accordance with Section 3 of the Standard Provisions.” Nissan NA interprets Section 3 of the Standard Provisions to require Gentile Nissan to sell the number of new vehicles that would be required to meet the regional average for Nissan’s sale penetration based on the number of competitive registrations in its PMA. This standard is referred to as regional sales effectiveness and is a common performance standard in the motor vehicle retail industry.

15. A dealer’s sales effectiveness is calculated by multiplying the market share a particular line-make achieves in a geographical area by the total number of new vehicles registered in that dealer’s assigned market area. This calculation produces a number that equals the expected sales the dealer should achieve. The dealer’s actual sales are then compared to the expected sales and the result is expressed as a percentage. A dealer that is selling the number of vehicles it is expected to sell is considered 100% sales effective. A dealer that is selling more new vehicles than expected is more than 100% sales effective and one selling fewer vehicles than expected is considered not sales effective.

16. On June 26, 2006, Gentile Nissan and Nissan NA executed another Term Agreement (exh. 275). The expiration of this Term Agreement remained July 1, 2006. The purpose of this new term agreement was to recognize the change in corporate ownership from Frank Gentile, Inc., to Ralph Gentile, Inc. In all other respects, this Term Agreement was identical to Amendment No. 2 to the Term Agreement.

17. In the three years preceding the sale of its Nissan franchise to Gentile Nissan, Kenosha Nissan’s sales and the respective sales effectiveness percentages were:

Year	Sales	Sales effectiveness
1999	286	79.4
2000	321	81.7
2001	426	110.6

(exh. 73, R-10)

Attachment 2

Case No. TR-07-0001
Page 8

In summary, in the last three years that it was a Nissan dealer, Kenosha Nissan's sales were increasing and it achieved sales effectiveness in the final year.

18. In 2003, Gentile Nissan's first full year of operation as a Nissan dealership, the number of sales it was expected to make to achieve the regional average was 410. The number of vehicles it actually sold was 273. This calculates to 58.3% sales effectiveness.

19. Nissan's sales penetration ratios for the North Central region and District 4 were:

Year	North Central Regional Average	District 4 Average
2003	3.1%	2.6%
2004	4.0%	4.1%
2005	4.5%	4.6%
2006	4.4%	4.8%
June 2007 CYTD	5.0%	4.8%

(exh. 72, A-12)

20. Gentile Nissan's expected sales at the regional average, actual sales, and sales effectiveness for the time period 2003 – 2007 are:

Year	expected sales	actual sales	sales effectiveness
2003	410	239	58.3%
2004	493	271	54.5%
2005	523	273	52.2%
2006	447	213	47.6%
2007	506	206	40.7%

These figures demonstrate that Gentile Nissan was not sales effective during any year that it has been a Nissan dealer. Additionally, after peaking in 2005, Gentile Nissan's Nissan sales declined in 2006 and 2007. Nissan NA repeatedly warned Gentile Nissan both in writing and orally that its sales performance was unacceptable. (See for example, exhs. 20, 28, 32, 38, and 106).

21. By letter dated June 30, 2006, Nissan NA issued a Notice of Default to Gentile Nissan (exh. 52). The Notice of Default alleged that the Gentile Nissan breached Sections 3 and 5 of the Standard Provisions of the Dealer Agreement by failing to achieve regional averages for sales penetration and to meet or exceed average CSI scores for the region. Nissan NA gave Gentile Nissan 180 days to cure the breach.

22. The industry considers a dealer that is 100% sales effective to be an average dealer. Nissan NA expects all its dealers to achieve sales effectiveness at the regional market penetration. For Nissan dealers particularly, this is a conservative standard because Nissan NA does not assign all territory to a dealer. A dealer's expected sales are calculated by the number of new vehicle registrations in its PMA; however, all its sales, including those made in

Attachment 2

Case No. TR-07-0001
Page 9

unassigned territory, are counted in determining whether the dealer is sales effective. In 2006 for example, the average sales effectiveness of Nissan dealers in the North Central Region was 117.9% and 69.6% of the Nissan dealers in the region exceeded the region average (testimony of Sharif Farhat, Tr. p. 703).

23. While Gentile Nissan's sales of Nissan vehicles were declining, Nissan sales nationally, in the North Central region and in Wisconsin were increasing. During the time period from 2003 until 2006, Gentile Nissan's Nissan sales decreased by 10.9% (239 vehicles to 213 vehicles). During that same time period Nissan's sales nationally, in the North Central Region, and in Wisconsin increased by 31.5%, 17.3%, and 49.5% respectively (exh. 73, R-11.1). It should also be noted that the local economy in southeastern Wisconsin is not a factor in evaluating Gentile Nissan's sales performance because Gentile Nissan's expected sales was calculated as a percentage of total sales in the Gentile Nissan's PMA. In other words, Gentile is only expected to get Nissan's average share of sales in the PMA. If for some reason new vehicle sales were depressed in southeastern Wisconsin, Gentile Nissan's expected sales would be reduced proportionately.

24. Gentile Nissan offered several reasons that it claims explains its poor sales. These reasons include the fact that the Racine PMA has bimodal population centers (the cities of Racine and Kenosha), is located between two high volume Nissan dealers, Rosen in South Milwaukee and Rosen in northern Illinois, the commuting nature of Racine and Kenosha residents, and the existence of a Chrysler engine plant in Kenosha.

25. Gentile Nissan's expert, Professor John Matthews, presented data and articles establishing the existence of the factors he claimed were extenuating circumstances that prevented Gentile Nissan from achieving sales effectiveness. However, he did not conduct any study or analysis demonstrating that any of the factors actually had any effect on Gentile Nissan's Nissan sales. Although one cannot summarily dismiss the factors Gentile Nissan claims are extenuating circumstances, with one exception Kenosha Nissan faced all the same circumstances and was able to achieve sales effectiveness in its final year of operation. These factors would also not explain the decline in Gentile Nissan's Nissan sales over time. Additionally, Gentile Nissan was successful selling Hyundai from essentially the same location as its Nissan dealership and under the same conditions.¹

26. The one factor that did change after Gentile Nissan purchased the Nissan franchise from Kenosha Nissan was the level of competition Gentile Nissan faced from two Nissan dealerships owned by Saul Rosen. Rosen is the Nissan dealer in South Milwaukee, which is the closest Nissan dealer to the north of Gentile Nissan. In 2004, Rosen constructed an NREDI facility in South Milwaukee and substantially increased its Nissan advertising around the same time (testimony of Scott Compton). In 2005, Rosen acquired the Nissan dealership in northern Illinois and relocated it from Waukegan to Gurnee, Illinois. Gurnee, Illinois is closer to

¹ Gentile Nissan's problem selling Nissans has nothing to do with the Nissan brand. As noted above, Nissan's sales overall were increasing during the time period that Gentile Nissan's sales were declining. Also, in 2005 and 2007, Nissan was registration effective in Racine County (exhs 73, R-10 and 325).

Attachment 2

Case No. TR-07-0001
Page 10

Gentile Nissan than was the dealership in Waukegan. These changes likely increased the level of intrabrand competition Gentile Nissan faced.

27. The complainant argues that because of the volume of Nissans the two Rosen dealerships sell, they enjoy some economies of scale. However, Gentile Nissan is part of the Gentile Automotive Group and as such also benefits from economies of scale. For example, all the dealerships in the Gentile Automotive Group have the same executive manager, most of the expense of advertising used vehicles is borne by the Toyota, Honda, and Subaru franchises, and, although they have separate facilities, Gentile Nissan and Gentile Hyundai are constructed on the same parcel.

28. Gentile Nissan also alleges that Nissan NA has assigned it an improperly drawn PMA. Specifically, Gentile Nissan alleges that its PMA should be only the census tracts it is currently assigned in Racine County. The impact of reducing the size of the PMA would be that Gentile Nissan's expected sales would be fewer. If one assumes that Gentile Nissan would sell the same number of vehicles if its PMA was reduced to just Racine County, it would have been sales effective in 2006 (Matthews preliminary report, exh. 320, p. 3).² The number of its expected sales would have been reduced to 210. Gentile Nissan's 2006 sales were 213.

28. Nissan NA's sets forth numerous reasons that it alleges are the cause of Gentile Nissan's poor sales performance. These reasons include the lack of a dedicated sales staff, inadequate advertising, and no dedicated executive manager.

29 Although the Gentile Automotive Group hired sales people for each of its dealerships, the sales staffs for Gentile Nissan and Gentile Hyundai were cross trained to sell both Nissans and Hyundais. Because of bonuses for selling Hyundais, the sales people had greater incentives to sell Hyundais than Nissans. At two or three unscheduled visits by Nissan NA's District Operations Manager for District 4, Scott Compton, no sales representatives were present at the Gentile Nissan's dealership facilities (testimony of Scott Compton).

30 Nissan NA required Gentile to have a dedicated executive manager for the Nissan dealership. Gentile repeatedly nominated Juanita Malkemes to be the executive manager for Nissan dealership. Ms. Malkemes may be qualified to be an executive manager, but she would not have been dedicated to Nissan. Ms. Malkemes is also the executive manager for Gentile Automotive Group other dealerships and her main office would have been at Gentile's dealership facilities at 6801 Washington Avenue facilities. Nissan required a dedicated executive manager for Gentile Nissan for most of the time that Gentile has been a Nissan dealer. This requirement was deleted from Amendment No. 2 to the term agreement.

31. Gentile Nissan frequently replaced the sales managers for its Nissan dealership. This was done in an effort to improve the performance of the dealership. Several of the sales managers were recommended by various DOMs. No explanation was offered for Gentile

² The assumption that Gentile Nissan's sales would remain the same if its PMA was reduced is not necessarily realistic because if Kenosha County was unassigned, it is likely that Nissan would appoint a new dealer in that area adding more intrabrand competition to the market.

Attachment 2

Case No. TR-07-0001
Page 11

Nissan's inability to find and retain a qualified sales manager; however, the revolving door for sales managers likely was part of the reason for Gentile Nissan's poor sales performance.

32. Nissan NA sets guidelines for the amount a dealer is expected to spend on advertising. The amount a dealer is expected to spend on advertising is a function of the dealers planning volume (expected sales). The amount spent on advertising for Nissan by Gentile Nissan is difficult to calculate because the Gentile Automotive Group prepares a combined financial statement for its Nissan and Hyundai franchises. However, even accepting Gentile Nissan's testimony regarding how much it spends on advertising, its spending is still below what guidelines indicate it should have spent to achieve the number of sales it was expected to achieve.

33. In 2005, Gentile Nissan spent \$353,839 on advertising for Nissan and Hyundai (exh. 140). Gentile Nissan's witnesses claimed the amount for advertising shown on the combined financial statement was all spent on new vehicle advertising (the witnesses testified that all the used vehicle advertising was paid for by the Toyota, Honda, and Subaru dealerships) and that it was equally divided between Nissan and Hyundai.³ This breaks down to \$661 per new vehicle retailed (PNVR) (exh. 45). Nissan NA's goal for Gentile Nissan advertising was \$400 PNVR (exh. 22). In 2006, Gentile spent \$250,181 on advertising for Hyundai and Nissan. This breaks down to \$497.40 PNVR (Tr. at 217).⁴ Although the amount Gentile Nissan spent on advertising PNVR exceeds Nissan NA's goals, its total advertising for Nissan falls short of Nissan NA's goal for Gentile Nissan. For 2005, Nissan NA's goal for Gentile Nissan's advertising was \$19,560 per month (exh. 22) and the amount Gentile Nissan spent was \$15,071. It is also noteworthy that using the figures provided by Gentile Nissan, Gentile Nissan did not meet its own internal goals for Nissan advertising.

34. The reason Gentile Nissan was above Nissan NA's goal on a PNVR basis but below the goal on a total basis is because the total is computed based on the expected sales for Gentile Nissan. Since Gentile Nissan's sales in 2005 were 314 vehicles below its expected sales (587 expected sales less 273 actual sales), its PNVR amount spent on advertising exceeded Nissan NA's goal. If Gentile Nissan had been attempting to sell the number of vehicles it was

³ Nissan NA accepted Gentile Nissan's assertion that the amount spent on advertising listed on the combined financial statements was split fifty-fifty between Hyundai advertising and Nissan advertising. However, this claim is suspect because the one instance that advertising is broken down by franchise, annual television advertising for the years 2005, 2006, and 2007, the amount spent on Nissan was substantially less than the amount spent on Hyundai or Subaru (testimony of Sharif Farhat and exh. 141). In its initial posthearing brief, the respondent recalculated the complainant's advertising expenditures on Nissan for 2005 and 2006 based on statements made by Ralph Gentile and Juanita Malkemes at the hearing. According to these recalculations, Gentile Nissan may have spent significantly less PNVR on Nissan advertising than it had reported to Nissan NA. For purposes of this decision, the figures that Nissan NA had when it made its decision to terminate Gentile Nissan's Dealer Agreement will be used.

⁴ The annual total for advertising was taken from exhibit 140, which is a summary of the advertising amounts listed in document identified as Hyundai-Nissan Gross Profit Summaries from 2005-2007 (exh. 92) prepared by Sharif Farhat, Nissan NA's expert witness, from exhibits 80, 81, and 92. Exhibits 80 and 81 are financial statements for Gentile Nissan and Gentile Hyundai. Exhibit 92 is Gentile's Hyundai-Nissan gross profits summaries for the time period from 2005 to 2007. The PNVR figures are taken from other exhibits which do not use the same figures for annual advertising. The PNVR figures are those used by the complainant in its post hearing brief and presumably are the most favorable to Gentile Nissan.

Attachment 2

Case No. TR-07-0001
Page 12

expected to sell, the amount it spent on advertising in 2005 and 2006 was inadequate. Advertising is only one component of actively and effectively promoting the sale of Nissan vehicles; however, there is evidence in the record of the direct effect of advertising on sales. Gentile Nissan reduced the amount it spent on advertising from 2005 to 2006. Its new Nissan sales decreased from 273 to 213 during the same time period.

35. After receiving the notice of default on June 30, 2006, Gentile's Nissan's sales numbers continued to be significantly lower than what it needed to sell to achieve the regional average. On January 3, 2007, Nissan NA issued a Notice of Termination to Gentile NA (exh: 62). The reasons stated for the termination were Gentile Nissan's failure to actively and effectively promote the sale of Nissan vehicles in violation of Section 3 of the Term Agreement and the failure to consistently perform at or above the regional average with respect to customer satisfaction as measured by surveys. During the cure period, Gentile Nissan's sales effectiveness declined further. So, not only did Gentile Nissan not cure the breach, its performance worsened.

36. Nissan NA also alleged that Gentile Nissan breached the Dealer Agreement by not achieving regional average on its customer satisfaction scores. Nissan NA surveys customers and calculates two customer satisfaction scores. One score attempts to measure customer satisfaction with the buying experience and is referred to as the Nissan Purchase Index (NPI). Gentile Nissan's NPI scores and the regional averages for the time period from 2003 to 2006 are:

	2003	2004	2005	2006
Gentile	77.1	81.9	88.2	90.1
Regional Average	84.1	87.4	92.6	92.3

(exhs. 52, 302)

Although Gentile Nissan's NPI score never reached or exceeded the regional average score, it has improved steadily during the time period Gentile Nissan has been a Nissan dealer and it was only slightly below the region average in 2006.

37. The other customer satisfaction calculated by Nissan NA measures customer's satisfaction with the experience of having their Nissan vehicle serviced by the dealer. This score is referred to as the Nissan Service Index (NSI). Gentile Nissan's NSI scores and the regional averages for the time period from 2003 to 2006 are:

	2003	2004	2005	2006
Gentile	72	76.2	91.5	87.4
Region	76.5	79.7	88.9	89.2

(exhs. 52, 302)

Gentile Nissan's NSI scores do not appear to be significantly below Nissan's regional average and exceeded the regional average in 2005.

Attachment 2

Case No. FR-07-0001
Page 13

38. At the hearing, the respondent presented some customer survey results referred to as “dashboard surveys” (exh. 68). The dashboard surveys indicate a more negative impression of the Gentile Nissan franchise by consumers. Nissan NA started using this survey in July 2007. The dashboard surveys seek different information than that used to compute the NPI and NSI scores, so the results of the dashboard survey can not be directly compared to those scores. Additionally, even if the dashboard surveys could be used to evaluate customer satisfaction, these surveys were not conducted until after the Notice of Termination was issued.

39. In 2006, the year ending prior to the issuance of the Notice of Termination, Gentile Nissan ranked last out of seventeen Nissan dealers in Wisconsin. It also ranked 164 out of 184 Nissan dealers in the North Central region (exh 70, at A-32). Not only was Gentile Nissan not achieving sales effectiveness at the regional average, its sales in terms of numbers and sales effectiveness were declining at the time the Notice of Termination was issued. Although Nissan NA terminated Gentile Nissan’s franchise after it had been in operation for only five full years, the termination was reasonable because Gentile Nissan’s sales performance was declining for no apparent reason other than the Dealer’s lack of effort. It was reasonable for Nissan NA to terminate Gentile Nissan’s franchise before the situation deteriorated any further. Nissan NA’s decision to terminate Gentile Nissan’s Dealer Agreement was fair and equitable.

40. The phrase “similarly situated dealers” is not defined in the statute. At a minimum, other Wisconsin single point Nissan dealers should be considered dealers similarly situated to Gentile Nissan. With respect to other Wisconsin dealers, Gentile Nissan is the lowest performing Nissan dealer in terms of sales performance. Nissan NA’s termination of Gentile Nissan’s franchise is not discriminatory compared to its treatment of other Wisconsin Nissan dealers. Since Gentile Nissan’s sales performance is compared to the average of Nissan dealers in the North central region, one could argue that all Nissan dealers in the North Central region could be considered similarly situated. However, there are too many variables such as market conditions and state regulations to compare Nissan NA’s treatment of Gentile Nissan with respect to all the Nissan dealers in the North Central region. Nissan NA’s termination of Gentile Nissan’s franchise is not discriminatory with respect to other similarly situated dealers.

Discussion

Nissan NA issued a Notice of Termination notifying Gentile Nissan that it was terminating its Nissan franchise based on Gentile Nissan’s failure to meet performance standards with respect to new vehicle sales and customer satisfaction. There is no dispute that Gentile Nissan has not been achieving sales effectiveness based on the regional average for Nissan dealers and competitive registrations in Gentile Nissan’s assigned PMA. The issue is whether this failure constitutes sufficient grounds to allow Nissan NA to terminate Gentile Nissan’s Dealer Agreement. In order to terminate Gentile Nissan’s franchise, Nissan NA must show the termination was fair, with just provocation, and with due regard to the equities (Wis. Stat. § 218.0114(7)(d)).

To determine whether the termination is “with just provocation” the first question is whether Gentile Nissan’s failure to achieve regional sales effectiveness constitutes a material

Attachment 2

Case No. TR-07-0001
Page 14

breach of the Dealer Agreement. The first step in answering this question is to determine what the Dealer Agreement requires. Article Second, paragraph (b) of the various Term Agreements entered into between Gentile Nissan and Nissan NA provides that it is the Dealer's responsibility to "actively and effectively promot[e] the sale at retail of Nissan Vehicles within Dealer's Primary Market Area in accordance with Section 3 of the Standard Provisions." The relevant provisions of Section 3 of the Nissan SSA provide:

A. General Obligations of Dealer:

Dealer shall actively and effectively promote through its own advertising and sales promotion activities the sale at retail (and if Dealer elects, the leasing and rental) of Nissan Vehicles to customers located within Dealer's Primary Market Area. . . .

B. Sales of Nissan Cars and Nissan Trucks.

Dealer's performance of its sales responsibility for Nissan Cars and Nissan Trucks will be evaluated by Seller on the basis of such reasonable criteria as Seller may develop from time to time, including for example:

1. Achievement of reasonable sales objectives which may be established from time to time by Seller for Dealer as standards for performance;
2. Dealer's sales of Nissan Cars and Nissan Trucks in Dealer's Primary Market Area and/or the metropolitan area in which Dealer is located, as applicable, or Dealer's sales as a percentage of:
 - (i) registrations of Nissan Cars and Nissan Trucks;
 - (ii) registrations of Competitive Vehicles;
 - (iii) registrations of Industry Cars;
 - (iv) registrations of vehicles in the Competitive Truck Segment;
3. A comparison of Dealer's sales and/or registrations to sales and/or registrations of all other Authorized Nissan Dealers combined in Seller's Sales Region and District in which Dealer is located and, where Section 3.C applies, for all other Authorized Nissan Dealers combined in the metropolitan area in which Dealer is located; and
4. A comparison of sales and/or registrations achieved by Dealer to the sales or registrations of Dealer's competitors.

The sales and registration data referred to in this Section 3 shall be those utilized in Seller's records or in reports furnished to Seller by independent sources

Attachment 2

Case No. TR-07-0001
Page 15

selected by it and generally available for such purpose in the automotive industry. If such reports of registration and/or sales are not generally available, Seller may rely on such other registration and/or sales data as can be reasonably obtained by Seller.

Nissan NA asserts that the second part of section 3.B.2 refers to the sales effectiveness performance standard generally used in the motor vehicle sales industry. The quoted language can certainly be interpreted in that manner. Additionally, to the extent that Gentile Nissan could legitimately claim that the language in the SSA is ambiguous, it should be noted that the section 3.B states that Nissan NA will evaluate its dealers "on the basis of such reasonable criteria as Seller may develop from time to time." The listed sales performance standards are only intended to be examples of criteria that Nissan NA may use. Nissan NA made it abundantly clear to Gentile Nissan in a number of documents that it was evaluating its sales performance based on sales effectiveness.

Sales effectiveness is calculated by multiplying the total number of new vehicle registrations in a dealer's PMA by the manufacture's market penetration in a chosen area (e.g. region average, national average, or state average) to determine a dealer's expected sales. The dealer's actual sales (regardless of where the vehicle is registered) are compared to its expected sales. Expected sales are calculated as if all a dealer's sales were to residents of the dealer's PMA, but actual sales are counted regardless of where the vehicle is registered.

The complainant argues that the standard Gentile Nissan's sales performance should be judged by is registration effectiveness, not sales effectiveness. Registration effectiveness measures the market penetration of Nissan automobiles and trucks in the respective dealer's PMA. The manufacturer looks at how well its products are selling in that territory to evaluate the dealer's sales performance. The manufacturer gives a dealer credit for retail registrations in the dealer's assigned territory, regardless of which dealer sold a particular vehicle. The use of retail registration effectiveness has a certain logical appeal in that it attempts to measure how well a dealer is representing the brand. Arguably, comparing Nissan's regional sales penetration with Gentile Nissan's total sales is an apple to oranges comparison. However, doing so is actually a conservative standard for judging Gentile Nissan's sales performance because Nissan is giving Gentile Nissan credit for all it sales, not just those within its PMA. Because substantial areas are unassigned, all Nissan dealers theoretically could have sales effectiveness in excess of the regional average.⁵

⁵ Nissan registrations for the Racine PMA were also below the regional average. Therefore, Gentile Nissan did not achieve registration effectiveness either. However, registration effectiveness for the Racine PMA is not as far below regional average as Gentile Nissan's sales effectiveness. In 2005 and 2007, the Nissan registrations in Racine County (a portion of the Racine PMA) exceeded the expected sales at regional average. This is the only incident during the time period that Gentile Nissan was a Nissan dealer that actual sales exceeded expected sales and it is only achieved by splitting the PMA in half. Additionally, it should be noted that the Nissan registrations in Racine County in 2007 (288) exceeded Gentile Nissan's total sales of new Nissans (206). Therefore, it is Nissan dealers other than Gentile Nissan that are responsible for the fact that Nissan was registration effective in Racine County in 2007.

Attachment 2

Case No. TR-07-0001
Page 16

Based on the language in the SSA, the appropriate performance standard is sales effectiveness. The next step is to determine whether the Dealer Agreement requires Gentile Nissan to achieve the regional average or merely use its best efforts to achieve it. Gentile Nissan cites Exhibit "A" of Article Twelfth of Amendment No. 2 of the Term Agreement which provides that Gentile is required to "use its best efforts to meet or exceed the North Central Region average sales penetration for the Nissan total competitive car and truck segments on or before July 1, 2006 based on data available at that time and at all times thereafter." (emphasis in original) Article Twelfth of the term agreement sets forth conditions that Gentile Nissan must meet in order to be offered a standard Nissan SSA.

The term agreement does not specify the consequences if Gentile does not meet the conditions. Arguably, if Gentile Nissan failed to use its best efforts, the term agreement would simply expire and its Nissan franchise would terminate. However, Wisconsin law gives motor vehicle dealers added protections. Nissan must still show a breach of the Dealer Agreement before it can involuntarily terminate Gentile Nissan's Nissan franchise. Gentile Nissan's responsibility under the Dealer Agreement is that it must actively and effectively promote Nissan products. Gentile Nissan has breached this provision of the Dealer Agreement. However, both the Dealer Agreement and the applicable Wisconsin Statute require consideration of any extenuating circumstances which may prevent a dealer from achieving sales effectiveness. Specifically, the relevant section of the dealer Agreement is Section 3, Paragraph "D" of the SSA. This paragraph provides:

D. Additional Factors for Consideration.

Where appropriate in evaluating Dealer's sales performance, Seller will take into account such reasonable criteria as Seller may determine from time to time, including, for example, the following: the Dealership Location; the general shopping habits of the public in such market area; the availability of Nissan Vehicles to Dealer and to other Authorized Nissan Dealers; any special local marketing conditions that would affect Dealer's sales performance differently from the sales performance of other Authorized Nissan Dealers; the recent and long term trends in Dealer's sales performance; the manner in which Dealer has conducted its sales operations (including advertising, sales promotion, and treatment of customers); and the other factors; if any, directly affecting Dealer's sales opportunities and performance.

Similarly, the definition for "just provocation" found at Wis. Stat. § 218.0116(1)(i)1.b provides that the breach must be "due to matters within the dealer's . . . control." The final step in deciding whether just provocation for the termination exists is to determine whether Gentile Nissan's failure to achieve regional sales effectiveness was due to extenuating circumstances beyond its control.

Gentile Nissan's expert identified several factors that he alleges have made it difficult for Gentile Nissan to achieve regional sales effectiveness. These factors include the bi-modal population distribution of the Racine PMA, the commuting patterns of the population of the Racine PMA, the existence of a large Chrysler engine plant in Kenosha, and the existence of the

Attachment 2

Case No. TR-07-0001
Page 17

two Rosen Nissan dealerships on either side of the Racine PMA. The effect of these factors was addressed in detail by Nissan NA's expert in his rebuttal report. For the most part, Nissan NA successfully refuted the factors that Gentile Nissan alleged were the cause of its poor sales performance. It is also important to note that, with one exception, all the extenuating circumstances alleged by Gentile Nissan were faced by Kenosha Nissan and have existed throughout the period that Gentile has operated a Nissan dealership.

Kenosha Nissan, although only sales effective its last full year of operating a Nissan dealership, had steadily improving sales numbers. Gentile Nissan's argument that its poor sales performance was caused by extenuating circumstances is also undermined by the fact that its sales numbers have been declining at a time that Nissan's sales, as a brand, have been growing. It is possible that some of these factors identified by Professor Matthews may make selling Nissans in the Racine PMA more difficult than other in other PMAs in Nissan's North Central region. However, Gentile Nissan's annual sales have never reached the number that Kenosha Nissan was achieving and have declined since 2005. Even if the factors that Gentile Nissan alleges make the Racine PMA a more difficult market to sell Nissans in were legitimate considerations, they do not explain why Gentile Nissan's sales would be declining during a period that Nissan's sales were increasing.

Nissan has asserted different reasons for Gentile Nissan's failure to achieve sales effectiveness. The primary reasons Nissan asserts include inadequate advertising, lack of a dedicated sales staff, a revolving door for sales managers, and a lack of a dedicated executive manager. The lack of a dedicated sales staff, a revolving door for sales managers, and a lack of a dedicated executive manager all contribute to an apparent lack of focus on Nissan by the complainant. These factors, however, are hard to quantify. Additionally, the inability of Gentile Nissan to retain a sales manager may be outside of its control. The remaining reason cited by Nissan NA is inadequate advertising.

Because of the use of combined financial statements one cannot determine how much Gentile Nissan actually spent on advertising for Nissan. If one accepts the testimony of Gentile Nissan's witnesses related to advertising, Gentile Nissan's advertising PNVR was at or slightly above the amount recommended by NADA and Nissan. However, this means that Gentile Nissan was only attempting to sell approximately the number of vehicles it actually sold, not the number it needed to sell to achieve the regional average. Even accepting Gentile Nissan numbers for advertising, Gentile Nissan was not spending the amount it was required to spend to effectively promote Nissan products.

In its posthearing brief, the complainant argues that motor vehicle dealers typically adjust their variable expenses, such as advertising, on the basis of past sales and that this is prudent business behavior. This may be rational behavior, but at a time that Gentile Nissan knew its sales performance was unsatisfactory, it does not make sense for it to adjust its advertising based on the unsatisfactory sales level. If in fact Gentile Nissan was adjusting its advertising expenditures in this manner, it means that it was content with its present levels of sales. Gentile Nissan knew that that level of sales was unacceptable to Nissan NA based on the numerous warning letters issued by Nissan and eventually by the Notice of Default.

Attachment 2

Case No. TR-07-0001
Page 18

The bottom line with respect to Gentile Nissan's sales performance is that there is no credible reason for Gentile Nissan's declining sales during a time period when Nissan as a brand had increasing sales. Nissan NA has shown that Gentile Nissan has breached the Dealer Agreement by not effectively promoting Nissan products. Gentile has suggested assorted circumstances beyond its control that have prevented it from achieving sales effectiveness. None of these extenuating circumstances explain the decline in sales. Additionally, with respect to the competition with the Rosen dealerships, the one area, if any, that Gentile Nissan should dominate is the area immediately surrounding its dealership. Gentile Nissan did not capture the majority of Nissan registrations in that area.

The other allegation in the Notice of Termination is that Gentile Nissan has failed to achieve the regional average in two measures of customer satisfaction. Customer satisfaction is an important consideration and it is reasonable for Nissan to require its dealers to achieve minimum customer satisfaction scores. Gentile Nissan only achieved the required minimum customer satisfaction score (regional average) once in a four year period. However, its scores the other years were not significantly below the regional average and do not constitute a material breach of the Dealer Agreement.

In conclusion, Gentile Nissan's ineffective sales performance constitutes a material breach of the Dealer Agreement. Gentile Nissan has not cured this breach despite being given notice and a reasonable opportunity to do so by Nissan NA. Nissan NA has established that it had just provocation to terminate the Dealer Agreement of Gentile Nissan and that it has done so with due regard to the equities.

Conclusions of Law

The administrator concludes:

1. Wis. Stat. § 218.0116(1)(i) prohibits motor vehicle manufacturers terminating the franchises of motor vehicle dealers without "just provocation." For purposes of Wis. Stat. § 218.0116(1)(i), "just provocation" requires that the dealer engage in conduct that is a material breach of the Dealer Agreement and the dealer continues to engage in the conduct after receiving written notice of the breach and a reasonable opportunity to cure the breach. Nissan NA gave Gentile Nissan notice of two alleged breaches of the franchise agreement.
2. Nissan NA gave Gentile Nissan 180 days to cure the alleged material breaches of the Dealer Agreement. This is a reasonable time to cure the alleged breaches. Gentile Nissan did not cure the breach of its failure to actively and effectively promote the sale at retail of Nissan products.
3. The conduct of Gentile Nissan as described in the Findings of Fact with respect to its efforts to "actively and effectively promote the sale of Nissan products at retail" constitutes a material breach of the Dealer Agreement.

Attachment 2

Case No. TR-07-0001
Page 19

4. Nissan NA termination of the Dealer Agreement with Gentile Nissan was fair, with due regard to the equities, and with just provocation.
5. Pursuant to Wis. Stat. § 218.0114(7)(d), the Division of Hearings and Appeals has the authority to issue the following orders.

Order

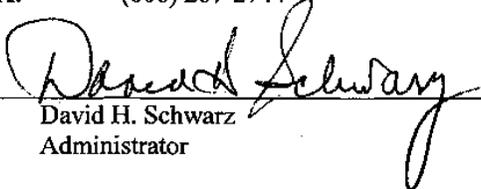
The administrator orders:

Nissan North America, Inc., has not cancelled the Dealer Agreement it entered into with Ralph Gentile, Inc., d/b/a Gentile Nissan unfairly, without due regard to the equities, and without just provocation. The complaint of Ralph Gentile, Inc., d/b/a Gentile Nissan, is hereby **DISMISSED**.

Dated at Madison, Wisconsin on February 4, 2010.

STATE OF WISCONSIN
DIVISION OF HEARINGS AND APPEALS
5005 University Avenue, Suite 201
Madison, Wisconsin 53705
Telephone: (608) 266-7709
FAX: (608) 267-2744

By:


David H. Schwarz
Administrator

Attachment 2

Case No. TR-07-0001
Page 20

NOTICE

Set out below is a list of alternative methods available to persons who may wish to obtain review of the attached decision of the Division. This notice is provided to insure compliance with Wis. Stat. § 227.48 and sets out the rights of any party to this proceeding to petition for rehearing and administrative or judicial review of an adverse decision.

1. Any person aggrieved by the attached order may within twenty (20) days after service of such order or decision file with the Division of Hearings and Appeals a written petition for rehearing pursuant to Wis. Stat. § 227.49. Rehearing may only be granted for those reasons set out in Wis. Stat. § 227.49(3). A petition under this section is not a prerequisite for judicial review under Wis. Stat. §§ 227.52 and 227.53.

2. Any person aggrieved by the attached decision which adversely affects the substantial interests of such person by action or inaction, affirmative or negative in form is entitled to judicial review by filing a petition therefore in accordance with the provisions of Wis. Stat. §§ 227.52 and 227.53. Said petition must be filed within thirty (30) days after service of the agency decision sought to be reviewed. If a rehearing is requested as noted in paragraph (1) above, any party seeking judicial review shall serve and file a petition for review within thirty (30) days after service of the order disposing of the rehearing application or within thirty (30) days after final disposition by operation of law. Any petition for judicial review shall name the Division of Hearings and Appeals as the respondent. The Division of Hearings and Appeals shall be served with a copy of the petition either personally or by certified mail. The address for service is:

DIVISION OF HEARINGS AND APPEALS
5005 University Avenue, Suite 201
Madison, Wisconsin 53705-5400

Persons desiring to file for judicial review are advised to closely examine all provisions of Wis. Stat. § 227.52 and 227.53 to insure strict compliance with all its requirements.

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)
800 N.W.2d 555, 2011 WI App 98

334 Wis.2d 712
Court of Appeals of Wisconsin.

RALPH GENTILE, INC., d/b/a
Gentile Nissan, Petitioner–Appellant,
v.
STATE of Wisconsin DIVISION OF HEARINGS
AND APPEALS, Respondent–Respondent,
Nissan North America, Inc.,
Interested Party–Respondent. †

No. 2010AP2524.
|
Submitted on Briefs May 3, 2011.
|
Opinion Filed May 24, 2011.

Synopsis

Background: Owner of car dealership filed complaint with Department of Transportation, alleging that car distributor had unfairly terminated owner's franchise. After a hearing, the Division of Hearings and Appeals entered decision determining that distributor had lawfully terminated franchise. Owner appealed. The Circuit Court, Racine County, Emily S. Mueller, J., affirmed. Owner appealed.

Holdings: The Court of Appeals, Fine, J., held that:

[1] distributor had just provocation to terminate agreement, and

[2] termination give due regard for the equities.

Affirmed.

West Headnotes (12)

[1] Administrative Law and Procedure

☞ Scope

In an administrative appeal, an appellate court reviews the agency decision and not the decision of the circuit court.

Cases that cite this headnote

[2] Administrative Law and Procedure

☞ Substantial evidence

An agency's findings of fact are binding on a reviewing court if they are supported by substantial evidence.

Cases that cite this headnote

[3] Administrative Law and Procedure

☞ Substantial evidence

“Substantial evidence,” as required to support an agency's findings of fact on judicial review, does not mean a preponderance of evidence; it means whether after considering all the evidence of record, reasonable minds could arrive at the conclusion reached by the trier of fact.

Cases that cite this headnote

[4] Administrative Law and Procedure

☞ Credibility

Administrative Law and Procedure

☞ Weight of evidence

The weight and credibility of the evidence are for the agency, not the reviewing court, to determine.

Cases that cite this headnote

[5] Administrative Law and Procedure

☞ Inferences or conclusions from evidence in general

Administrative Law and Procedure

☞ Rational basis for conclusions

An agency's findings of fact may be set aside on appeal only when a reasonable trier of fact could not have reached them from all the evidence before it, including the available inferences from that evidence.

Cases that cite this headnote

[6] Administrative Law and Procedure

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

— Erroneous construction; conflict with statute

Courts applying due weight deference in an administrative appeal will sustain an agency's statutory interpretation if it is not contrary to the clear meaning of the statute and no more reasonable interpretation exists.

Cases that cite this headnote

[7] **Administrative Law and Procedure**

— Permissible or reasonable construction

Applying due weight deference to an agency's statutory interpretation, a reviewing court will not set aside the agency's interpretation in favor of another equally reasonable interpretation, but will replace it with a more reasonable interpretation if one exists.

Cases that cite this headnote

[8] **Administrative Law and Procedure**

— Law questions in general

Although a reviewing court gives substantial deference to an agency in connection with its findings of fact and its interpretation of applicable statutes, review of questions of law is de novo.

Cases that cite this headnote

[9] **Contracts**

— Questions for Jury

Whether a party to a contract has committed a material breach of that contract is a question of fact.

Cases that cite this headnote

[10] **Contracts**

— Questions for Jury

Unless there are no disputed material facts, whether a party in breach of a contract has cured the breach is a question of fact.

Cases that cite this headnote

[11] **Antitrust and Trade Regulation**

— Duration, termination, and renewal

Owner of car dealership materially breached dealership agreement with car distributor, and thus distributor had just provocation to terminate agreement, as required under statutes governing termination of dealership agreements; sales at dealership were approximately half of calculated expected sales and declining at time of termination. W.S.A. 218.0114(7), 218.0116.

Cases that cite this headnote

[12] **Antitrust and Trade Regulation**

— Duration, termination, and renewal

Statute governing termination of car dealership, prohibiting car distributor from discriminating against similarly situated dealers, did not require distributor to treat dealership owner in a non-discriminatory manner as compared to out-of-state dealership owners, and thus distributor's termination of dealership agreement because of owner's poor sales performance satisfied statutory requirement that termination give due regard for the equities, even if distributor had not terminated agreements with out-of-state dealerships with similar sales performance; statute required only that distributor enforce sales expectations in a non-discriminatory manner as between dealerships within state. W.S.A. 218.0114(7)(d), 218.0116(1)(i).

Cases that cite this headnote

Attorneys and Law Firms

****556** On behalf of the petitioner-appellant, the cause was submitted on the briefs of Paul R. Norman and Eric A. Baker of Boardman, Suhr, Curry & Field, LLP, Madison.

On behalf of the interested party-respondent, the cause was submitted on the brief of Thomas M. Devine and Anthony P. Hahn of Hostak, Henzl & Bichler, S.C., Racine and Steven J. Wells of Dorscy & Whitney LLP, Minneapolis, Minnesota.

Before FINE, KESSLER and BRENNAN, JJ.

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

Opinion

FINE, J.

*715 Ralph Gentile, Inc., d/b/a Gentile Nissan, appeals the circuit court order affirming a decision of the Division of Hearings and Appeals determining that Nissan North America lawfully terminated Ralph Gentile's Nissan dealership. *See* WIS. STAT. § 218.0114(7)(d) (Dealer may complain to **557 the Department of Transportation that cancellation of dealership was “unfair”; complaint heard and decided by “the division of hearings and appeals.”). Ralph Gentile argues that the Division improperly interpreted the applicable statutes, WIS. STAT. §§ 218.0114(7)(a) 3, 218.0114(7)(d) & 218.0116, by concluding that: (1) Ralph Gentile materially breached its dealership agreement with Nissan North America and thus Nissan North America had “just provocation” to terminate Ralph Gentile's dealership agreement, *see* §§ 218.0114(7)(d) & 218.0116(1)(i)1.b; and (2) the termination satisfied the statute's “due regard to the equities” requirement, *see* §§ 218.0114(7)(d) & 218.0116(1)(i)1.a. We affirm.

*716 I.

¶ 2 Nissan North America is a California corporation that, among other things, distributes its automobiles through dealers, and is licensed to do business in Wisconsin. As material to this appeal, Ralph Gentile owns both Gentile Nissan and Gentile Hyundai, and operated Gentile Nissan under a 2002 term dealership agreement between Nissan North America and Ralph Gentile's predecessor.¹ A term dealership agreement, as the Division noted, “differs from the standard agreement” Nissan North America uses with its dealers “in that it has an expiration date.” The initial term dealership agreement expired on January 1, 2005, and was extended to July 1, 2006. According to the Division, Nissan North America “was unwilling” to give Gentile Nissan a standard dealership agreement “because of its unsatisfactory sales performance.”

¶ 3 By letter dated June 30, 2006, Nissan North America sent Gentile Nissan a Notice of Default alleging breach of dealership performance standards. The notice gave Gentile Nissan 180 days to cure the alleged breach. By letter dated January 3, 2007, Nissan North America terminated Gentile Nissan's dealership agreement and gave the following reasons: (1) “Unsatisfactory Sales Penetration Performance,”

alleged to breach Section 3 of the dealership agreement; and (2) “Unsatisfactory Customer Satisfaction Performance,” alleged *717 to breach section 5F of the dealership agreement. (Bolding and underlining omitted.) As noted, the Division upheld Nissan North America's termination of Gentile Nissan's dealership agreement. The Division found that although Gentile Nissan breached Section 3 of the dealership agreement, Gentile Nissan did not breach Section 5F, which concerned the satisfaction of Gentile Nissan customers. Accordingly, we only discuss the Division's findings and conclusions in connection with Section 3.

II.

[1] [2] [3] [4] [5] [6] [7] ¶ 4 Ralph Gentile's appeal attacks the Division's decision. Accordingly, we review that decision and not that of the circuit court. *See Weston v. Wisconsin Dep't of Workforce Development*, 2007 WI App 167, ¶ 11, 304 Wis.2d 418, 428, 737 N.W.2d 74, 78. The Division's findings of fact are binding on us if they are supported by “substantial evidence.” *See* **558 *Volvo Trucks North America v. State of Wisconsin Dep't of Transportation*, 2010 WI 15, ¶ 19, 323 Wis.2d 294, 305, 779 N.W.2d 423, 428; WIS. STAT. § 227.57(6) (“If the agency's action depends on any fact found by the agency in a contested case proceeding, the court shall not substitute its judgment for that of the agency as to the weight of the evidence on any disputed finding of fact.”).

Substantial evidence does not mean a preponderance of evidence. It means whether after considering all the evidence of record, reasonable minds could arrive at the conclusion reached by the trier of fact. “The weight and credibility of the evidence are for the agency, not the reviewing court, to determine.” An agency's findings of fact may be set aside only when a reasonable trier of fact could not have reached them from all the evidence before it, including the available inferences from that evidence.

Volvo Trucks, 2010 WI 15, ¶ 19, 323 Wis.2d at 306, 779 N.W.2d at 428–429 (footnotes and quoted source omitted). The parties agree, and so do we (as did the circuit court), that we should give “due weight” deference to the Division's interpretation of the applicable statutes.

Courts applying “due weight” deference will sustain an agency's statutory interpretation if it is not

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

contrary to the clear meaning of the statute and no more reasonable interpretation exists. Applying “due weight” deference, a reviewing court will not set aside the agency’s interpretation in favor of another equally reasonable interpretation, but will replace it with a more reasonable interpretation if one exists.

Id., 2010 WI 15, ¶ 15, 323 Wis.2d at 304, 779 N.W.2d at 427–428 (footnotes omitted).

[8] [9] [10] ¶ 5 Although we thus give to the Division substantial deference in connection with its findings of fact and its interpretation of the applicable statutes, our review of the contracts in this case is *de novo*. See *Wisconsin End-User Gas Ass’n v. Public Service Commission of Wisconsin*, 218 Wis.2d 558, 566, 581 N.W.2d 556, 559 (Ct.App.1998). Whether a party to a contract has committed a “material breach” of that contract, however, is a question of fact. *Volvo Trucks*, 2010 WI 15, ¶ 50 n. 28, 323 Wis.2d at 315 n. 28, 779 N.W.2d at 433 n. 28 (“Whether a material breach of contract has occurred is a question of fact to be determined by the fact finder.”). Unless there are no disputed material facts, whether a breaching party has cured the breach is also a question of fact. *719 *Id.*, 2010 WI 15, ¶ 50, 323 Wis.2d at 315–316, 779 N.W.2d at 433. With these standards in mind, we turn to the applicable statutes and Ralph Gentile’s contentions.

¶ 6 WISCONSIN STAT. 218.0114(7)(d), which concerns hearings before the Division on a dealer’s complaint that its franchise was improperly cancelled, provides that the “manufacturer, distributor, or importer” has the burden to prove that the “cancellation was fair, for just provocation, and with due regard to the equities.” WISCONSIN STAT. § 218.0116(1)(i) 2 similarly provides that “[a] license” of a “manufacturer, importer or distributor” “may be denied, suspended or revoked” if it “unfairly, without due regard to the equities or without just provocation, directly or indirectly cancel[s] or fail [s] to renew the franchise of any motor vehicle dealer.”

¶ 7 “ ‘Due regard to the equities’ means treatment in enforcing an agreement that is fair and equitable to a motor vehicle dealer ... and that is not discriminatory compared to similarly situated dealers.” WIS. STAT. § 218.0116(1)(i)1.a. “ ‘Just provocation’ means a material breach by a motor vehicle dealer ... due to matters within the dealer’s ... control, of a reasonable and necessary provision of an

agreement and the breach is not cured within a reasonable time after written notice of the **559 breach has been received from the manufacturer, importer or distributor.” WIS. STAT. § 218.0116(1)(i)1.b. Thus, “just provocation” has four elements:

- the terminated dealer must “materially breach” the dealership agreement;
- the breached provision of the dealership agreement must be “a reasonable and necessary provision”;
- *720 • the “material breach” must have been caused by “matters within the dealer’s ... control”; and
- the dealer has not “cured” the breach “within a reasonable time” after it got “written notice of the breach.”

WISCONSIN STAT. § 218.0114(7)(a) 3 provides, as material, that “a manufacturer, distributor or importer shall notify a dealer ... of the ... cancellation of the [dealership] agreement ... together with the specific grounds for ... cancellation of the agreement.”

III.

¶ 8 Before we analyze Gentile Nissan’s contentions we first look at the contract provisions Nissan North America accused Gentile Nissan of breaching, and the Division’s findings of fact. As noted, we limit our analysis to Section 3 because the Division concluded that Gentile Nissan did not breach Section 5F.

A. The Contract.

¶ 9 Section 3A of the dealership agreement set out the dealer’s “General Obligations”:

Dealer shall actively and effectively promote through its own advertising and sales promotion activities the sale ... of Nissan vehicles to customers located within the Dealer’s Primary Market Area. Dealer’s Primary Market Area is a geographic area which [Nissan North America] uses as a tool to evaluate Dealer’s performance of its sales obligations hereunder.

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)
800 N.W.2d 555, 2011 WI App 98

Section 3B explained how the dealer's fulfillment of those obligations would be assessed:

Dealer's performance of its sales responsibility for Nissan Cars and Nissan Trucks will be evaluated by ***721** [Nissan North America] on the basis of such reasonable criteria as [Nissan North America] may develop from time to time, including, for example:

1. Achievement of reasonable sales objectives which may be established from time to time by [Nissan North America] for Dealer as standards for performance;
2. Dealer's sales of Nissan Cars and Nissan Trucks in Dealer's Primary Market Area and/or the metropolitan area in which Dealer is located, as applicable, or Dealer's sales as a percentage of:
 - (i) registrations of Nissan Cars and Nissan Trucks;
 - (ii) registrations of Competitive Vehicles;
 - (iii) registrations of Industry Cars;
 - (iv) registrations of vehicles in the Competitive Truck Segment;
3. A comparison of Dealer's sales and/or registrations to sales and/or registrations of all other Authorized Nissan Dealers combined in [Nissan North America] Sales Region and District in which Dealer is located ...
4. A comparison of sales and/or registrations achieved by Dealer to the sales or registrations of Dealer's competitors.

Section 3C explained how a Dealer's location in an area where it had competition from other Nissan dealers affected the assessment process:

If Dealer is located in a metropolitan or other marketing area where there are ****560** located one or more Authorized Nissan Dealers other than Dealer, the combined sales performance of all Nissan Dealers in such metropolitan or other marketing area may be evaluated as indicated in Sections 3.B.2 and 3.B.3 above, and ***722** Dealer's sales performance may also be evaluated on the basis of the proportion of sales and potential sales of Nissan Vehicles in the metropolitan

or other marketing area in which Dealer is located for which Dealer fairly may be held responsible.

Section 3D acknowledged that the dealer's measured sales performance might be affected by matters beyond the dealer's control:

Where appropriate in evaluating Dealer's sales performance, [Nissan North America] will take into account such reasonable criteria as [Nissan North America] may determine from time to time, including, for example, the following: the Dealership Location; the general shopping habits of the public in such market area; ... any special local marketing conditions that would affect Dealer's sales performance differently from the sales performance of other Authorized Nissan Dealers; the recent and long term trends in Dealer's sales performance; the manner in which Dealer has conducted its sales operations (including advertising, sales promotion, and treatment of customers); and the other factors, if any, directly affecting Dealer's sales opportunities and performance.

¶ 10 Further, Section 3 required that the dealer “organize and maintain a sales organization that includes a sufficient number of qualified and trained sales managers and sales people to enable Dealer to effectively fulfill its responsibilities under this Section 3.” Finally, as material to this appeal, Section 3 required the dealer to “promptly take such action as may be required to correct any deficiencies in Dealer's performance of its responsibilities under this Section 3” when Nissan North America's periodic evaluations of the dealer disclosed problems with its fulfillment of the dealer's sales-performance obligations.

***723 B. Division's Findings of Fact.**

¶ 11 The Division made extensive findings. Given the extreme deference that we owe to those findings and the importance of those findings to this appeal, we set them out at some length.

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)
800 N.W.2d 555, 2011 WI App 98

- Gentile Nissan's Primary Market Area was Racine and Kenosha counties.
- Gentile Nissan was "geographically located" in what Nissan North America designated as the "North Central Region": "the United States bordered on the east by the Ohio/Pennsylvania border, Kentucky on the South, on the west to parts of Missouri, Iowa, and South and North Dakota, and the Canadian border on the north."
- Nissan North America also divides the sales regions into districts. "District 4 primarily consists of the Nissan dealers in Wisconsin."
- Nissan North America "interprets" the sales requirements set out in Section 3 "to require Gentile Nissan to sell the number of new vehicles that would be required to meet the regional average for Nissan's sales penetration based on the number of competitive registrations in [Gentile Nissan's Primary Market Area]. This standard is referred to as regional sales effectiveness and is a common performance standard in the motor vehicle retail industry."
- A Nissan dealer's sales performance is measured on a metric that calculates what the dealer is expected to sell in a particular year versus what it actually ****561** does sell. A dealer has a "100% sales effective" rating if it meets the "expected" number of sales, and a rating of less or more than 100% if it sells fewer or more vehicles than expected.
- *724** • "Expected sales are calculated as if all a dealer's sales were to residents of the dealer's [Primary Market Area], but actual sales are counted regardless of where the vehicle is registered."
- "Nissan [North America] made it abundantly clear to Gentile Nissan in a number of documents that it was evaluating [Gentile Nissan]'s sale performance based on sales effectiveness."
- From 2003 through 2007, Gentile Nissan had the following "sales effectiveness" ratings:
 - 2003—58.3%
 - 2004—54.5%
 - 2005—52.2%
 - 2006—47.6%
- 2007—40.7%
- In July of 2002, Ralph Gentile's predecessor purchased the Nissan dealership from a dealer in Kenosha. The dealership was in Kenosha, and Ralph Gentile's predecessor moved it to Racine with Nissan North America's approval.
- From 1999 through 2001, the predecessor Kenosha dealership had the following "sales effectiveness" ratings:
 - 1999—79.4[%]
 - 2000—81.7[%]
 - 2001—110.6[%]
- Gentile Nissan's Primary Market Area "is essentially the same [Primary Market Area] that had been assigned to Kenosha Nissan."
- "The industry considers a dealer that is 100% sales effective to be an average dealer."
- *725** • In 2006, "the average sales effectiveness of Nissan dealers in the North American Central Region was 117.9%."
- In 2006, "69.6% of the Nissan dealers in the [North American Central] region exceeded the region average."
- "While Gentile Nissan's sales of Nissan vehicles were declining, Nissan sales nationally, in the North Central region and in Wisconsin were increasing."
- "During the time period from 2003 until 2006, ... Nissan's sales nationally, in the North Central Region, and in Wisconsin increased by 31.5%, 17.3%, and 49.5% respectively."
- "[T]he local economy in southeastern Wisconsin is not a factor in evaluating Gentile Nissan's sales performance because Gentile Nissan's expected sales was [*sic*] calculated as a percentage of total sales in the Gentile Nissan's [Primary Market Area]. In other words, Gentile is only expected to get Nissan's average share of sales in the [Primary Market Area]. If for some reason new vehicle sales were depressed in southeastern Wisconsin, Gentile Nissan's expected sales would be reduced proportionately."

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

- “[S]ales staffs for Gentile Nissan and Gentile Hyundai were cross trained to sell both Nissans and Hyundais. Because of bonuses for selling Hyundais, the sales people had greater incentives to sell Hyundais than Nissans.”
- Gentile Nissan had a “revolving door for sales managers” and this “likely was part of the reason for Gentile Nissan’s poor sales performance.”
- “For 2005, [Nissan North America]’s goal for Gentile Nissan’s advertising was \$19,560 per month and the *726 amount Gentile Nissan spent was **562 \$15,071. It is also noteworthy that using the figures provided by Gentile Nissan, Gentile Nissan did not meet its own internal goals for Nissan advertising.” (Record reference omitted.)
- “If Gentile Nissan had been attempting to sell the number of vehicles it was expected to sell, the amount it spent on advertising in 2005 and 2006 was inadequate. Advertising is only one component of actively and effectively promoting the sale of Nissan vehicles; however, there is evidence in the record of the direct effect of advertising on sales. Gentile Nissan reduced the amount it spent on advertising from 2005 to 2006. Its new Nissan sales decreased from 273 to 213 during the same period.”
- “Gentile Nissan was not spending the amount it was required to spend to effectively promote Nissan products.”
- “In 2006, the year ending prior to the issuance of the Notice of Termination, Gentile Nissan ranked last out of seventeen Nissan dealers in Wisconsin.² It also ranked 164 out of 184 Nissan dealers in the North Central region.”
- Gentile Nissan breached the provision of the dealership agreement that required it to “actively and effectively promote through its own advertising and sales promotion activities the sale ... of Nissan vehicles to customers located within the Dealer’s Primary Market Area.”
 - “During the cure period [following receipt of the notice of default on June 30, 2006], Gentile Nissan’s *727 sales effectiveness declined further. So, not

only did Gentile Nissan not cure the breach, its performance worsened.”

The Division assessed the scope of “similarly situated dealers,” used by WIS. STAT. § 218.0116(1)(i)1.a, as an overlay with which to determine whether a dealer’s termination is “fair and equitable”:

The phrase “similarly situated dealers” is not defined in the statute. At a minimum, other Wisconsin single point Nissan dealers should be considered dealers similarly situated to Gentile Nissan. With respect to other Wisconsin dealers, Gentile Nissan is the lowest performing Nissan dealer in terms of sales performance. Nissan [North America]’s termination of Gentile Nissan’s franchise is not discriminatory compared to its treatment of other Wisconsin Nissan dealers. Since Gentile Nissan’s sales performance is compared to the average of Nissan dealers in the North central region, one could argue that all Nissan dealers in the North Central region could be considered similarly situated. However, there are too many variables such as market conditions and state regulations to compare Nissan [North America]’s treatment of Gentile Nissan with respect to all the Nissan dealers in the North Central region. Nissan [North America]’s termination of Gentile Nissan’s franchise is not discriminatory with respect to other similarly situated dealers.

Based on its analysis of the Record before it, the Division found:

Although Nissan [North America] terminated Gentile Nissan’s franchise after it had been

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

in operation for only five full years, the termination was reasonable because Gentile Nissan's sales performance was declining for no apparent reason other than [Gentile Nissan]'s lack of **563 effort. It was reasonable for Nissan [North America] to terminate Gentile Nissan's franchise *728 before the situation deteriorated any further. Nissan [North America]'s decision to terminate Gentile Nissan's Dealer Agreement was fair and equitable.

IV.

¶ 12 We now analyze Ralph Gentile's contentions that we should reverse the circuit court's order affirming the Division's dismissal of Ralph Gentile's complaint.

A. Sales Effectiveness Criteria.

[11] ¶ 13 The January 3, 2007, letter terminating Gentile Nissan's dealership asserted that despite the June 30, 2006, notice to cure, and attempts by Nissan North America to help Gentile Nissan with what Nissan North America perceived as Gentile Nissan's "unsatisfactory sales performance," Gentile Nissan's "sales penetration continue[d] to fall significantly below regional average." Ralph Gentile tells us that it "does not dispute the Division's finding that 'sales effectiveness' is a performance standard generally used in the motor vehicle industry."

¶ 14 In a largely unfocused argument, Ralph Gentile complains that the Division unfairly conflated the requirement in Section 3A that Gentile Nissan promote the sale of Nissan vehicles in its Primary Market Area with the sales assessment criteria in Section 3B. It contends that by using "dealer sales anywhere in the country, sales effectiveness does not measure the effectiveness of a dealer's promotional efforts within its own [Primary Market Area]." It argues that "[o]nly a sales performance standard based on Nissan sales within the [Primary Market Area] can *729 accurately measure the effectiveness of Gentile's promotional activities within the [Primary Market Area]." ³ As we have seen, however, the Division found that Gentile Nissan significantly lagged in regional sales effectiveness,

even though the metric *combined* the dealer's sales within *and* outside its Primary Market Area—"actual sales are counted regardless of where the vehicle is registered." Thus, if Gentile Nissan had done a superb job of promoting and selling Nissan vehicles within its Primary Market Area, as Section 3A of the agreement required, its sales effectiveness would have been high; again, contrary to Ralph Gentile's contention that it was a *bonus* that it also got credit for sales outside its Primary Market Area. ⁴

¶ 15 Further, the Division found, as we have also seen, that Gentile Nissan did not spend what "it was required to spend to effectively promote Nissan products." Significantly, there are charts in the Record that show Gentile Nissan near the bottom of "Nissan Dealers' *730 Sales in Own [Primary Market Area]/Metro as a Percent of North Central Region Average **564 North Central Region ...—2006" (uppercasing omitted) and "Nissan Dealers' Sales in Own [Primary Market Area]/Metro as a Percent of North Central Region [] Average State of Wisconsin—2006" (uppercasing omitted). Additionally, there is a chart in the Record that shows "Gentile Nissan Sales in Racine [Primary Market Area] as a Percent of Competitive Registrations vs Wisconsin Average" (uppercasing omitted) for the years 2004 through June of 2007 as being barely one-half of, or less than, the average of competitive registrations.

¶ 16 Ralph Gentile has not shown that sales effectiveness, as used by Nissan North America and accepted by the Division, was improper. Further, insofar as Ralph Gentile contends that the Chrysler factory in Kenosha County adversely affected Gentile Nissan's sales beyond Gentile Nissan's control, the Division found, as we have seen, that Kenosha Nissan, then located in Kenosha County, had better sales effectiveness than did Gentile Nissan when it took over the dealership and moved it to Racine, and also determined that the "local economy" was "not a factor in evaluating Gentile Nissan's sales performance." ⁵

*731 The facts found by the Division clearly show that Gentile Nissan's sales performance was well below what it should have been. There is more than "substantial evidence" in the Record to support those findings. Indeed, as we have seen, Gentile Nissan's sales-effectiveness ratings were far below the Kenosha dealership from whom Ralph Gentile's corporate predecessor bought the Nissan franchise.

B. The "Best Efforts" Clause.

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)
800 N.W.2d 555, 2011 WI App 98

¶ 18 Ralph Gentile argues that Gentile Nissan did not have to successfully sell Nissan vehicles but only had to use its “best efforts” to do so. It bases this contention on a June 26, 2006, amendment to the term dealership agreement. The amendment provided, as material (all bolding and underlining in original):

Article Twelfth (e), is hereby amended to read as follows:

A. Sales Performance

[Gentile Nissan] agrees that it will use its best efforts to meet or exceed the North Central Region average sales penetration for the Nissan total competitive car and truck segment on or before **July 1, 2006** based on data available at that time and at all times thereafter.

Article Twelfth of the term dealership agreement reads as material:

If this agreement is not terminated prior to the expiration date set forth in the Final Article, [Nissan North America] may offer to enter into as of such date a Nissan Dealer Sales & Service Agreement in such ***732** form as may be in use by [Nissan North America] at such time. [Nissan North America] will make the offer and Dealer may accept such offer only if Dealer has fulfilled and continues to fulfill, during the term of this Agreement and at the expiration thereof, of all the following conditions, ****565** each of which Dealer understands and agrees to be reasonable and necessary:

The clause sets out in subparts (a) through (d) the specific preconditions to the offer by Nissan North America of a non-term, standard dealership agreement. Subpart (e) reads: “(e) Other conditions (if any): See Exhibit ‘A’, which is incorporated by this reference into this Agreement for all purposes.” The “Exhibit ‘A’ ” is the “best efforts” amendment, set out above.

¶ 19 As we have seen, we interpret and apply *de novo* the parties' contracts under the standards we have already explained. By its clear language, the “best efforts” clause was an amendment to “**Article Twelfth (e)**,” which was a “condition” to an offer by Nissan North America of a

standard dealership agreement. Thus, the words “for all purposes” is cabined within “**Article Twelfth**” and modifies the conditions (a) through (d) that Gentile Nissan had to meet before being offered a non-term dealership agreement.⁶ By its terms, the ***733** amendment, which inserted the “best efforts” language in subsection (e) of “**Article Twelfth**,” made Gentile Nissan's “best efforts” a condition to getting an offer of standard dealership agreement and nothing more.⁷

C. Just Provocation.

¶ 20 Ralph Gentile argues that the Division erroneously interpreted the “reasonable and necessary ***734** provision” of WIS. STAT. § 218.0116(1)(i) 1.b. The essence of Ralph Gentile's complaint is that applying Section 3B (the criteria used to measure sales performance) of the term dealership agreement concurrently with Section 3A results in a faux breach of Section 3A because, as phrased by Ralph Gentile's brief, the criteria in Section 3B do “not accurately measure the dealer's performance of its obligations under” Section 3A. ****566** Thus, Ralph Gentile argues, Section 3A is not a “reasonable provision.” We have already determined, however, that the Division did not err in applying the criteria in Section 3B of the agreement. Accordingly, the Division did not err—especially when, as noted, we must give its interpretation of the statute “due weight” deference—in concluding that Section 3A was a “reasonable and necessary provision” under § 218.0116(1)(i) 1.b so that the “just provocation” condition was met.

¶ 21 Ralph Gentile also argues that the Division erred by focusing on Gentile Nissan's actual sales, rather than the total sales of Nissan vehicles in Gentile Nissan's Primary Market Area irrespective of whether those sales were made by Gentile Nissan or other Nissan dealers. Ralph Gentile contends that “[t]he only performance standard relevant to Gentile's compliance with § 3.A., for which there is evidence in the record, is ‘*registration effectiveness*.’ As discussed, registration effectiveness is the ratio of the number of Nissan's sold to customers located in a dealer's [Primary Market Area] (*i.e.*, registrations), regardless of which dealer sold them, to the expected registrations of Nissans in the [Primary Market Area].” (Emphasis by Ralph Gentile.) There are two main problems with this contention. First, the Division determined that sales effectiveness, not registration effectiveness, was the appropriate standard to measure Gentile Nissan's compliance with ***735** Section 3 of the term dealership agreement. That is certainly a reasonable construction of industry practice, and, therefore, under due-weight deference, is

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

binding on us. Indeed, Ralph Gentile's expert witness at the hearing testified, albeit apparently reluctantly, that "[m]ost" automobile manufacturers "make, as far as I know, this [regional sales effectiveness] calculation in one form or another."

¶ 22 Second under our *de novo* review of the agreement, the whole thrust of Section 3 is, as the section's heading says, the dealer's "Vehicle Sales Responsibilities" (bolding in original); the marketing obligations are focused on the dealer successfully selling Nissan vehicles. To read Section 3's command that Gentile Nissan "shall actively and effectively promote through its own advertising and sales promotion activities the sale ... of Nissan vehicles to customers located within the Dealer's Primary Market Area" as license to ignore whether Gentile Nissan actually sold Nissan vehicles would transform the dealership agreement into one for mere advertising. As Nissan North America pithily observes, "Gentile was a car dealer, not an advertising agency."

¶ 23 The Division properly found "just provocation."

D. Due Regard to the Equities.

[12] ¶ 24 Ralph Gentile argues that the Division misinterpreted the requirement in WIS. STAT. § 218.0116(1)(i)1.a that the "treatment in enforcing" the sales-effectiveness provisions in Gentile Nissan's term dealership agreement must "not [be] discriminatory compared to similarly situated dealers" by excluding *736 non-Wisconsin Nissan dealers from the "similarly situated" population. It contends that "[s]everal [out-of-state] dealers had lower sales penetration than Gentile, but, unlike Gentile, were not terminated by Nissan for unsatisfactory sales." Ralph Gentile points out that the legislature did not specify in § 218.0116(1)(i)1.a that "similarly situated" was restricted to Wisconsin dealers, as it could have, and as it did in WIS. STAT. § 218.0125(5), by using the phrase "similarly situated franchised motor vehicle dealers in this state."⁸ It also **567 argues that even though WIS. STAT. § 135.02(4)(a) also uses the stand-alone phrase

"similarly situated dealers," two courts have construed that phrase to encompass out-of-state dealers.⁹ See *Wisconsin Music Network, Inc. v. Muzak Ltd. Partnership*, 822 F.Supp. 1332, 1337 (E.D.Wis.1992) (assuming that an out-of-state licensee was "similarly situated" to an in-state licensee, but finding no *737 disparate treatment) (commerce clause not discussed), *aff'd* 5 F.3d 218 (7th Cir.1993) (commerce clause not discussed); *Advanced Agri-Systems, Ltd. v. Southwestern Porcelain, Inc.*, No. 81-C-352, 1982 U.S. Dist. LEXIS 18400, *30 (W.D.Wis.1982) (assuming that out-of-state franchisees were "similarly situated" to an in-state franchisee).

¶ 25 It may be, in light of the legislature's use of the phrase "in this state" in WIS. STAT. § 218.0125(5) but not in WIS. STAT. § 218.0116(1)(i) 1.a, that the legislature meant to encompass out-of-state dealers in the due-regard-to-the-equities analysis. But our review, as we have already seen, is not *de novo*; under the applicable due-weight-deference standard of review, we must affirm the Division's interpretation of § 218.0116(1)(i)1.a if it is "reasonable." In light of the serious federal commerce-clause problems that might result if a Wisconsin law forced an automobile company to either terminate dealerships in another state based on Wisconsin-law criteria, see *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 336-337, 109 S.Ct. 2491, 105 L.Ed.2d 275 (1989), or forego terminating a Wisconsin dealer that was not effectively selling cars, the Division's restriction of the "similarly situated" mandate to Wisconsin dealers is reasonable, "not contrary to the clear meaning of the statute," and Ralph Gentile's interpretation is not "more reasonable."¹⁰ See *738 **568 *Volvo Trucks*, 2010 WI 15, ¶ 15, 323 Wis.2d at 304, 779 N.W.2d at 428.

*739 Order affirmed.

All Citations

334 Wis.2d 712, 800 N.W.2d 555, 2011 WI App 98

Footnotes

† Petition for Review filed June 22, 2011.

1 None of the parties contend that the changes in corporate structure affect the issues on this appeal. Accordingly, we ignore those changes. WISCONSIN STAT. ch. 218, which, among other things, regulates motor vehicle dealers in this state, recognizes that, as used in that chapter, the word "[a]greement" means a contract that describes the franchise relationship between manufacturers, distributors, importers and dealers." WIS. STAT. § 218.0101(1).

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

- 2 Presumably, the Division is referring to the January 3, 2007, letter terminating Gentile Nissan's dealership, after the requisite time within which to cure the alleged breach of the dealership agreement, which was triggered by the June 30, 2006, letter.
- 3 As we see later in ¶¶ 21–22, we reject Ralph Gentile's contention that Section 3 only obligated Gentile Nissan to "promote" Nissan vehicles, not sell them.
- 4 Thus, Ralph Gentile argues that because Gentile Nissan had a *higher* percentage of sales within its Primary Market Area when compared to Gentile Nissan's national sales (for 2006: of Gentile Nissan's total sales of 217, 182 were sales within its Primary Market Area) than did another Nissan dealer in southeastern Wisconsin (for 2006: of Gordie Boucher's total sales of 615, 222 were sales within its Primary Market Area), it successfully fulfilled its obligation to promote Nissan vehicles in its Primary Market Area. As noted in the main text, however, this argument ignores the fact as found by the Division that Gentile Nissan's sales effectiveness was inadequate; it was an inadequacy that would have been ameliorated *if* Gentile Nissan had been as successful promoting the sales of Nissan vehicles in its Primary Market Area as it contends it was.
- 5 Ralph Gentile also argues that Gentile Nissan was adversely affected by matters beyond its control because it was the "only ... Nissan dealer in the Racine/Kenosha [Primary Market Area], while several competitive brands had two or more dealers in the [Primary Market Area]." First, Ralph Gentile does not explain how this Nissan "monopoly" for Gentile Nissan hurts its efforts to sell Nissan vehicles. Second, it also does not explain how or why that non-Nissan competition differed from general automobile competition in the areas against which Gentile Nissan's sales effectiveness was measured. See *Vesely v. Security First National Bank of Sheboygan Trust Dep't*, 128 Wis.2d 246, 255 n. 5, 381 N.W.2d 593, 598 n. 5 (Ct.App.1985) (We will not address arguments that are not sufficiently developed.).
- 6 The conditions (a) through (d) are:
- (a) Comply with [Nissan North America]'s net working capital, net worth requirements as specified in Section 6.E and in amount not less than the Guides therefor as specified in the Final Article of this Agreement;
 - (b) Provide [Nissan North America], on or before the tenth day of each month, on such forms as may be designated by [Nissan North America], with the financial and operating statement specified in Section 6.G.1 of the Standard Provisions;
 - (c) If New Dealership Facilities are required under Article Twelfth (d), below:
 - (i) Complete the acquisition and installation, at the New Dealership Facilities, of signs, furniture, furnishings, tools and equipment as required by [Nissan North America] for Dealer's New Dealership Facilities;
 - (ii) Employ that number of qualified persons to operate the dealership required by [Nissan North America] for Dealer's New Dealership Facilities;
 - (iii) Comply with all other [Nissan North America]'s requirements for Dealer to operate the New Dealership Facilities and qualify in all other respects for a Nissan Dealer Sales & Service Agreement;
 - (iv) Comply with all federal, state and local governmental licensing and other requirements for Dealer to do business as an Authorized Nissan Dealer at the New Dealership Facilities;
 - (d) New Dealership Facilities (or upgrade to existing Dealership Facilities, if applicable);
- 7 Ralph Gentile misreads what would happen if Gentile Nissan *did* use its "best efforts" pursuant to the amendment to Article Twelfth of the term dealership agreement when it asserts that if Gentile Nissan used its "best efforts" Nissan North America would be "requir[ed] ... to renew." As we see, however, Article Twelfth provided that if Gentile Nissan satisfied the conditions expressed in that Article, Nissan North America "*may offer* to enter into as of such date a Nissan Dealer Sales & Service Agreement." (Emphasis added.) Generally "may" means the action is permissive, not mandatory. See *Mercantile Contract Purchase Corp. v. Melnick*, 47 Wis.2d 580, 590, 177 N.W.2d 858, 863 (1970) (statutory construction).
- 8 WISCONSIN STAT. § 218.0125(5) reads in full:
- A manufacturer, importer or distributor who fails to compensate a dealer for parts at an amount not less than the amount the dealer charges its other retail service customers for parts used to perform similar work shall not be found to have violated this section if the manufacturer, importer or distributor shows that the amount is not reasonably competitive to the amounts charged to retail service customers by other similarly situated franchised motor vehicle dealers in this state for the same parts when used by those dealers to perform similar work.
- 9 WISCONSIN STAT. § 135.02(4) defines "good cause" for the Wisconsin Fair Dealership Law. It reads, as material:
- "Good cause" means:
- (a) Failure by a dealer to comply substantially with essential and reasonable requirements imposed upon the dealer by the grantor, or sought to be imposed by the grantor, which requirements are not discriminatory as compared with requirements imposed on other similarly situated dealers either by their terms or in the manner of their enforcement.

Attachment 2

Ralph Gentile, Inc. v. State, Div. of Hearings and Appeals, 334 Wis.2d 712 (2011)

800 N.W.2d 555, 2011 WI App 98

- 10 *Healy v. Beer Institute, Inc.*, 491 U.S. 324, 336–337, 109 S.Ct. 2491, 105 L.Ed.2d 275 (1989) explained how a state law might impermissibly impinge on interstate commerce:

Taken together, our cases concerning the extraterritorial effects of state economic regulation stand at a minimum for the following propositions: First, the “Commerce Clause ... precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State,” and, specifically, a State may not adopt legislation that has the practical effect of establishing “a scale of prices for use in other states.” Second, a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority and is invalid regardless of whether the statute's extraterritorial reach was intended by the legislature. The critical inquiry is whether the practical effect of the regulation is to control conduct beyond the boundaries of the State. Third, the practical effect of the statute must be evaluated not only by considering the consequences of the statute itself, but also by considering how the challenged statute may interact with the legitimate regulatory regimes of other States and what effect would arise if not one, but many or every, State adopted similar legislation. Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State.

(Quoted sources and internal citations omitted; ellipsis in original.) Significantly, both *Wisconsin Music Network, Inc. v. Muzak Ltd. Partnership*, 822 F.Supp. 1332, 1337 (E.D.Wis.1992), *aff'd* 5 F.3d 218 (7th Cir.1993) and *Advanced Agri-Systems, Ltd. v. Southwestern Porcelain, Inc.*, No. 81–C–352, 1982 U.S. Dist. LEXIS 18400, *30 (W.D.Wis.1982), relied on by Ralph Gentile, did not even discuss, no less decide, whether the commerce clause prohibited the extra-territorial reach of Wisconsin's Fair Dealership Law to affect out-of-state dealers. Ralph Gentile also cites *Forest Home Dodge, Inc. v. Karns*, 29 Wis.2d 78, 93–94, 138 N.W.2d 214, 222 (1965) (A statute that prohibited an automobile manufacturer from applying for a Wisconsin dealership did not place an “undue” burden on interstate commerce so as to violate the commerce clause when the manufacturer could accomplish the same thing by buying an existing dealership.), and *Wisconsin Truck Center, Inc. v. Volvo White Truck Corp.*, 692 F.Supp. 1010, 1017–1018 (W.D.Wis.1988) (upholding the then existing Wisconsin Motor Vehicle Dealership Law against a challenge that it violated the commerce clause by limiting the rights of out-of-state distributors to terminate Wisconsin dealers) (“Volvo GM's absurd contention that the [Wisconsin Motor Vehicle Dealership Law] prohibits ‘newly appointed distributors’ from ever terminating dealers is apparently the heart of this twisted analysis.”), *aff'd in part, rev'd in part, by unpublished order*, 894 F.2d 1338 (Table) (7th Cir.1990) (affirming district court's ruling that non-discriminatory withdrawal from market did not violate Wisconsin's then-extant Motor Vehicle Dealer Law; reversing district court's denial of attorney fees) (constitutional issue not discussed) (unpublished order not available on Westlaw, but is on file with the clerk of the court of appeals), in support of its proposition that some Wisconsin laws can affect interstate commerce without violating the commerce clause. Of course. Unlike those cases (where the focus was mainly on what an out-of-state company could or could not do in affecting the rights of Wisconsin companies), however, if Ralph Gentile's “similarly situated” argument was applied here, Wisconsin's law would, as noted in the main body of this opinion, force an automobile company to either terminate dealerships in another state based on Wisconsin-law criteria, or forego terminating a Wisconsin dealer that could not sell cars. This would give Wisconsin law a more significant extra-territorial effect than there was in the cases upon which Ralph Gentile relies. We note, though, that we do not *decide* the constitutional issue; we merely hold that given the potential commerce-clause problems, the Division's interpretation of WIS. STAT. § 218.0116(1)(i)1.a was, in light of the section's clear language, “reasonable.”

Attachment 2

Before the
N.H. MOTOR VEHICLE INDUSTRY BOARD
James H. Hayes Safety Building
33 Hazen Drive, Concord, N.H. 03305

In the Matter of:

Seacoast Imported Auto, Inc. d/b/a Nissan of Stratham, Docket
No. 04-06 et al

(Termination Protest; Prohibited Conduct)

DECISION AND ORDER

By: Christopher Casco, Chair; Archie Burnett, Robert
Copeland, and William Fenollosa, Board Members

Not Participating: William Perry, Lloyd Freese, and Walter
McCarthy

Appearances: Gregory A. Holmes, Esq., Elizabeth M. Leonard,
Esq. for Seacoast Imported Auto, Inc. d/b/a Nissan of
Stratham
William N. Berkowitz, Esq., Justin M. O'Sullivan, Esq.,
Cecil Davis, Esq. for Nissan North America, Inc.

PROCEDURAL HISTORY

This proceeding began on or about June 29, 2004 when
Seacoast Imported Auto, Inc., d/b/a Nissan of Stratham
("Seacoast") filed a protest with the New Hampshire Motor
Vehicle Industry Board ("Board") pursuant to RSA 357-C:3,
I, RSA 357-C:3, II(d), RSA 357-C:3, III(b), RSA 357-C:3,
III(c), RSA 357-C:3, III(n) and RSA 357-C:7. Seacoast
alleged that the manufacturer, Nissan North America, Inc.,
("Nissan") engaged in unfair and deceptive practices,
engaged in conduct that was arbitrary, in bad faith and

Attachment 2

unconscionable, coerced Seacoast to change its location unreasonably, and to enter into a dealership agreement, impose unreasonable restrictions on the sale of the dealership, and terminate the franchise without good cause. This resulted from Nissan's issuance of a termination notice on or about June 2, 2004 pursuant to RSA 357-C:7, V(a). The matter proceeded through various hearing steps but was set aside by the Board due to Nissan's non-complying notice of default for failing to provide a 180-day cure period by order dated May 6, 2005. Nissan appealed such order and the Superior Court remanded the case back to the Board by order dated January 12, 2006.

Thereafter, Nissan issued a July 8, 2005 Notice of Default and an April 17, 2006 Notice of Termination to Seacoast. Seacoast filed a second termination protest with the Board on or about May 9, 2006 alleging the same statutory violations as the initial protest with additional allegations of violations of RSA 357-C:3, III(o) claiming a change in Seacoast's market area without good cause, RSA 357-C:7 due to termination based on the dualled nature of the dealership, and RSA 357-C:3, I and RSA 357-C:3, III(n) for failing to inform Seacoast of the prior dealer's fraud and lack of market penetration but then agreeing to remove the exclusivity requirement from the proposed dealership

Attachment 2

agreement which induced Seacoast to invest \$2.5 million but then refusing to execute the franchise agreement. Such protests resulted in substantial efforts by the parties to resolve their differences. Despite these efforts, the parties were unable to negotiate a settlement.

Thereafter, on or about July 15, 2008, Seacoast filed its third protest with the Board alleging an additional violation of RSA 357-C:3, I by arbitrary application of its exclusivity policy. This related to Nissan's refusal to allow Seacoast to sell the dealership and move it to a site in Epping, New Hampshire.

On or about September 2, 2008 Nissan filed a motion entitled: "MOTION OF NISSAN NORTH AMERICA TO STRIKE ALL REFERENCES TO SETTLEMENT COMMUNICATIONS CONTAINED IN THE JULY 15, 2008 PROTEST," which the Board denied after a hearing on December 12, 2008 by order dated December 18, 2008. Thereafter, the Board conducted a hearing on outstanding discovery issues on August 27, 2009 and issued an order to resolve such on October 5, 2009 and a timeline was developed to schedule the case for final hearing.

Discovery was completed and the Board held a final hearing which the parties agreed consolidated all prior cases filed in this matter on February 8 and 9, 2010.

Attachment 2

Nissan introduced the testimony of Mark Grimm, President, Nissan Canada, Al Castingetti, Vice President & General Manager, Nissan Division, Nissan North America, and Sharif Farhat, an automotive dealer network expert from Urban Science Applications. In addition, Nissan introduced the depositions of Joseph Trebes, Donna Martinez, Eric Rogers, Carlos Alvarez, and Rudy Guillen and the affidavits of William Bergmann and Kitty Spencer.

Seacoast introduced the testimony of Roger Groux, President of Seacoast, and Alan Gladkowski, salesperson for Seacoast and the deposition of James Lurvey and portions of depositions of Joseph Trebes, Al Castingetti, and Mark Grimm.

Moreover, Nissan introduced 4 bound volumes of exhibits marked A through RRRRRR and separate exhibits SSSSSS, TTTTTT and UUUUUU. Seacoast introduced 1 bound volume of exhibits marked 1 through 126 and a series of photographs marked 127. All exhibits were admitted into evidence.

Both parties submitted requests of proposed findings of fact and rulings of law which have been considered by the Board in reaching this decision.

BACKGROUND INFORMATION

Description of the Parties: Seacoast is a New Hampshire corporation, owned entirely by Roger Groux ("Groux").

Attachment 2

Seacoast operates its Nissan dealership at 34 Portsmouth Avenue in Stratham, NH at the same location as a Honda dealership also owned by Groux.

Nissan is a California corporation and is the exclusive distributor of Nissan brand motor vehicles and parts through a network of independent dealers throughout the United States, including New Hampshire.

Position of Seacoast: Seacoast alleges that Nissan has not acted in good faith and that there was not good cause to terminate the franchise. Moreover, it argues that Nissan engaged in prohibited conduct in that it arbitrarily applied its exclusivity policy and engaged in bad faith and unconscionable conduct.

Position of Nissan: Nissan alleges that it has good cause to terminate based on chronically poor sales performance and the failure of Seacoast to designate an approved executive manager exclusively devoted to the Nissan dealership.

FINDINGS OF FACT

The parties have filed Proposed Findings of Fact and Rulings of Law which the Board has considered. To the extent that there may be inconsistencies between those findings and rulings and the following, this order shall be controlling.

Attachment 2

On December 31, 1998, Seacoast entered into an Asset Purchase Agreement to acquire the Nissan dealership assets of Nissan of Exeter. Exhibit 3. Seacoast moved the Nissan dealership into the same building as its Honda dealership at 34 Portsmouth Avenue in Stratham, and planned to expand the facility to accommodate and sell both brands. Exhibit RRR; Exhibit 3. Seacoast purchased the dealership from Robert Campellone who conducted business as Nissan of Exeter ("Exeter"). Seacoast's Proposed Findings of Fact and Rulings of Law ("Seacoast's Findings") at paragraph 25. Unbeknownst to Groux at the time of the purchase, Exeter had sent a fraudulent recall notice to customers in an effort to generate business for the service department in 1997. Exhibit 51.

As part of its application to Nissan, Seacoast submitted documents indicating that it expected to sell 300 new Nissan vehicles and spend \$327,550 on Nissan advertising in the first year. Nissan approved the application and the parties entered into a Nissan Dealer Term Sales and Service Agreement ("Dealer Agreement") in the hope of qualifying for a perpetual franchise agreement later. Nissan's Requested Findings of Fact ("Nissan's Facts") at paragraph 6. This is the only agreement ever reached due to an

Attachment 2

ongoing dispute over the terms to be included in a perpetual dealership agreement.

The Dealer Agreement obligated Seacoast to actively and effectively promote the sale of Nissan vehicles within its Primary Market Area ("PMA"). Exhibit B. A PMA is a geographic area comprised of census tracts that Nissan assigns. Nissan's Facts at paragraph 8. Nissan assigns PMA's the same way for every Nissan dealer in the United States and such method is accepted within the automotive industry. Transcript Day 1 ("Tr. I") at pages 151-152.

Moreover, in the Dealer Agreement, Nissan was given the right to change the PMA periodically. Exhibit B. Nissan changed the market area twice, in 2002 and 2004. Exhibit C. The 2004 changes were caused by Nissan's nationwide changes based on year 2000 census data. Exhibit D.

Under the Dealer Agreement, Nissan was given the right to evaluate Seacoast's sales performance based on reasonable criteria to be developed by Nissan. Exhibit B. In addition, Nissan reserved the right to terminate the franchise agreement if Seacoast substantially failed to satisfy its sales responsibility for Nissan vehicles. Exhibit B.

Another essential term of the agreement contained a requirement of Seacoast to hire and retain a qualified

Attachment 2

Executive Manager, acceptable to, and approved by, Nissan. Exhibit B. Seacoast never obtained an approved Executive Manager devoted exclusively to the sale of new Nissan vehicles.

In addition, the dealer agreement required Seacoast to have a fixed wall to separate its Honda and Nissan showrooms. Exhibit B. Seacoast notified Nissan that it would have a wall with planters on top. Tr. I at 115.

Groux renovated the dealership to accommodate the addition of the Nissan brand, spending \$2.5 to \$3 million to do so. Tr. I at 294-295. This substantially increased the size of the dealership. Although Groux missed the original construction deadline of June 1, 2001, Nissan agreed to an extension until February 28, 2002. Exhibit M. Construction was completed in 2002. Both parties understood the dualled nature of the dealership, although they disputed the nature of the fixed wall.

The Dealership Agreement also provided that Seacoast must obtain approval from Nissan to sell the dealership to a third party. It further provided that Nissan could condition a sale of the dealership on a location consistent with a market study to determine the best location for a Nissan dealership. Exhibit B.

Attachment 2

Nissan conducted such market study which recommended, that within Seacoast's PMA, an exclusive facility on Route 108 was preferable. Exhibit J.

On or about March 26, 2002, Nissan made Seacoast an offer of a standard Nissan Dealer Sales & Service Agreement and Seacoast objected the a right of first refusal in the dealership property, and therefore, rejected the offer. The parties continued to negotiate a new agreement but were unable to do so and continued to operate under the original Dealer Agreement.

During its term as a Nissan dealer, Seacoast consistently demonstrated poor sales performance and a lack of effort in making Nissan sales. For example, dealer operations manager Rudy Guillen ("DOM"), testified in his deposition concerning an incident where he had to intervene to sell a new Nissan Xterra vehicle to a customer whom the Seacoast salespeople ignored. Guillen completed the sale of the new Xterra to the customer while 2 Seacoast salespeople sat at a desk. Guillen deposition at 36-37. Also, he testified concerning derogatory comments about the Nissan brand by Seacoast salespeople. Guillen deposition at 40. Such demonstrates an intentional lack of effort selling new Nissan vehicles which harmed Nissan sales and contributed to poor performance.

Attachment 2

Seacoast never sold 300 vehicles in a year as it stated it could sell in the first year. Seacoast's yearly Nissan sales are as follows:

2001	134
2002	137
2003	137
2004	222
2005	190
2006	179
2007	146
2008	128
2009	78

Average 150

Exhibit GGG.

These are substantially less than the 300 promised sales per year as outlined in Seacoast's dealer application. The average sales per month were 13.3 from 2001 to 2008.

Exhibit U and PP.

Nissan's sales evaluation criteria is the dealer's sales penetration within its PMA. Exhibit B. Sales penetration calculates a Nissan dealer's new vehicle sales as a percentage of the registrations of all competitive makes in the dealer's PMA. Tr. I at 166. Thereafter, to determine sales effectiveness, the average sales penetration is

Attachment 2

compared to other dealers in its region. Exhibit BBBB.

Seacoast is within the Northeast region, which consists of 190 dealers. Exhibit BBBB. Nissan calculates a dealer's sales penetration as a percentage of regional average sales penetration. Exhibit BBBB. This calculation is known as Retail Sales Effectiveness ("RSE"). A dealer who makes sufficient sales will make the sales necessary to achieve regional average sales penetration, the dealer's RSE is 100 percent. This is comparable to a "C" sales grade. Many dualled dealers have achieved 100 percent RSE. Tr. I at 95-96.

Seacoast's sales penetration was substantially lower than other dealers between 2001 and 2008 as outlined below:

	<u>Seacoast's Sales Penetration</u>	<u>Other NH Dealer Sales Penetration</u>	<u>Northeast Region Sales Penetration</u>	<u>Seacoast's Retail Sales Effectiveness</u>
2001	3.0%	9.0%	9.4%	33.7%
2002	3.0%	8.9%	9.4%	34.3%
2003	2.2%	7.5%	8.4%	29.8%
2004	4.0%	8.7%	9.6%	44.3%
2005	3.6%	9.4%	10.3%	37.3%
2006	3.2%	8.9%	10.4%	32.5%
2007	2.9%	9.9%	10.8%	28.9%
2008	2.4%	10.2%	11.1%	23.1%

Exhibit BBBB

Attachment 2

Moreover, Seacoast's low sales numbers are demonstrated by its RSE which has always been among the lowest in New Hampshire and the Northeast Region, and well below the 100 percent benchmark. Such figures are outlined below:

	Seacoast's Retail Sales Effectiveness	NH Rank	Northeast Region Rank
2001	33.7%	9 of 11	179 of 188
2002	34.3%	10 of 11	180 of 189
2003	29.8%	11 of 11	186 of 189
2004	44.3%	9 of 11	174 of 188
2005	37.3%	11 of 11	184 of 190
2006	32.5%	10 of 11	184 of 190
2007	28.9%	10 of 10	187 of 191
2008	23.1%	10 of 10	190 of 191

Exhibit BBBB.

In addition, while Seacoast indicated in its application that it would spend \$327,550 per year for Nissan vehicle advertising, it spent significantly less, averaging \$40,741 per year between 2001 and 2008. Exhibit HHH. Also, Seacoast continued to use an old, obsolete Nissan sign to identify the dealership, the only dealership in the country to do so.

Nissan made many suggestions to Seacoast to help it improve sales performance including maintaining an exclusive Nissan dedicated sales staff and manager, install

Attachment 2

a sign with the updated Nissan logo, increase advertising, structure employee pay to encourage Nissan sales, increase inventory for better selection, improve employee's attitudes towards Nissan, and for Groux to take a more active role in operations. Seacoast, however, failed to implement any of these suggestions. The low sales numbers caused Nissan to lose thousands of sales of new Nissan vehicles in Seacoast's PMA between 2001 and 2008.

Nissan issued several notices of default and termination and provided Seacoast with time to cure its deficient sales performance. Seacoast's performance only slightly increased during the first cure period. Tr. I at 83-84. The basis of the termination was unsatisfactory sales penetration and the failure to appoint a qualified executive manager.

In 2005, Seacoast located a buyer interested in purchasing the franchise and moving it to Epping, New Hampshire. Exhibit MM. Nissan did not approve the move based on a market study that suggested that the best site was located on Route 108 in the existing Exeter PMA. Exhibit NN.

Moreover, in 2005 Seacoast proposed to move into an exclusive Nissan dealership location and purchased property for that purpose at 43 Portsmouth Avenue in Stratham.

Attachment 2

Nissan did not approve this move because in Nissan's opinion, Seacoast's sales performance did not justify such move. Notwithstanding the disapproval, Groux pursued special permits and approvals from the town to move the dealership to 43 Portsmouth Avenue. During that time, the parties continued to attempt to resolve this dispute and resolve the pending termination protests. The parties, however, did not reach a settlement.

DISCUSSION AND CONCLUSIONS

In order to terminate Seacoast's Nissan franchise, Nissan must prove, by a preponderance of the evidence, that it acted in good faith, that all notice requirements have been satisfied, and that there exists good cause for the termination. RSA 357-C:7, IV; Mvi 208.12(b).

Moreover, to prevail on its claim of prohibited conduct, Seacoast must prove, by a preponderance of the evidence, that Nissan engaged in unfair business practice as defined by RSA 357-C:3, I through IV; Mvi 209.01.

Based on the manifest weight of the evidence presented, the Board rules that Nissan has sustained its burden of proof. Also, based on the evidence, Seacoast has failed to sustain its burden of proof on its claims under RSA 357-C:3.

Attachment 2

Nissan provided notice of deficient performance and its intent to terminate to Seacoast on June 2, 2004, as required by RSA 357-C:7, I (a). Although the Board set aside the first protest based on the first notice, the Superior Court reversed. Thereafter, Nissan issued subsequent termination notices which contained the appropriate cure period requirements. Therefore, it satisfied the statutory notice requirement. The Board rules that sales performance, as reasonably and objectively defined by Nissan in the Dealer Agreement, which it clearly articulated to Seacoast, is a reasonable and material element of such agreement, and that Seacoast's performance, by any reasonable measure, was substandard. Consequently, Nissan acted in good faith and had good cause to terminate the franchise under RSA 357-C:7, IV.

At the beginning of the parties' relationship, Nissan set forth reasonable sales expectations and the method by which they would be measured in the Dealer Agreement. Nissan, through its DOMs, reinforced these objectives and the required sales goals repeatedly to Groux and Seacoast employees like James Lurvey, the general manager of the dealership, and provided many reasonable suggestions to Seacoast to improve its performance, all of which went unheeded.

Attachment 2

The evidence establishes that Nissan has good cause for termination because Seacoast has not substantially complied with reasonable performance criteria established by Nissan. RSA 357-C:7, II(a) and RSA 357-C:7, II(b)(3). Seacoast's perpetually poor performance was reviewed by Nissan's expert witness, Sharif Farhat, Vice-President of Expert Services for Urban Science Applications. Mr. Farhat's testimony was previously accepted and given significant weight by the Board in the case of Lakes Subaru, Ltd, No. 0080, (5/1/00), where the Board upheld the non-renewal of a New Hampshire Subaru dealer for poor sales performance. Mr. Farhat is a nationally recognized authority in the area of dealer network planning, part of which is assessing dealership performance. He has 23 years of experience and has been certified as an expert witness 80 different times, approximately 15 to 20 being sales based termination cases in state and federal courts, administrative agencies, and before motor vehicle boards. In fact, the majority of his work as an expert witness has been done before administrative agencies and boards.

In this case, the Board finds Mr. Farhat's testimony compelling and credible, and his lengthy analysis establishes that the termination in this case is warranted, objectively based, and not motivated by bias or prejudice

Attachment 2

against Groulx because he "pushed back" against Nissan after refusing to accept Nissan's dealer agreement terms. Mr. Farhat's testimony provides substantial weight that in this termination Nissan acted in good faith, satisfied the notice requirements, and that there was good cause for termination.

Specifically, Nissan's method of assigning and using PMAs and RSE to measure performance is recognized and is one used within the automotive industry and is standard practice. It is a practice used by various manufacturers to evaluate dealer performance. This method is applied throughout the country by Nissan to all of its dealers. Such evidences that its treatment of Seacoast was not arbitrary.

The methodology that Mr. Farhat used in reaching his conclusion that Nissan properly terminated Seacoast, has been recognized and accepted by court's, administrative agencies, and this Board. He concluded that the performance by Seacoast has been significantly lower than what was required by Seacoast's Dealer Agreement with Nissan. Mr. Farhat's testimony indicates that Seacoast's performance was grossly and blatantly inadequate based on the data that he evaluated. The requirements of the Dealer Agreement were reasonable and conservative. Also, he

Attachment 2

concluded that the performance factors were operational in nature, and well within Seacoast's control, and were not caused by factors outside of its control, like a failure to obtain proper inventory from Nissan. Moreover, the evidence presented shows that Nissan's allocation system for vehicles was fair and objective, and that Nissan did not manipulate Seacoast's allocations to harm Seacoast. In addition, there were several examples of DOMs assisting Seacoast in obtaining desirable vehicles to ensure that Seacoast had adequate Nissan inventory. The Board finds that Seacoast had proper inventory in order to make sufficient sales.

Also, Seacoast was given many opportunities to cure its poor performance yet failed to do so. The evidence demonstrated that Seacoast did not even try to cure its performance in that it did not implement any of Nissan's suggestions for improvement, all of which the Board finds were reasonable.

Also, since 2004, sales of Nissan brand vehicles have been trending upward, while during the same time, Seacoast sales trended downward. On average, New Hampshire Nissan dealers achieve 98% of region sales average, and several have exceeded such average. For example, Port City Nissan in Portsmouth has reached 258 percent of the region average

Attachment 2

for sales penetration, further demonstrating that the 100 percent percentage is only average, and that performance above such average is attainable.

Moreover, Mr. Farhat explained the impact that Seacoast's sales performance had on Nissan's overall sales. He pointed out that this performance caused Nissan to lose many sales to other brands in Seacoast's PMA. This caused significant harm to the Nissan brand in this marketplace. Also, Seacoast's sales performance represents a significant loss in revenue for the company. For example, during its time as a Nissan dealer, Seacoast has lost an estimated 2529 sales. Therefore, based on the sales statistics, it is clear that Seacoast did not actively and effectively promote Nissan sales within the PMA for which it was responsible under the Dealer Agreement. In some instances, other Nissan dealers sold twice as many vehicles within Seacoast's PMA as Seacoast did.

Seacoast argues that the termination is based on many other non-performance related reasons, and that Nissan engaged in unfair business practices and bad faith conduct. It also alleges that its sales performance was caused by factors beyond Seacoast's control.

First, Seacoast alleges that Nissan attempted to coerce it into becoming an exclusive dealer. Also, Seacoast

Attachment 2

alleges that Nissan coerced and threatened it into becoming an exclusive Nissan dealer after agreeing to allow it to dual with Honda. Next, it alleges that it is moving to terminate without good cause and not in good faith. Also, that Nissan imposed unreasonable restrictions on Seacoast's ability to transfer the dealership. Moreover, that it did not fail to comply with a material provision of the Dealer Agreement because it was not given a reasonable opportunity to exert good faith efforts to correct its deficiencies and that the termination is in fact, based on the dualled nature of the dealership. Also, that Nissan arbitrarily applied its exclusivity policy. Moreover, that Nissan failed to inform Seacoast of the prior dealer's fraudulent recall notice, agreed to a dual dealership, then allowed Seacoast to spend \$2.5 million in reliance of such representation, and then refused a franchise agreement.

The evidence presented does not support these claims. Based on the testimony of Mr. Grimm and Mr. Castingetti, Nissan exhibited remarkable patience with Seacoast during this often tense dealer/manufacturer relationship. Moreover, Nissan's DOMs exerted great effort to assist Seacoast with its operations in order to increase its sales performance. Groux often proved difficult to work with, as is demonstrated by his failure to implement any of the

Attachment 2

operational suggestions made by the DOMs. Nissan personnel repeatedly suggested that Seacoast spend more on Nissan advertising, yet even during the cure periods, Seacoast spent substantially more on Honda advertising than Nissan. Mr. Groux's testimony that the dealership financial statements did not correctly reflect the amount of money actually spent on Nissan advertising was not supported by the other evidence. As it was facing termination, Seacoast had a substantial motivation to document every dollar it spent on Nissan advertising in order to support its theory of unfair treatment by Nissan, and to enable it to dispute Nissan's claims that it was not expending sufficient funds on Nissan advertising.

Also, Nissan continually requested that Seacoast employ salespeople and an executive manager dedicated to selling Nissan vehicles yet Seacoast failed to do so. Therefore, Nissan's disapproval of the new facility was based on its belief that Seacoast's management was insufficient and did not warrant a new facility rather than due to a motivation to punish Seacoast. Seacoast's performance would not justify a new facility because its sales would not even pay for such new facility. Had Seacoast's sales performance improved to an acceptable level, it is reasonable to infer that Nissan would have then approved the move to a new

Attachment 2

facility. Nissan has had prior cases where a poor performing dealer's move into a new, exclusive facility failed to rectify poor sales performance and still resulted in termination. See Ralph Gentile, Inc, v. Nissan North America, Inc., No. TR-07-0001 (Wis. DAH 12/15/09).

Consequently, its decision to disallow Seacoast's move had an objective, reasonable basis.

Moreover, that Nissan continued to work with Seacoast to improve performance during the many years that this case has been pending before the Board suggests that it dealt objectively and reasonably with Seacoast. Otherwise, it would have refused to negotiate, and pushed the case to final hearing. That Nissan continued to negotiate, even while Seacoast continued to harm Nissan's sales penetration into the Exeter PMA, further evidences that it treated Seacoast fairly.

The Board, after careful review, finds that all of Seacoast's claims in this termination are not supported by the evidence. Based on the record, the Board finds that Nissan acted in good faith and had good cause for termination of the Dealer Agreement with Seacoast under RSA 357-C:7. The Board further finds that Seacoast's claims of prohibited conduct under RSA 357-C:3 are without merit and accordingly denied.

Attachment 2

THEREFORE, IT IS ORDERED that the consolidated termination protests No. 04-03, 06-04 and 07/15/08 are denied; and

IT IS FURTHER ORDERED that Seacoast's prohibited conduct claims under RSA 357-C:3 are denied; and

IT IS FURTHER ORDERED that Nissan shall provide Seacoast with the payment required under RSA 357-C:7, VI within 90 days from the date of this order.

By Order of the Board



Christopher Casco, Esq., Chair

Dated: April 12, 2010

Attachment 3

Texas Bill Analysis, H.B. 2559, 2007, Texas Bill Analysis, H.B. 2559, 2007

TX B. An., H.B. 2559, 2007

Texas Bill Analysis, 2007 Regular Session, House Bill 2559

2007

Texas House of Representatives
80th Legislature, 2007 Regular Session

C.S.H.B. 2559

By: Otto

Transportation

Committee Report (Substituted)

BACKGROUND AND PURPOSE

The Texas Occupations Code, Transportation Code, and Administrative Rules have been interpreted as restricting licensed Texas franchise and independent automobile dealers from using the Internet to advertise and sell vehicles to buyers who choose not to visit the dealership's licensed and established place of business.

Under the current law, existing auto dealers could be deemed to be engaging in offsite sales when they use the Internet to sell and ship vehicles to buyers who never personally appears at the dealer's permanent showroom or business location. Consequently, legitimate dealers fearing civil or criminal sanctions may be reluctant to adopt competitive online marketing and sales strategies.

CSHB 2559 reiterates the legal requirement for dealers to have an established and permanent place of business, which is approved by the Texas Department of Transportation's Motor Vehicles Division, and for which a general distinguishing number has been issued. This bill clarifies that off-site sales are prohibited, but provides licensed dealers a clear exemption to the off-site sales prohibition for sales and offers of sale that they make through the Internet to buyers who never visit the dealer's licensed place of business.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

SECTION 1. Amends Section 2301.361 of the Occupations Code to clarify the definition of offsite motor vehicle sales and provides that it would not be an offsite sale for a licensed Texas dealer, who is otherwise fully in compliance with the law at an established and permanent place of business, to use the Internet to sell motor vehicles to buyers who never physically appear at the dealer's established and permanent place of business.

EFFECTIVE DATE

Upon passage, or, if the Act does not receive the necessary vote, the Act takes effect September 1, 2007.

COMPARISON OF ORIGINAL TO SUBSTITUTE

The substitute adds the word "advertisement" so that it refers to an "advertisement on the Internet..." This language is aimed at ensuring that advertising violations contained in the Internet vehicle sales postings are treated the same as advertising violations in vehicle print or electronic media, and subject to regulation by the MVD under their advertising rules.

Attachment 3

Texas Bill Analysis, H.B. 2559, 4/23/2007, Texas Bill Analysis, H.B. 2559, 4/23/2007...

TX B. An., H.B. 2559, 4/23/2007

Texas Bill Analysis, 2007 Regular Session, House Bill 2559

April 23, 2007

Texas House Research Organization
80th Legislature, 2007 Regular Session

HB 2559

Otto

(CSHB 2559 by Haggerty)

SUBJECT: Authority to conduct motor vehicle sales on-line outside of a dealership

COMMITTEE: Transportation -- committee substitute recommended

VOTE: 8 ayes -- Krusee, Harper-Brown, Deshotel, Haggerty, Harless, Hill, Macias, Murphy

1 nay -- Phillips

WITNESSES: For -- Pedro "Speedy" Gonzales, Red McCombs Automotive Group; Robert McBryde, eBay Inc.; Karen Philips, Texas Automobile Dealers Association; (*Registered, but did not testify*: Beau Rothschild, New Car Dealers of Dallas; Jerry Thompson, FinServ Group, LTD; Geoff Wurzel, TechNet)

Against -- None

On -- (*Registered, but did not testify*: Brett Bray, Texas Dept. of Transportation)

BACKGROUND: Occupations Code, ch. 2301 governs the sale and lease of motor vehicles.

Transportation Code, ch. 503 defines "dealer" as a person who regularly and actively buys, sells, or exchanges vehicles at an established and permanent location. A dealer applying for a general distinguishing number or a wholesale motor vehicle auction general distinguishing number must demonstrate that the location for which the applicant requests the number is an established and permanent place of business.

Texas Administrative Code, Title 43, part 1, ch. 8, subch. E, sec. 8.136 governs off-site sales by an automobile dealer. Under this rule, a dealer is not permitted under Transportation Code, ch. 503 to sell or offer for sale vehicles from a location other than an established and permanent place of business that has been approved by the Motor Vehicle Division of the Texas Department of Transportation (TxDOT) and for which a general distinguishing number has been issued.

DIGEST: HB 2559 would amend Occupations Code, ch. 2301 to allow a dealer to sell or offer a motor vehicle for sale through an advertisement on the Internet to a buyer who never personally appeared at the dealer's established and permanent place of business.

A dealer would be allowed to sell or offer to sell a motor vehicle only from an established and permanent place of business that was approved by TxDOT's Motor Vehicle Division and for which a general distinguishing number had been issued.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2007.

Attachment 3

Texas Bill Analysis, H.B. 2559, 4/23/2007, Texas Bill Analysis, H.B. 2559, 4/23/2007...

SUPPORTERS SAY: CSHB 2559 would help Texas automobile dealers compete with out-of-state dealers by specifically allowing the online sale of vehicles. Current law has been interpreted to prohibit Texas dealers from selling vehicles over the Internet to buyers who never appear personally at the dealership. Many dealers could increase their business by using the Internet to sell and ship vehicles to customers who live in distant parts of Texas or out of state. In fact, the requirement to personally visit a dealership in Texas can be a deal-breaker for some customers.

Many industries in recent years have used the Internet to reach new customers seeking a quick and convenient way to shop. The Internet would be an excellent way for established, licensed dealerships and their customers to conduct negotiations, complete financial transactions, and arrange for delivery. The bill would apply to both domestic and out-of-state purchasers, and online sales from Texas dealerships would generate sales tax revenue for the state.

CSHB 2559 would not legalize "curbstoning," tent shows, or other sorts of illegal off-site sales. It is narrowly tailored to allow for Internet exchange by franchised dealers who complied with existing standards. In addition, like merchants in any line of business, automobile dealers already have adopted practices to prevent identity theft. The same protections dealers use to prevent fraud and identity theft in face-to-face transactions could be applied to online sales.

OPPONENTS SAY: Texas long has required purchasers of motor vehicles to visit the dealer's established and permanent place of business. This helps prevent fly-by-night dealers and other unscrupulous operators from taking advantage of customers. By allowing dealers to operate online, CSHB 2559 could weaken consumer protections that are supported by the current requirement for face-to-face interactions between customers and established dealers.

In addition, dealers historically have been able to offer customers additional and superior merchandise and services when they visit the dealership. Customers who did not visit the dealership in person under this bill would lose that valuable opportunity.

CSHB 2559 could increase the vulnerability of car dealerships to identity theft by removing traditional safeguards that spring from face-to-face contact. Online transactions already are hotbeds for identity theft as criminals use assumed identities and credit records to make purchases. This bill would make it harder for dealers to verify that their online customers were who they claimed to be.

OTHER OPPONENTS SAY: The bill could have some unforeseen consequences. Current law allows off-site sales of travel and boat trailers, motor homes, ambulances, and fire trucks at certain sanctioned events. It is not clear that such activities still would be permitted under CSHB 2559.

Rather than amending the section of the Occupations Code that regulates new car dealers, the bill should amend Transportation Code, ch. 503, which deals with general distinguishing numbers. This would bring the provisions of the bill to the attention of all car dealers, new and used.

NOTES: The committee substitute would modify the bill as introduced to allow a dealer to sell a vehicle online specifically through an "advertisement" on the Internet.

The companion bill, SB 1632 by Wentworth, was considered and left pending by the Senate Transportation and Homeland Security Committee on April 18.

TX B. An., H.B. 2559, 4/23/2007

Attachment 4 PFD's First Method vs. RSE

Dealer	Below Average Based on PFD's 1st Method ¹	Above Average Based on RSE ²
Nissan of San Marcos	56.88	120.50
Trophy	55.79	205.10
Nissan of Fort Worth	55.24	139.70
Round Rock	54.90	114.40
Autonation		
Lewisville	53.91	183.90
Ingram Park	53.03	149.10
Gillman	49.69	119.40
McDavid	47.52	129.10
Texas of Grapevine	46.83	219.90
Tom Peacock	46.81	154.00
Ancira	45.23	171.90
Mossy	44.98	141.80
Courtesy	41.11	149.90
Gunn	39.77	207.10
Mike Smith	37.73	105.20

¹ Each dealer's Nissan sales in its PMA as a percentage of total Nissan registrations in the dealer's PMA is taken from Ex. C-1, Tab 11, pp. 3R-4R.

² The dealer's RSE score is taken from Ex. R-274.

Attachment 5
PFD's Second Method vs. RSE
(October 2012-September 2013)

Dealer	Below Average Based on PFD's 2nd Method (R12 Sept. 2013) ¹	Above Average Based on RSE ²
Clear Lake	66.27	124.90
Nissan of Fort Worth	64.28	139.70
Ingram Park Autonation	62.10	149.10
Lewisville	60.94	183.90
Garlyn Shelton	60.16	101.30
Nissan of Midland	59.93	102.40
South West	59.50	166.80
Casa	56.93	105.60
Streater-Smith	54.84	102.70
Tom Peacock	53.39	154.00
Texas of Grapevine	52.63	219.90
Nissan of San Marcos	51.63	120.50
McDavid	48.98	129.10
Mike Smith	48.44	105.20
Ancira	47.69	171.90
Round Rock	46.11	114.40
Courtesy	41.38	149.90
Mossy	40.99	141.80
Gillman	39.38	119.4
Gunn	38.89	207.1

¹ Each dealer's Nissan sales in its PMA as a percentage of Nissan registrations in the dealer's PMA at region average is taken from Ex. C-2, Tab 1R, pp. 4-5.

² The dealer's RSE score is taken from Ex. R-274.

Attachment 6
PFD's Second Method vs. RSE
Calendar Year 2012

Dealer	Below Average Based on PFD's 2nd Method (CY 2012) ¹	Above Average Based on RSE ²
Victoria	65.08	103.80
Clear Lake	64.27	111.10
Casa	64.03	120.80
Viva	63.91	100.20
Ingram Park	62.62	159.90
Streater-Smith	58.84	104.00
South West	57.76	173.30
Nissan of McKinney	55.20	117.90
Tom Peacock	52.97	153.10
Gunn	49.13	253.80
Autonation Katy	49.07	106.60
Texas of Grapevine	48.93	198.70
McDavid	47.21	116.60
Town North	46.79	107.50
Mike Smith	46.71	106.90
Round Rock	45.67	112.10
Grubbs	45.40	103.30
World Car	43.36	103.10
Courtesy	42.40	159.7
Ancira	41.77	159.1
Gillman	39.93	142.40
Mossy	38.23	138.30
Autonation Irving	33.71	116.90
Autonation Dallas	28.03	105.40

¹ Each dealer's Nissan sales in its PMA as a percentage of Nissan registrations in the dealer's PMA at region average is taken from Ex. C-2, Tab 1R, pp. 13-14.

² The dealer's RSE score is taken from Ex. R-274.

Attachment 7

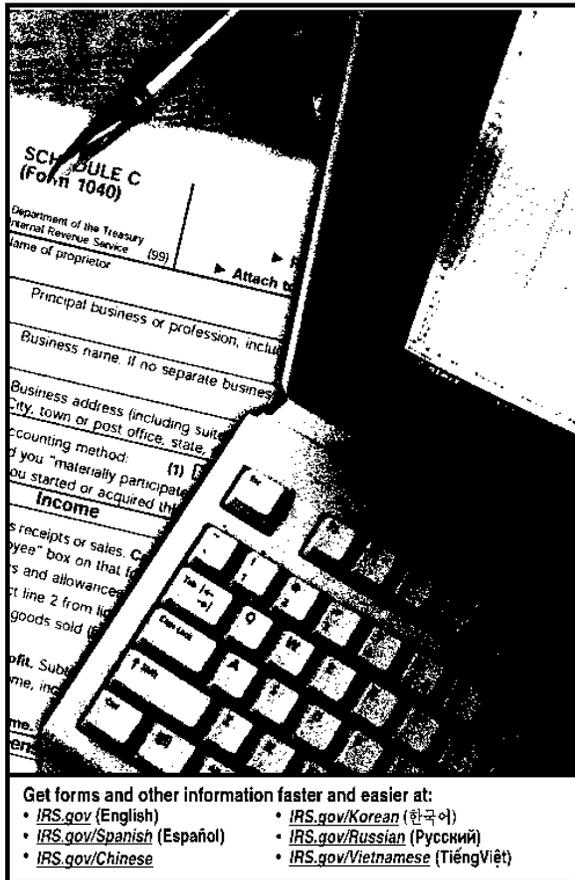


Department of the Treasury
Internal Revenue Service

Publication 583

(Rev. January 2015)
Cat. No. 15150B

Starting a Business and Keeping Records



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Contents

Introduction	1
What New Business Owners Need To Know	2
Determining Which Type of Business to Use	3
Getting a Taxpayer Identification Number	4
Employer Identification Number (EIN)	4
Payee's Identification Number	4
Designating a Tax Year	5
Choosing an Accounting Method	5
Business Taxes	6
Income Tax	6
Self-Employment Tax	7
Employment Taxes	7
Excise Taxes	8
Depositing Taxes	8
Information Returns	8
Penalties	9
Deducting Business Expenses	9
Business Start-Up Costs	9
Depreciation	10
Business Use of Your Home	10
Recordkeeping	11
How To Get Tax Help	24
Index	27

Introduction

This publication provides basic federal tax information for people who are starting a business. It also provides information on keeping records and illustrates a recordkeeping system.

Throughout this publication we refer to other IRS publications and forms where you will find more information. In addition, you may want to contact other government agencies, such as the Small Business Administration (SBA). See *How To Get Tax Help*, later.

Future Developments

For the latest information about developments related to Publication 583, such as legislation enacted after it was published, go to www.irs.gov/pub583.

Attachment 7

Single-entry. A single-entry system is based on the income statement (profit or loss statement). It can be a simple and practical system if you are starting a small business. The system records the flow of income and expenses through the use of:

1. A daily summary of cash receipts, and
2. Monthly summaries of cash receipts and disbursements.

Double-entry. A double-entry bookkeeping system uses journals and ledgers. Transactions are first entered in a journal and then posted to ledger accounts. These accounts show income, expenses, assets (property a business owns), liabilities (debts of a business), and net worth (excess of assets over liabilities). You close income and expense accounts at the end of each tax year. You keep asset, liability, and net worth accounts open on a permanent basis.

In the double-entry system, each account has a left side for debits and a right side for credits. It is self-balancing because you record every transaction as a debit entry in one account and as a credit entry in another.

Under this system, the total debits must equal the total credits after you post the journal entries to the ledger accounts. If the amounts do not balance, you have made an error and you must find and correct it.

An example of a journal entry exhibiting a payment of rent in October is shown next.

General Journal

Date	Description of Entry	Debit	Credit
Oct. 5	Rent expense	780.00	
	Cash		780.00

Table 3. Period of Limitations

IF you...	THEN the period is...
1. Owe additional tax and situations (2), (3), and (4), below, do not apply to you	3 years
2. Do not report income that you should report and it is more than 25% of the gross income shown on the return	6 years
3. File a fraudulent return	Not limited
4. Do not file a return	Not limited
5. File a claim for credit or refund after you filed your return	Later of: 3 years or 2 years after tax was paid
6. File a claim for a loss from worthless securities or a bad debt deduction	7 years

Computerized System

There are computer software packages you can use for recordkeeping. They can be purchased in many retail stores. These packages are very helpful and relatively easy to use; they require very little knowledge of bookkeeping and accounting.

If you use a computerized system, you must be able to produce sufficient legible records to support and verify entries made on your return and determine your correct tax liability. To meet this qualification, the machine-sensible records must reconcile with your books and return. These records must provide enough detail to identify the underlying source documents.

You must also keep all machine-sensible records and a complete description of the computerized portion of your recordkeeping system. This documentation must be sufficiently detailed to show all of the following items.

- Functions being performed as the data flows through the system.
- Controls used to ensure accurate and reliable processing.
- Controls used to prevent the unauthorized addition, alteration, or deletion of retained records.
- Charts of accounts and detailed account descriptions.

For more information, see Revenue Procedure 98-25 in Cumulative Bulletin 1998-1, available at www.irs.gov/Businesses/Automated-Records.

How Long To Keep Records

You must keep your records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep records that support an item of income or deduction on a return until the period of limitations for that return runs out.

The period of limitations is the period of time in which you can amend your return to claim a credit or refund, or the IRS can assess additional tax. Table 3 contains the periods of limitations that apply to income tax returns. Unless otherwise stated, the years refer to the period after

Attachment 7

the return was filed. Returns filed before the due date are treated as filed on the due date.



Keep copies of your filed tax returns. They help in preparing future tax returns and making computations if you file an amended return.

Employment taxes. If you have employees, you must keep all employment tax records for at least 4 years after the date the tax becomes due or is paid, whichever is later. For more information about recordkeeping for employment taxes, see Publication 15.

Assets. Keep records relating to property until the period of limitations expires for the year in which you dispose of the property in a taxable disposition. You must keep these records to figure any depreciation, amortization, or depletion deduction, and to figure your basis for computing gain or loss when you sell or otherwise dispose of the property.

Generally, if you received property in a nontaxable exchange, your basis in that property is the same as the basis of the property you gave up, increased by any money you paid. You must keep the records on the old property, as well as on the new property, until the period of limitations expires for the year in which you dispose of the new property in a taxable disposition.

Records for nontax purposes. When your records are no longer needed for tax purposes, do not discard them until you check to see if you have to keep them longer for other purposes. For example, your insurance company or creditors may require you to keep them longer than the IRS does.

Recordkeeping System Example

This example illustrates a single-entry system used by Henry Brown, who is the sole proprietor of a small automobile body shop. Henry uses part-time help, has no inventory of items held for sale, and uses the cash method of accounting.

These sample records should not be viewed as a recommendation of how to keep your records. They are intended only to show how one business keeps its records.

1. Daily Summary of Cash Receipts

This summary is a record of cash sales for the day. It accounts for cash at the end of the day over the amount in the Change and Petty Cash Fund at the beginning of the day.

Henry takes the cash sales entry from his cash register tape. If he had no cash register, he would simply total his cash sale slips and any other cash received that day.

He carries the total receipts shown in this summary for January 3 (\$267.80), including cash sales (\$263.60) and sales tax (\$4.20), to the *Monthly Summary of Cash Receipts*.

Petty cash fund. Henry uses a petty cash fund to make small payments without having to write checks for small amounts. Each time he makes a payment from this fund, he makes out a petty cash slip and attaches it to his receipt as proof of payment. He sets up a fixed amount (\$50) in his petty cash fund. The total of the unspent petty cash and the amounts on the petty cash slips should equal the fixed amount of the fund. When the totals on the petty cash slips approach the fixed amount, he brings the cash in the fund back to the fixed amount by writing a check to "Petty Cash" for the total of the outstanding slips. (See the *Check Disbursements Journal* entry for check number 92.) This restores the fund to its fixed amount of \$50. He then summarizes the slips and enters them in the proper columns in the monthly check disbursements journal.

2. Monthly Summary of Cash Receipts

This shows the income activity for the month. Henry carries the total monthly net sales shown in this summary for January (\$4,865.05) to his *Annual Summary*.

To figure total monthly net sales, Henry reduces the total monthly receipts by the sales tax imposed on his customers and turned over to the state. He cannot take a deduction for sales tax turned over to the state because he only collected the tax. He does not include the tax in his income.

3. Check Disbursements Journal

Henry enters checks drawn on the business checking account in the *Check Disbursements Journal* each day. All checks are prenumbered and each check number is listed and accounted for in the column provided in the journal.

Frequent expenses have their own headings across the sheet. He enters in a separate column expenses that require comparatively numerous or large payments each month, such as materials, gross payroll, and rent. Under the *General Accounts* column, he enters small expenses that normally have only one or two monthly payments, such as licenses and postage.

Henry does not pay personal or nonbusiness expenses by checks drawn on the business account. If he did, he would record them in the journal, even though he could not deduct them as business expenses.

Henry carries the January total of expenses for materials (\$1,083.50) to the *Annual Summary*. Similarly, he enters the monthly total of expenses for telephone, truck/auto, etc., in the appropriate columns of that summary.

4. Employee Compensation Record

This record shows the following information.

- The number of hours Henry's employee worked in a pay period.
- The employee's total pay for the period.

Attachment 8
HEARING ON THE MERITS - RESPONDENT'S EXH. NO. R-493
SOAH DOCKET NO. 608-14-3211.LIC

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>TOTAL</u> <u>2010 TO 2013</u>
RECOVERED PROFIT	\$ 121,571	\$ 277,447	\$ 442,245	\$ 813,448	\$ 1,654,711
CURRENT YEAR PROFIT	\$ 201,543	\$ 254,567	\$ 549,859	\$ 166,544	\$ 1,172,513
TOTAL PROFIT (12 TH MONTH)	\$ 323,114	\$ 532,014	\$ 992,104	\$ 979,992	\$ 2,827,224 NNA
TAXABLE INCOME REPORTED (13 TH MONTH)	\$ 74,988	\$ 68,251	\$ 76,605	\$ 100,300	\$ 320,144 IRS
13 TH MONTH WRITE DOWN	\$ 248,126	\$ 463,763	\$ 915,499	\$ 879,692	\$ 2,507,080
INVENTORY WRITE DOWNS	\$ 277,447	\$ 442,245	\$ 813,448	\$ 726,532	\$ 2,259,672
NON-INVENTORY ADJUSTMENTS	\$ -29,321	\$ 21,518	\$ 102,051	\$ 153,160	\$ 247,408
13 TH MONTH WRITE DOWN	\$ 248,126	\$ 463,763	\$ 915,499	\$ 879,692	\$ 2,507,080

SOURCE: R-368, ATTACHMENTS 5R AND 6R

SOURCE:

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
12 TH MONTH	R-75	R-142	R-203	R-292
13 TH MONTH	R-77	R-146	R-204	R-288
INVENTORY WRITE DOWNS	R-79	R-147	R-206	R-298

Attachment 9

1428	<p>1 dealer that is give or take roughly linear somewhat of a</p> <p>2 45-degree angle going up. And that's indicative of this</p> <p>3 unreliability of the early month income statements</p> <p>4 because of the write-down recovery.</p> <p>5 Q And what does Attachment 30 tell us about the</p> <p>6 accuracy and reliability of the financial statements?</p> <p>7 A They're not accurate and reliable on a</p> <p>8 month-by-month basis.</p> <p>9 Q Let's go to Attachment 31, please. What is</p> <p>10 Attachment 31, Mr. Walter?</p> <p>11 A Attachment 31 we're still talking about the</p> <p>12 write-downs. This is simply a count of the write-downs,</p> <p>13 the number of units written down, the yellow being new,</p> <p>14 the gray being used. What's evident here is consistent</p> <p>15 with some of the testimony that we've heard earlier that</p> <p>16 the number of write-downs increased over the years to</p> <p>17 get from a couple hundred thousand write-down to up to</p> <p>18 \$813,000 write-down. And you can see that just in the</p> <p>19 number of units written down, it's growing from about 60</p> <p>20 units up to north of 160 units. So over the years, not</p> <p>21 only is the write-down compounding, but the need for</p> <p>22 more and more units to be written down is similarly</p> <p>23 growing.</p> <p>24 Q And finally let's look at Attachment 33.</p> <p>25 What does Attachment 33 show us,</p>	1430	<p>1 MR. DONLEY: Your Honor, may Mr. Walter</p> <p>2 and I head over here to these charts for a moment?</p> <p>3 JUDGE BENNETT: That's fine.</p> <p>4 MR. DONLEY: One last thing we'd like to</p> <p>5 do.</p> <p>6 If I could have just one moment, Your</p> <p>7 Honor, to switch this around.</p> <p>8 Q (BY MR. DONLEY) Mr. Walter, have you taken</p> <p>9 what's on Exhibit 490 and actually translated that into</p> <p>10 the actual numbers on the financial statements that were</p> <p>11 provided to Nissan?</p> <p>12 A Yes, I have.</p> <p>13 Q Let's flip these pages back. Would you flip</p> <p>14 that other one back for me?</p> <p>15 A (Complied)</p> <p>16 Q Is that now what you have written on the board</p> <p>17 on these two pages that are being displayed?</p> <p>18 A Yes, it is.</p> <p>19 Q Can you walk us through this and tell us what</p> <p>20 these two pages actually show us with regard to the</p> <p>21 actual financial statements 2010 to 2013 that were</p> <p>22 provided to Nissan by Bates Nissan?</p> <p>23 A I can.</p> <p>24 Madam reporter, can you hear me okay?</p> <p>25 THE REPORTER: Yes.</p>
1429	<p>1 Mr. Walter?</p> <p>2 A It's a simple example of the 2013 reductions</p> <p>3 that were taken in early '14. There was a little bit of</p> <p>4 testimony on this that the initial write-downs occurred</p> <p>5 in February 5th of '14, and then for the same stock</p> <p>6 number, the same vehicle, five days later the write-down</p> <p>7 was kicked up.</p> <p>8 This is just a complete list of them, Your</p> <p>9 Honor. I think there's 26 or 27 of them on the page,</p> <p>10 and it's just showing that over a five-day period these</p> <p>11 27 units – 26, 27 units that were written down somehow</p> <p>12 or another were kicked up an extra five hundred to a</p> <p>13 couple thousand dollars in greater write-downs in order</p> <p>14 to accomplish the \$75,000 profitability goal.</p> <p>15 Q Have you seen or heard any evidence,</p> <p>16 Mr. Walter, for the initial write-downs, anything that</p> <p>17 would support those, or for the additional write-downs</p> <p>18 that were taken five days later?</p> <p>19 A No.</p> <p>20 Q What do you conclude based on Attachment 33?</p> <p>21 A It just goes as part of the overall story that</p> <p>22 we've heard over and over again, and that is that the</p> <p>23 write-downs were unsupported and that they were done for</p> <p>24 a purpose, and that purpose was to manage the taxable</p> <p>25 income.</p>	1431	<p>1 A What I'm showing is very similar to your</p> <p>2 Attachment R90 – excuse me, Exhibit R90 -- 490 is you</p> <p>3 start with the profitability in the 12th-month period.</p> <p>4 And Your Honor asked a question and I think you made a</p> <p>5 statement yesterday about what the actual numbers are</p> <p>6 instead of the hypothetical on 490, and so that's what</p> <p>7 this is laying out.</p> <p>8 The original profitability reported in '10</p> <p>9 to Nissan was 323,000. That's comprised of two</p> <p>10 components, the current-year profit plus the carryover</p> <p>11 2009 write-downs that are reversed in 2010. If we then</p> <p>12 look at the goal of taxable income of just approximately</p> <p>13 75,000, in this case 74,988, you come to the 13th-month</p> <p>14 write-downs for how much was written down. But the</p> <p>15 bottom half of this page I break that write-down into</p> <p>16 two components. One is the next year write-downs, which</p> <p>17 is the 277, and the other is the noninventory</p> <p>18 adjustments, which I'm not taking criticism of. They</p> <p>19 are whatever they are based on depreciation or bonuses</p> <p>20 or something for the total 248. But this 277 write-down</p> <p>21 then rolls up into the next year, 2011, and you go</p> <p>22 through the same process again.</p> <p>23 So the numbers I showed you on the chart a</p> <p>24 few minutes ago on the screen were what was the 12th</p> <p>25 period, what was the 13th period and how do they</p>

Attachment 9

1432	<p>1 actually roll together as you look at the write-downs. 2 And so what this exhibit is up on the charts is showing 3 you that the 277 in '10 rolls up as a component of the 4 2011 profits. The 2011 write-down rolls up as a 5 component of the 2012 profits. The number that's been 6 mentioned a number of times, you'll recognize the 7 \$13,448 rolls up from 2012 to '13. So I'm showing how 8 the cumulative effect of the write-downs is rolling from 9 year to year to year in this chart. That's the first 10 thing I'm showing. 11 The second thing is I'm totaling it across 12 the page, Your Honor, to show what the total impact is. 13 And so if you just look at the third line, Nissan was 14 told in these years there was \$2.8 million in profit. 15 The IRS was told it was about \$320,000 in profit. And 16 if you look at that difference, it's \$2.5 million. That 17 \$2.5 million is broken into two components, 2,259,672, 18 which is the cumulative effect of the write-downs, plus 19 the noninventory adjustments, which I'm not taking 20 criticism of, gives you the 2.5. And so basically what 21 I'm showing is that the -- the updated version, if you 22 will, of the \$2.7 million that I testified about 23 yesterday, which I learned about or showed in my 24 October of '14 report. In my July of '15 report on 25 Attachments 5R and 6R, I've updated that based on an</p>
1433	<p>1 updated income in 2010 from a financial statement. It's 2 based on not taking criticism of the normal year-end 3 adjustments that are not inventory related. And so I 4 would say that the new version, if you will, of the 5 2.7 million is roughly 2.25 million, two and a quarter 6 million. 7 Q (BY MR. DONLEY) Mr. Walter, are you aware of 8 any basis at all, any lawful basis, accounting basis, 9 any kind of basis at all that would support telling 10 Nissan \$2.8 million in profit versus telling the IRS 11 \$320,000? 12 A Not based on the testimony that I've heard here 13 and records I've reviewed. 14 Q And that was based on the total. How about how 15 that same thing occurred in 2010, '11, '12 and '13? 16 A Same thing for each year. 17 Q Based on these two charts, which I'll mark in a 18 moment with the next number and ask for admission, what 19 do you conclude regarding the accuracy and reliability 20 of the financial statements that were provided to 21 Nissan? 22 A They're not accurate or reliable either 23 annually or, as I testified a few minutes ago, month by 24 month by month during the course of this time period. 25 Q Was the information that was inaccurately</p>
1434	<p>1 reported to Nissan on the 2010 through 2013 financial 2 statements, was that information material? 3 A Absolutely. 4 Q Why do you say that? 5 A Well, because again we've heard other testimony 6 from the Nissan witnesses and, frankly, Your Honor, from 7 my experience with a variety of manufacturers, the OEMs 8 rely upon those financial statements for their monthly 9 meetings with the -- what Nissan calls their DOMs. 10 There's other terms for other manufacturers. But those 11 financial statements go into the evaluation in those 12 meetings in terms of counseling the dealer and trying to 13 improve the overall performance of this dealer body, 14 Bates Nissan and all the rest of the Nissan dealers. 15 Q One more thing if I could, Mr. Walter. I want 16 to focus your attention on 2011 and what you call the 17 recovered profit of 277,447. Do you see that? 18 A I do. 19 Q And when you add the current year profit, you 20 had a total profit for that year of 532,000. Correct? 21 A Correct. 22 Q Now, there was a write-down in 2011 on the 23 financial statements of 463,763. Correct? 24 A That's the total including both the inventory 25 and the noninventory write-downs.</p>
1435	<p>1 Q Now, if -- if 277 and 254 are added together 2 and you're driving to around \$75,000 in taxable income, 3 how much of the 277 -- at a minimum, how much of the 277 4 had to be further wrote down in 2011 to get there? 5 A Certainly at least the difference between 6 270 -- excuse me -- 442,245, which is the inventory 7 write-down, and the other profits that were earned 8 during the year. So somehow -- and these are fungible 9 dollars. So somehow the write-down is accumulated as 10 part of the 277 or it's accumulated as part of the 254. 11 I frankly don't care which is which, but in total the 12 write-down covers the substantial part of both of those 13 numbers. 14 Q And do we see that reoccurring in 2012 and 15 2013? 16 A We do. 17 Q Is there anything you know of that would 18 support doing that? 19 A No. 20 MR. DONLEY: What is the next R number, 21 please? 22 MS. GOEHRS: It would be 493. 23 (Discussion off the record) 24 JUDGE BENNETT: Okay. Yeah. Back on the 25 record now.</p>

Attachment 9

<p style="text-align: right;">1436</p> <p>1 MR. DONLEY: All right, Your Honor. These 2 two pieces of paper, the charts that Mr. Walter and I 3 just went through, I'd ask to have those marked as 4 R-493, and I understand Your Honor's prior instructions; 5 we'll take care of that if it's okay with Your Honor. 6 (Exhibit Respondent No. 493 marked) 7 JUDGE BENNETT: Okay. Any objection? 8 MR. COFFEY: No objection, Judge. 9 JUDGE BENNETT: Okay. R-493 is admitted 10 and it will be produced and provided to the record. 11 (Exhibit Respondent No. 493 admitted) 12 MR. DONLEY: Thank you, Your Honor. And 13 with that, Your Honor, I'll pass the witness. 14 RE-CROSS-EXAMINATION 15 BY MR. COFFEY: 16 Q Mr. Walter, in relation to -- 17 A Excuse me, Mr. Coffey. Can you speak up just a 18 little bit? Thank you. 19 Q In reference to this chart that you've just 20 been testifying about, did you do any analysis of any 21 other Nissan dealer that uses lower of cost or market to 22 determine whether or not Bates was completely out of 23 line with other LCM dealers or give us any kind of 24 insight in the degree to which Bates may be different 25 from other LCM dealers?</p>	<p style="text-align: right;">1438</p> <p>1 really hard to hear you, but I think I heard you enough 2 to answer the question, and that is, this is their 3 actual sales and availability. This is not an 4 allocation chart, but it's testing the allocation system 5 to see how it worked with respect to Bates and then with 6 respect to the next chart, which is the comparison with 7 the other dealers. 8 Q And all I'm saying is that this availability 9 does not include any allocation issues. In other words, 10 it's what he had on hand, however he might have gotten 11 it, whether dealer trades or allocation or whatever, as 12 compared to his actual sales? 13 A Correct, same for him and all the other 14 dealers, yes, sir. 15 Q All righty. Now, I noticed in all of these 16 charts your data cutoff seems to be September 2013. Is 17 that correct? 18 A That -- for most -- all these inventory charts, 19 that's correct. 20 Q Okay. I take it then that you did not look 21 beyond September of 2013 when making your various 22 analyses of whether or not Bates was making good 23 management decisions regarding how he handled his 24 inventory? 25 A That's correct. I was asked to analyze it</p>
<p style="text-align: right;">1437</p> <p>1 A I did not analyze other dealers. I analyzed 2 Bates. 3 Q Okay. Let's go back to the beginning of your 4 attachments in your first report, R-366, and let's start 5 with Attachment No. 4. 6 A I'm there. 7 Q All right. You went through these attachments 8 a little fast for me because I was trying to write down 9 what you were saying and watch at the same time. So 10 let's make sure I have an understanding of these 11 attachments. 12 Attachment 4, Bates Nissan Total Nissan 13 Sales Versus Availability. How are you defining 14 "availability" on that chart? 15 A That's in the footnote at the bottom. And I 16 gave Your Honor an example if he had 30 at the end of 17 the month and he sold ten during the month, then the 18 total availability is the sales plus the ending 19 inventories, you touched 40 vehicles during the course 20 of the month. 21 Q So this doesn't really address allocation. 22 When you're talking about availability, you're talking 23 about what he had on hand to sell, and then comparing to 24 that the actual sales that he made. 25 A Two things. I'm not sure your mic is on. It's</p>	<p style="text-align: right;">1439</p> <p>1 through the NOD period ending in September of '13. 2 Q Right. So if we have testimony in the record 3 as to the management decisions made by Bates following 4 the notice of termination in December of 2013, you're 5 not going to have any comments or refutation for that 6 testimony. Is that correct? 7 A As it relates to inventory, I'm not. I think 8 other witnesses may talk about that, but that's not my 9 topic. 10 Q All right, sir. Let's go to Chart No. 8. Now, 11 when you were putting these charts together, I guess you 12 were probably told or became aware that the periods of 13 time that you're looking at, roughly 2010 through 14 September of 2013, that was basically the default period 15 we've been talking about through these proceedings. 16 Correct? 17 A Yes. 18 Q That was the period of time in which Nissan 19 expected Bates to achieve 100 percent RSE on a 12-month 20 rolling basis. Correct? 21 A That's my understanding of the testimony, yes. 22 Q Okay. Now, you testified the other day that 23 you did not go into the dealership, you did not observe 24 dealership operations. Correct? 25 A Yes, sir.</p>

Attachment 10

1

SOAH DOCKET NO. 608-14-3211.LIC

MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

BATES NISSAN, INC.,	)	STATE OFFICE OF
Complainant,)	
)	
v.)	
)	
NISSAN NORTH AMERICA, INC.,)	
Respondent.	)	ADMINISTRATIVE HEARINGS

HEARING ON THE MERITS

Tuesday, September 15, 2015

BE IT REMEMBERED THAT at 9:00 a.m., on Tuesday, the 15th day of September 2015, the above-entitled matter came on for hearing at the State Office of Administrative Hearings, William P. Clements, Jr., Building, 300 West 15th Street, Room 404, Austin, Texas, before CRAIG BENNETT, Administrative Law Judge, and the following proceedings were reported by Lorrie A. Schnoor and Dalia F. Inman, Certified Shorthand Reporters.

Volume 1

Pages 1 - 247

Attachment 10

102	<p>1 change?</p> <p>2 A This was actually generated by my conversation</p> <p>3 with Pete Muriel. So they were telling me what they</p> <p>4 needed to -- what I needed to provide in order to do</p> <p>5 what I was trying to do at the time, which was</p> <p>6 straighten the ownership up. And I was unsuccessful</p> <p>7 with that because the estate was tied up in probate, or</p> <p>8 our however you say that. Sherri was, at the time,</p> <p>9 unwilling to make herself financially or physically</p> <p>10 responsible for that trust or for that third ownership.</p> <p>11 So none of that got done because she kind of put the</p> <p>12 brakes on it.</p> <p>13 Q I understand. But the purpose of my question</p> <p>14 is to point out your dealership was on notice that</p> <p>15 Nissan expected, when changes happened, to see corporate</p> <p>16 documents reflecting the change, did it not?</p> <p>17 A Again, I don't know that I would say put on</p> <p>18 notice. I requested this information so that I could --</p> <p>19 so that I could do that very thing, straighten up the</p> <p>20 ownership with the company and make -- un muddy the</p> <p>21 waters, so to speak.</p> <p>22 Q Okay. Let's now go to Exhibit C-63. Now, this</p> <p>23 one's dated July 1st of 2013. Do you see that?</p> <p>24 A I do.</p> <p>25 Q And it's also regarding this minority ownership</p>	104	<p>1 A It is.</p> <p>2 Q And in -- on September 22nd, 2014, you and your</p> <p>3 father signed a letter sent to Nissan; and in the</p> <p>4 letter, at the bottom, it represents that your father,</p> <p>5 Jimmy, is dealer principal, does it not?</p> <p>6 A It does.</p> <p>7 Q Now, did you prepare this letter?</p> <p>8 A Actually, I think this letter was prepared by</p> <p>9 counsel. But we approved the letter.</p> <p>10 Q You read it and approved it before it was</p> <p>11 mailed, didn't you?</p> <p>12 A Yes.</p> <p>13 Q Now, let's look at the first paragraph of this</p> <p>14 letter. Now, here, you and your father sent the letter</p> <p>15 in September stating that Bates Nissan intends to change</p> <p>16 its dealer principal from Jimmy to you. Do you see</p> <p>17 that?</p> <p>18 A Yes.</p> <p>19 Q And that you further said you, Bobby, currently</p> <p>20 serving as executive manager to Bates Nissan and will</p> <p>21 continue to serve as executive manager?</p> <p>22 A Correct.</p> <p>23 Q And we know that to be true because you became</p> <p>24 executive manager in 2002. Correct?</p> <p>25 A Correct.</p>
103	<p>1 change. Now, you recognize this as the follow-up letter</p> <p>2 submitted prior from the 2012, do you not?</p> <p>3 A If you want to call it a follow up. It's a</p> <p>4 year later.</p> <p>5 Q In fact, in this letter, it's still, again,</p> <p>6 asking --</p> <p>7 A Asking for the same documentation.</p> <p>8 Q Yeah, same documentation including corporate</p> <p>9 resolutions regarding the changes that are made at the</p> <p>10 dealership.</p> <p>11 A Yes.</p> <p>12 Q And throughout 2010, '11, '12, and '13, your</p> <p>13 dealership didn't complete any of those ownership or</p> <p>14 management changes, did it?</p> <p>15 A No. Was unable to do so.</p> <p>16 Q Now, let's go to Exhibit C-32. Do you</p> <p>17 recognize this letter, sir?</p> <p>18 A I do.</p> <p>19 Q It's dated September 22nd of, 2014. Do you see</p> <p>20 that?</p> <p>21 A I do.</p> <p>22 Q And down at the bottom, is that your signature?</p> <p>23 A It is.</p> <p>24 Q And in the left, is that your father, Jimmy's,</p> <p>25 signature?</p>	105	<p>1 Q And then the next sentence states, "Mr. Jimmy</p> <p>2 B. Bates will retire from dealership operations." Do</p> <p>3 you see that?</p> <p>4 A Yes.</p> <p>5 Q That's a future speaking event, is it not?</p> <p>6 A Correct. It is.</p> <p>7 Q Now, let's then go to the fact that the letter</p> <p>8 doesn't state that Mr. Jimmy Bates had already retired,</p> <p>9 does it?</p> <p>10 A Well, he still wouldn't consider himself</p> <p>11 retired today, so that depends on who you ask.</p> <p>12 Q Okay. Now, there's no other prior letter</p> <p>13 that's an exhibit in this case that your dealership sent</p> <p>14 to Nissan notifying it of any requested change in dealer</p> <p>15 principal, is there?</p> <p>16 MR. COFFEY: Judge, I have to ask the</p> <p>17 relevance of all this. We have not been noticed with</p> <p>18 termination for not providing them proper ownership</p> <p>19 information or anything like that. Why are we even</p> <p>20 going through all of this?</p> <p>21 JUDGE BENNETT: Well, I'm not going to get</p> <p>22 too much into that because, as I indicated, generally</p> <p>23 speaking, I give a great deal of leeway, especially when</p> <p>24 the parties have time limits. So if they want to use</p> <p>25 their time on something that may ultimately be</p>

Attachment 10

106	<p>1 irrelevant, they can do so. So I'm going overrule that 2 objection.</p> <p>3 Q (BY MR. JARRETT) Now, let's go back to your 4 prefiled direct, because this is a future speaking event 5 as to Jimmy, is it not, on retiring?</p> <p>6 A Yes.</p> <p>7 Q Let's go back to C-338-1, Page 10 of your -- of 8 the PDF. Now, in prefiled direct, you told the ALJ, and 9 you're telling the Board, in Lines 14 through 18 in 10 questions from your own attorney, he asked, "Let's go 11 back to Jimmy Bates, your dad. Was he once involved in 12 the operations of the Nissan dealership?"</p> <p>13 And your answer was, "Yes, he was very 14 active in the car business probably up until six, seven 15 years ago and more or less turned it over to myself and 16 our general manager, John Johnston, to take an active 17 role in day-to-day operations."</p> <p>18 Is that what you said?</p> <p>19 A That's what I said, yes, sir.</p> <p>20 Q And this filed in 2015 in this case?</p> <p>21 A Yes.</p> <p>22 Q And six or seven years ago meant that that 23 happened -- your father turned over to you and 24 Mr. Johnson active day-to-day operations as you state 25 here, sometime in 2008 or '09, did he not?</p>	108	<p>1 C-31, these minutes with respect to an attachment to 2 that September 2014 letter, did you?</p> <p>3 A We didn't.</p> <p>4 Q Now, let's focus your attention on the 5 Paragraph No. 4 of this document. Now, on January 1 of 6 2014, the officers that were elected at Bates Nissan was 7 you as dealer principal. Do you see that?</p> <p>8 A Yes.</p> <p>9 Q And now, this election of you as dealer 10 principal, that's not conditioned upon any approval from 11 Nissan, was it?</p> <p>12 A No. But approval wouldn't -- it was solved 13 later and would've been solved later. We had reasons 14 not to -- that we didn't pursue that at that time. 15 Whether you want to hear that or not, it's a good 16 question.</p> <p>17 Q But when you, your father, and Gailya did this 18 act on January 1 of '14, your corporation, without 19 reservation, unconditionally made you both president and 20 dealer principal, did it not?</p> <p>21 A Yes.</p> <p>22 Q Now, let's go to Page 2 of Exhibit 31. Is that 23 your signature, sir?</p> <p>24 A Yes, sir.</p> <p>25 Q And is that Gailya's signature?</p>
107	<p>1 A Yes.</p> <p>2 Q And you don't change from that testimony, do 3 you?</p> <p>4 A No, no reason to. I mean, I know where you're 5 going with this as far as on the retirement basis. But 6 like I said, turning over the day-to-day operations 7 doesn't instantly put you in retirement.</p> <p>8 Q Now let's go to Exhibit C-31. Do you recognize 9 these as minutes of your own corporation of an event 10 that it did January 1 of 2014, do you not?</p> <p>11 A Yes.</p> <p>12 Q These are official corporate documents, are 13 they not?</p> <p>14 A They are.</p> <p>15 Q And this document memorializes those acts that 16 you, in fact, did take on January 1 of '14. Correct?</p> <p>17 A Yes.</p> <p>18 Q These are produced in discovery in this case. 19 Right?</p> <p>20 A Yes.</p> <p>21 Q They hadn't been given to Nissan before 22 discovery -- before the case had been involved in 23 discovery?</p> <p>24 A They had not.</p> <p>25 Q Okay. And you didn't provide this Exhibit</p>	109	<p>1 A It is.</p> <p>2 Q And is that your father, Jimmy's, signature?</p> <p>3 A It is.</p> <p>4 Q So nine months before the September letter, you 5 signed these minutes being the director, president, and 6 dealer principal of Bates Nissan, didn't you?</p> <p>7 A I did.</p> <p>8 Q And but for this litigation and the production 9 of that in litigation, this document was never provided 10 to Nissan, was it?</p> <p>11 A It was not.</p> <p>12 Q Now, let's turn back to the area of sales 13 performance. In your prefiled direct, I take it your 14 position there's no industry in Killeen other than the 15 Fort Hood military base. In fact, you stated it twice 16 in prefiled direct. Do you recall that?</p> <p>17 A That is our industry.</p> <p>18 Q Now, let's look at your prefiled direct as to 19 how you testified as to the effect of the military in 20 Killeen as to your business. And let's go to 338-1, 21 Page 17, Lines 30 to 34.</p> <p>22 Now, you testified that -- on questioning 23 from your own counsel, "In what ways does being a 24 military town affect your business," you testified that 25 when Fort Hood's on lockdown, all of Killeen's on</p>

Attachment 10

248

SOAH DOCKET NO. 608-14-3211.LIC

MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

BATES NISSAN, INC.,	)	STATE OFFICE OF
Complainant,)	
)	
v.)	
)	
NISSAN NORTH AMERICA, INC.,	)	ADMINISTRATIVE HEARINGS
Respondent.)	

HEARING ON THE MERITS

Wednesday, September 16, 2015

BE IT REMEMBERED THAT at 8:33 a.m., on Wednesday, the 16th day of September 2015, the above-entitled matter came on for hearing at the State Office of Administrative Hearings, William P. Clements, Jr., Building, 300 West 15th Street, Room 404, Austin, Texas, before CRAIG BENNETT, Administrative Law Judge, and the following proceedings were reported by Kim Pence and Steven Stogel, Certified Shorthand Reporters.

Volume 2

Pages 248 - 543

Attachment 10

253	<p>1 to just one round. For example, if another party wants</p> <p>2 to ask a couple of follow-up questions, I do that until</p> <p>3 pretty much all questions are exhausted from all sides.</p> <p>4 MR. ALANIZ: Thank you, Your Honor.</p> <p>5 JUDGE BENNETT: So I don't think you'll</p> <p>6 have a problem. If you need to ask additional</p> <p>7 questions, I'm going to allow it.</p> <p>8 Okay. Anything else housekeeping-wise?</p> <p>9 (No response)</p> <p>10 JUDGE BENNETT: Okay. Well, then let's</p> <p>11 resume then. I think we're ready for you, Mr. Jarrett.</p> <p>12 MR. JARRETT: Thank you.</p> <p>13 PRESENTATION ON BEHALF OF RESPONDENT</p> <p>14 (CONTINUED)</p> <p>15 BOBBY BATES (ADVERSE),</p> <p>16 having been previously duly sworn, continued to testify</p> <p>17 as follows:</p> <p>18 DIRECT EXAMINATION (CONTINUED)</p> <p>19 BY MR. JARRETT:</p> <p>20 Q Good morning, Mr. Bates. How are you?</p> <p>21 A Good morning.</p> <p>22 Q From where we left off yesterday, I'd like to</p> <p>23 focus on the issue of whether your actions were</p> <p>24 voluntary or involuntary. And you understand an</p> <p>25 involuntary action means that you had no choice in what</p>	255	<p>1 do you not?</p> <p>2 A I do.</p> <p>3 Q And at the bottom of the document, that's your</p> <p>4 signature, isn't it?</p> <p>5 A It is.</p> <p>6 Q And you signed this document on July -- looks</p> <p>7 like the 16th, possibly the 18th, of 2010. Do you see</p> <p>8 that?</p> <p>9 A Yes, I do.</p> <p>10 Q Now, let's call that the first paragraph, if</p> <p>11 you would. And you're the individual who put the</p> <p>12 checkmark in the yes box, are you not?</p> <p>13 A I believe so.</p> <p>14 Q And in that you stated that -- to Nissan that</p> <p>15 you've read and understood the general program</p> <p>16 guidelines for the Nissan regional marketing program,</p> <p>17 RMP. Then by checking the box you stated, "Dealer</p> <p>18 understands that by voluntarily agreeing to participate,</p> <p>19 dealer is agreeing to contribute on a dollar-for-dollar</p> <p>20 matching basis with Nissan into a regionally-controlled</p> <p>21 marketing fund." Did I read that correctly?</p> <p>22 A You did.</p> <p>23 Q Now, then it's true that your participation</p> <p>24 into the RMP was not involuntary, but it was, in fact,</p> <p>25 voluntary?</p>
254	<p>1 to do. Is that correct?</p> <p>2 A Yes.</p> <p>3 Q Now, let's look at your testimony on Exhibit</p> <p>4 C-338-1 at Page 65 of the transcript. And if we would</p> <p>5 look -- focus your attention on Lines through 7, on</p> <p>6 direct examination through your attorney, he asked if</p> <p>7 the co-op advertising program was voluntary or</p> <p>8 involuntary, and you recall your answer here was that it</p> <p>9 was involuntary. Correct?</p> <p>10 A That's what I testified to, yes.</p> <p>11 Q And you said you had to pay the invoice charge</p> <p>12 whether we want it or not. Is that optimal -- and it is</p> <p>13 not optimal. Is that what you said?</p> <p>14 A I think optional was what I meant, but, yes.</p> <p>15 Q That's right. You meant not optimal but</p> <p>16 optional?</p> <p>17 A Yes.</p> <p>18 Q Now, this co-op advertising program, that's the</p> <p>19 RMP program. Correct?</p> <p>20 A That's what we were speaking of, yes.</p> <p>21 Q Okay. Now, let's now go to Exhibit 294,</p> <p>22 please.</p> <p>23 MR. DONLEY: C or R?</p> <p>24 MR. JARRETT: C-294, I'm sorry.</p> <p>25 Q (BY MR. JARRETT) You recognize this document,</p>	256	<p>1 A It was voluntary, but in my -- in my thinking,</p> <p>2 it's basically required that we participate in that,</p> <p>3 understanding the wording of this contract. But at the</p> <p>4 same time, had I opted out of that, then surrounding</p> <p>5 dealers would have an advantage over me.</p> <p>6 So, yes, it's listed as voluntary, but</p> <p>7 required in my way of thinking or in my mind.</p> <p>8 Q And let's -- before we pull out of that, if you</p> <p>9 would, and let's look at the -- pull up the second</p> <p>10 paragraph under the yes column there.</p> <p>11 Yeah, thank you.</p> <p>12 Now, here it states by you having checked</p> <p>13 yes that you understood, "Dealer voluntarily chooses to</p> <p>14 participate in this program. Dealer understands that</p> <p>15 Nissan is relying upon this document as evidence of</p> <p>16 dealer's choice to participate."</p> <p>17 Now, is that an accurate -- did I read</p> <p>18 that accurately?</p> <p>19 A Yes.</p> <p>20 Q And then next it states, "Dealer's decision to</p> <p>21 participate is completely voluntary, and I acknowledge</p> <p>22 that dealer is free to sell Nissan products at whatever</p> <p>23 price, markup or margin I wish." Is that a true</p> <p>24 statement?</p> <p>25 A That's the way it's written, yes, sir.</p>

Attachment 10

317	<p>1 Do you understand that what Nissan</p> <p>2 conveyed here is that the creation of a Month 13 is</p> <p>3 optional? Not all dealers do it, do they?</p> <p>4 A No, they do not.</p> <p>5 Q And yet in this, the next one is that we will</p> <p>6 accept paper copies of your Month 13 beginning</p> <p>7 January 21, 2012. Do you see that?</p> <p>8 A I do.</p> <p>9 Q And your dealership has never sent in any paper</p> <p>10 copies of its Month 13s to Nissan --</p> <p>11 A We have not.</p> <p>12 Q Now, back out and we'll just generally look at</p> <p>13 the statement to make sure we clarify one thing. Take a</p> <p>14 moment if you would, Mr. Bates, to just generally</p> <p>15 review, because here is my question I'd like to you</p> <p>16 answer after you do so.</p> <p>17 You do not read anything in this bulletin</p> <p>18 that attempts to clarify the warning we saw in the prior</p> <p>19 bulletin relative to the government expecting the same</p> <p>20 information that is reported to it to be on what's</p> <p>21 reported to Nissan. You don't see that --</p> <p>22 A I don't see that in this document, no.</p> <p>23 Q Okay, sir. Now, let's call up your prefiled</p> <p>24 testimony, Exhibit 338-2, at Page 9 of the transcript.</p> <p>25 And we need to also bring up Page 10, please -- no, Page</p>	319	<p>1 A In order to comply with what I understand to be</p> <p>2 IRS regulations, again, the first 90 days are somewhat</p> <p>3 skewed.</p> <p>4 Q And --</p> <p>5 JUDGE BENNETT: Let's -- oh, go ahead.</p> <p>6 MR. JARRETT: No, I'm sorry.</p> <p>7 JUDGE BENNETT: Well, we're going to take</p> <p>8 a break, so I didn't know if you were --</p> <p>9 MR. JARRETT: That's fine, Your Honor.</p> <p>10 JUDGE BENNETT: But if you want to finish</p> <p>11 this line --</p> <p>12 MR. JARRETT: No, that's fine, Your Honor.</p> <p>13 JUDGE BENNETT: Okay. Let's go ahead and</p> <p>14 go off the record. We'll take our first morning break.</p> <p>15 It will last approximately 15 minutes until about 10:15</p> <p>16 and we'll start back.</p> <p>17 (Recess: 10:00 a.m. to 10:20 a.m.)</p> <p>18 JUDGE BENNETT: All right. Let's go ahead</p> <p>19 and go back on the record and resume with the</p> <p>20 examination of the witness.</p> <p>21 MR. JARRETT: Thank you, Your Honor.</p> <p>22 Q (BY MR. JARRETT) Let's bring up Exhibit C-160,</p> <p>23 please. And if you would, go to the second page, upper</p> <p>24 left-hand column.</p> <p>25 Would you call out the top of the page</p>
318	<p>1 9 and Page 10, please. Thank you.</p> <p>2 Let's focus on Lines 29 on Page 9 over to</p> <p>3 Line 1 on Page 10. The question your counsel asked you</p> <p>4 for your prefiled direct was, "All right. Let's just</p> <p>5 talk just about the 12-month statements. Do those</p> <p>6 12-month statements that you have to file with Nissan</p> <p>7 accurately report the financial condition of the</p> <p>8 dealership?"</p> <p>9 And your answer was "They do." Do you see</p> <p>10 that?</p> <p>11 A I do.</p> <p>12 Q Now, today do you stand by that testimony?</p> <p>13 A After some education I probably have to amend</p> <p>14 that to some degree, at least for the first few months</p> <p>15 in the timeframe that we're talking about. The first</p> <p>16 few months of the Year the financial picture is a</p> <p>17 recovery of written down amounts, which are shown as</p> <p>18 profit -- paper profits, if you will, on the financial</p> <p>19 statement for the first 90 days of the Year.</p> <p>20 Q We'll get to that later, but I think you've</p> <p>21 just -- for the record, let's make sure it's all clear.</p> <p>22 You now admit that your Month 13 -- or your standard</p> <p>23 financial statements that are submitted to Nissan do not</p> <p>24 accurately reflect the true financial picture of your</p> <p>25 dealership?</p>	320	<p>1 down through Line 16 or thereabouts?</p> <p>2 Now, Mr. Bates, earlier you testified that</p> <p>3 you didn't know if any of the RMP was reflected anywhere</p> <p>4 on your financial statement. Do you recall that?</p> <p>5 A I do.</p> <p>6 Q Now, looking at Page 2 of Exhibit C-160 at</p> <p>7 Line 10, do you see that on advertising?</p> <p>8 A I do.</p> <p>9 Q Would it be your understanding that the RMP</p> <p>10 money would be reflected into that account?</p> <p>11 A No.</p> <p>12 Q Okay. If it's not reflected in that account</p> <p>13 and you don't know where it would be on the financial</p> <p>14 statement, do you even know if it's put anywhere in the</p> <p>15 financial statement?</p> <p>16 A I -- I don't believe it is, because it's -- it</p> <p>17 has become part of the invoice on the car. So it's</p> <p>18 listed on -- on the vehicle invoice as a 1 percent</p> <p>19 charge to the invoice price.</p> <p>20 Q And then every time your dealership sells that</p> <p>21 vehicle at over invoice, that charge to your dealership,</p> <p>22 that 1 percent, that ultimately gets passed onto the</p> <p>23 consumer, doesn't it?</p> <p>24 A No. It's not part of -- I mean, it's never --</p> <p>25 it's not reflected anywhere except to my costs, not -- I</p>

Attachment 10

325	<p>1 Q I understand.</p> <p>2 Now, earlier today before the break, we</p> <p>3 reviewed the Nissan bulletins that went to all dealers,</p> <p>4 including your dealership, where it contained the</p> <p>5 warning about financial statements used for tax purposes</p> <p>6 and financial statements submitted to Nissan and that</p> <p>7 those should match.</p> <p>8 Do you recall that, I mean, just this</p> <p>9 morning?</p> <p>10 A I recall that, yes.</p> <p>11 Q And relative to this financial statement and</p> <p>12 others just like it, where you do a Month 13 write-down</p> <p>13 for new vehicle inventory, would you agree that as</p> <p>14 between those statements at that line entry and the</p> <p>15 corresponding calendar year-end '12 statement, where --</p> <p>16 which would correspond to this one, those do not match?</p> <p>17 A They do not match, but the write-down had to go</p> <p>18 somewhere, so we had to choose a spot to put it.</p> <p>19 Q And they do not match for each and every year</p> <p>20 for which your company wrote down new vehicle inventory?</p> <p>21 A On the month -- on the Month 13 statement, it</p> <p>22 does not match the 12-month statement or --</p> <p>23 Q Now let's also look to this exhibit and go to</p> <p>24 Line 41.</p> <p>25 Line 41 is where your dealership, after</p>	327	<p>1 A That's what it said and I -- that's not the way</p> <p>2 I understood it ever to -- to be so, so I --</p> <p>3 Q And so my question is: The ones that are</p> <p>4 submitted to Nissan do not match at Lines 21 -- or 20</p> <p>5 through 41, relative to the write-downs of either new or</p> <p>6 used vehicles.</p> <p>7 You -- you agree with that?</p> <p>8 A I would agree with that.</p> <p>9 Q Now for this particular statement, if my math</p> <p>10 is correct, for the year 2012, your dealership wrote</p> <p>11 down \$438,130 of new Nissan and \$375,317 of used, and</p> <p>12 that would total \$813,447, if my math is correct.</p> <p>13 A That sounds about right.</p> <p>14 Q Does that sound about right?</p> <p>15 A Yes.</p> <p>16 Q Now, these write-downs do not represent any</p> <p>17 sort of a cash transaction at your dealership, does it?</p> <p>18 A No, it doesn't.</p> <p>19 Q And from 2009 through 2013 whenever these</p> <p>20 statements were created with vehicle inventory</p> <p>21 write-downs, those write-downs ultimately get rolled up</p> <p>22 into the final numbers as to net profit or loss to the</p> <p>23 dealership, does it not?</p> <p>24 A For a tax return, yes.</p> <p>25 Q And if I understand your testimony from earlier</p>
326	<p>1 you created the reduction values, would input the amount</p> <p>2 of the used vehicle reduction. Is that true?</p> <p>3 A Yes.</p> <p>4 Q And on the statements that are submitted to</p> <p>5 Nissan, you agree that each and every one of those</p> <p>6 statements contain blanks in Line 41. Correct?</p> <p>7 A Our reductions are done at the end of every --</p> <p>8 every year, so, yes.</p> <p>9 Q And as to the same question I asked earlier</p> <p>10 relative to the matching of the Month 13 to the one</p> <p>11 submitted to Nissan, you would agree that on Line 41, as</p> <p>12 between each and every year where there's a calendar</p> <p>13 year statement and a corresponding Month 13 statement,</p> <p>14 those do not match at that line entry?</p> <p>15 A Again, Month 13 has to be different than a</p> <p>16 12-month statement for the purpose of write-downs and</p> <p>17 depreciation and such.</p> <p>18 Q I understand, but I think I've asked a -- a</p> <p>19 little bit of a different question.</p> <p>20 Nissan, in the bulletin, informed your</p> <p>21 dealership, whether you read it or not, that its</p> <p>22 understanding of the IRS regulations is that the dealer</p> <p>23 should submit to Nissan an -- a financial statement that</p> <p>24 matches what the dealer submits to use for the</p> <p>25 government. Correct?</p>	328	<p>1 before the break, you've admitted that your statements</p> <p>2 submitted to Nissan for the next following year,</p> <p>3 where -- those write-down amounts are then recorded on</p> <p>4 the next year's statement submitted to Nissan. True?</p> <p>5 A Yes, that is true.</p> <p>6 Q And your understanding is that's recorded in</p> <p>7 the values of the monthly dollars you purportedly earned</p> <p>8 for each and every month of the year for which you've</p> <p>9 sold a vehicle that you previously wrote down?</p> <p>10 A The question you asked me before was due to the</p> <p>11 accuracy of my statements, and I still will say that</p> <p>12 my -- my statements were as accurate as possible.</p> <p>13 And -- and by being accurate, it includes having to</p> <p>14 include written-down amounts that were recovered from</p> <p>15 the sale of vehicles.</p> <p>16 So, I mean, I don't know how to answer</p> <p>17 your question better as to accuracy but --</p> <p>18 Q Well, I guess, I'm not -- I'm not asking you</p> <p>19 about accuracy, sir.</p> <p>20 A Well, you did. You were.</p> <p>21 Q I was, but my question is focused on after the</p> <p>22 write-downs are taken and the Month 13 is created, those</p> <p>23 write-downs roll up into whether your dealership had an</p> <p>24 increased amount of net profit or a reduced amount of</p> <p>25 net profit for the year. Correct?</p>

Attachment 10

329	<p>1 A That's correct. Correct.</p> <p>2 Q And you already admitted in testimony that the</p> <p>3 statements submitted to Nissan contained inflated value,</p> <p>4 you stated. Right?</p> <p>5 A As we sold these -- as we sold the cars, we</p> <p>6 have to recover any overage to the -- from our</p> <p>7 written-down amount.</p> <p>8 Q And that's --</p> <p>9 A That is recorded as additional profit to the</p> <p>10 car.</p> <p>11 Q And that's recorded as additional profit to the</p> <p>12 car, and it's reported to Nissan in the monthly</p> <p>13 statements your dealership submits in the following</p> <p>14 year?</p> <p>15 A There's no other way to do it.</p> <p>16 Q And for every month from which there is a -- a</p> <p>17 purported dollar amount in there that includes a sale of</p> <p>18 a vehicle that has been written down, to whatever extent</p> <p>19 those vehicles were written down and sold in the month,</p> <p>20 that includes that inflated profit, does it not?</p> <p>21 A It has to, yes.</p> <p>22 MR. JARRETT: Let me -- let's -- can I go</p> <p>23 to the board, Your Honor?</p> <p>24 JUDGE BENNETT: Yes.</p> <p>25 Q (BY MR. JARRETT) Let me try to see if I can</p>	331	<p>1 year change and it's still on your lot at the end of the</p> <p>2 year, and if that's the case, you would write that</p> <p>3 vehicle down?</p> <p>4 A I would.</p> <p>5 Q Correct?</p> <p>6 A Correct.</p> <p>7 Q Now let's assume, just for the sake of this</p> <p>8 hypothetical, that you write that vehicle down by</p> <p>9 25 percent.</p> <p>10 If my math is correct, that 25 percent</p> <p>11 would be \$7,500. Do you agree?</p> <p>12 A That's the math, yes.</p> <p>13 Q And the way you testified in this case as to</p> <p>14 how you did it, my hypothetical use of 25 percent, that</p> <p>15 coincides with what you've already testified to as</p> <p>16 having used a ratio range between 20 to 25 percent.</p> <p>17 Right?</p> <p>18 A That's correct.</p> <p>19 Q Now, at the time you wrote this down, would you</p> <p>20 agree with me that your dealership did not obtain \$7,500</p> <p>21 in cash from anyone, did it?</p> <p>22 A No, we did not.</p> <p>23 Q And so at the end of the year, after having</p> <p>24 written it down on the books of your dealership, it</p> <p>25 would be reported now as a value and a cost to you of</p>
330	<p>1 create a simple example here, Mr. Bates.</p> <p>2 Now in my little example, dollar amounts</p> <p>3 may not coincide with the particular model, but it's a</p> <p>4 2012 Nissan Sentra in my example. And your cost less</p> <p>5 holdback on that -- let's say it's \$30,000. All right?</p> <p>6 And this -- if we added the holdback -- if</p> <p>7 it was cost plus your holdback, that would be called</p> <p>8 invoice. Right?</p> <p>9 A For the most part, yes.</p> <p>10 Q Okay. Now, here, let's assume that at the end</p> <p>11 of the year, that vehicle is still in inventory at the</p> <p>12 end of 2012. Now, the way you did your books, you</p> <p>13 assumed and concluded that this 2012 Sentra had a model</p> <p>14 year change. Correct?</p> <p>15 A It would have, yes.</p> <p>16 Q And --</p> <p>17 JUDGE BENNETT: Hold on a second.</p> <p>18 Mr. Bates, it's going to be important for</p> <p>19 you to pull the microphone, especially now that you're</p> <p>20 facing that way because it's harder to hear you.</p> <p>21 THE WITNESS: Sorry.</p> <p>22 JUDGE BENNETT: And the court reporter has</p> <p>23 to be able to hear what you're saying.</p> <p>24 THE WITNESS: I'll do it.</p> <p>25 Q (BY MR. JARRETT) So this has incurred a model</p>	332	<p>1 \$22,500.</p> <p>2 Do you see that?</p> <p>3 A I do.</p> <p>4 Q And do you agree that would be the accurate</p> <p>5 math?</p> <p>6 A That would be it.</p> <p>7 Q Now, let's assume that that Nissan is retailed</p> <p>8 to a customer on January 13, let's say, of 2013, and</p> <p>9 your retail price for that vehicle is \$30,000. Okay?</p> <p>10 A Okay.</p> <p>11 Q Your actual true gross profit on that vehicle</p> <p>12 is only your holdback amount, isn't it?</p> <p>13 A That would be correct.</p> <p>14 Q And how much is holdback? 3 percent?</p> <p>15 A 2 to 3 percent.</p> <p>16 Q Let's assume it's 3.</p> <p>17 On \$30,000, that holdback equates to \$900,</p> <p>18 does it not?</p> <p>19 A It would.</p> <p>20 Q So your -- your profit -- I'm going to write</p> <p>21 "true gross profit," \$900.</p> <p>22 You would agree with that, wouldn't you?</p> <p>23 A In your scenario, yes.</p> <p>24 Q And then, after that, when this vehicle is then</p> <p>25 sold, on the corresponding 2013 statement submitted to</p>

Attachment 10

333	<p>1 Nissan within the month of January -- sold in January --</p> <p>2 what month would this vehicle be reported to Nissan on</p> <p>3 the statement? It would be in February?</p> <p>4 A If it was sold, in your scenario, on the 13th,</p> <p>5 it would be shown in January.</p> <p>6 Q And this -- it would be shown in January, but</p> <p>7 it would be submitted to Nissan on the February</p> <p>8 statement, would it not?</p> <p>9 A That's correct.</p> <p>10 Q So I agree. I think we're right. You and I</p> <p>11 are on the same wavelength here.</p> <p>12 You, in your records to the dealership,</p> <p>13 would report this sale in January of the month, but in</p> <p>14 the financial statement submitted to Nissan, that --</p> <p>15 because it's after the 10th or the 11th of the month, it</p> <p>16 would be on the next statement to Nissan. Right?</p> <p>17 A Yes.</p> <p>18 Q And that's in the ordinary course of business?</p> <p>19 A Right.</p> <p>20 Q That profit that would be incrementally shown</p> <p>21 for each and every month that something like this</p> <p>22 happened would not be the \$900, would it? It would be</p> <p>23 the difference between this amount and that amount, and</p> <p>24 it would be the \$7,500, wouldn't it?</p> <p>25 A It would.</p>	335	<p>1 can offer it, but it will be admitted. So let's take</p> <p>2 care of that in that fashion.</p> <p>3 MR. JARRETT: Thank you, Your Honor.</p> <p>4 JUDGE BENNETT: And it will be -- just so</p> <p>5 you're clear, it will be marked as 485.</p> <p>6 (Exhibit Respondent No. 485 marked and</p> <p>7 admitted)</p> <p>8 Q (BY MR. JARRETT) Now, second hypothetical sir,</p> <p>9 Let's assume we're dealing in the same year. Again,</p> <p>10 we'll just stick with the Sentra, and this particular</p> <p>11 vehicle is used. That vehicle, to your dealership --</p> <p>12 actual cost to you, we will say, is \$20,000.</p> <p>13 If you write that -- and it's on your lot</p> <p>14 in the same tax year for this. So the end of 2012, it's</p> <p>15 on your lot; and if it's on your lot at the end of 2012,</p> <p>16 you would write that vehicle down, would you not?</p> <p>17 A I would.</p> <p>18 Q Now, in this hypothetical, in deciding how to</p> <p>19 write down that vehicle, what did you do generally?</p> <p>20 A I would look at the NADA book.</p> <p>21 (Discussion off the record)</p> <p>22 Q (BY MR. JARRETT) Now, when you looked at the</p> <p>23 NADA book -- I take it for each and every used vehicle</p> <p>24 that you wrote down, you never physically went out on</p> <p>25 the lot and inspected the condition of any of them, did</p>
334	<p>1 Q And that is your view of this 7,500, that is</p> <p>2 the, quote, inflated amount, is it not?</p> <p>3 A It would be, yes.</p> <p>4 Q And for each and every vehicle where the</p> <p>5 inflated amount is there, if you sold 100 of those at</p> <p>6 that price on that day of the month in this</p> <p>7 hypothetical, you would end up reporting not 100 times</p> <p>8 900 for \$90,000, you would be reporting \$750,000 of</p> <p>9 inflated profit, would you not?</p> <p>10 A If I could sell 100 of those in a month, yes.</p> <p>11 Q But the hypothetical is -- is the -- would bear</p> <p>12 out how --</p> <p>13 A The hypothetical is the extreme.</p> <p>14 THE REPORTER: Try not to talk over each</p> <p>15 other, please.</p> <p>16 THE WITNESS: I'm sorry.</p> <p>17 MR. JARRETT: I'm sorry.</p> <p>18 Now, Your Honor, if I might, for purposes</p> <p>19 of the record -- assuming no objection -- I'd like to</p> <p>20 have this admitted as -- as the next R-exhibit for</p> <p>21 Nissan.</p> <p>22 JUDGE BENNETT: I'm going to give you the</p> <p>23 same instruction as I gave before. That is, I want it</p> <p>24 reduced to an 8-1/2 by 11, normal-sized sheet of paper.</p> <p>25 So you can have your people get it reduced and then you</p>	336	<p>1 you?</p> <p>2 A No, I did not.</p> <p>3 Q And that's true throughout the entire timeframe</p> <p>4 of 2009 through 2013?</p> <p>5 A Yes.</p> <p>6 Q And the only thing, as I understand your</p> <p>7 testimony, is you would look solely and only to the NADA</p> <p>8 book? Is that what you --</p> <p>9 A On a used vehicle, yes.</p> <p>10 Q Was it the book for December of the year?</p> <p>11 A It would be the latest book, whatever the</p> <p>12 latest book was.</p> <p>13 Q And let's assume that in that book, you're</p> <p>14 looking at this Nissan Sentra. And what is the</p> <p>15 determination of -- what parameters are you looking at</p> <p>16 within the book to decide how much to write down?</p> <p>17 A Well, you could tell by the serial number of</p> <p>18 the car as to the make -- or the model and whether --</p> <p>19 say, it's a Sentra, if it was an S model, SE model,</p> <p>20 whatever. So what -- so all the models are listed in</p> <p>21 the book, and each has a different value.</p> <p>22 From that, the -- the only other thing I</p> <p>23 look at is, of course, type of transmission and things</p> <p>24 like that can all be determined by the serial number.</p> <p>25 And other than that, mileage.</p>

Attachment 10

337	<p>1 Q Okay. Let's assume, for purposes of this</p> <p>2 hypothetical, you've done all of that, and at the end of</p> <p>3 the day, it just conveniently coincides with our earlier</p> <p>4 percent of write-down, 25 percent. And if that were</p> <p>5 true, the write-down you would have taken on this</p> <p>6 vehicle would have been \$5,000.</p> <p>7 Do you agree?</p> <p>8 A I agree that's 25 percent. That may be extreme</p> <p>9 on a used car.</p> <p>10 Q Fair enough.</p> <p>11 And so if that's what -- you wrote it</p> <p>12 down. Then it was carried on your books for January of</p> <p>13 the next year at a value of \$15,000.</p> <p>14 Do you agree?</p> <p>15 A Yes.</p> <p>16 Q Now, let's assume, like we did the other</p> <p>17 hypothetical, this now is retail, January 13 of 2013.</p> <p>18 And let's assume that this vehicle is retailed for</p> <p>19 \$21,000.</p> <p>20 Your true actual profit on this vehicle is</p> <p>21 how much, sir? True gross?</p> <p>22 A From the -- the first cost figures, \$1,000.</p> <p>23 Q So it would be \$1,000.</p> <p>24 Yet, what you would report to Nissan in</p> <p>25 the lowering of the value and what you would show in</p>	339	<p>1 JUDGE BENNETT: Okay. That's going to be</p> <p>2 marked 486, and it will be admitted when you provide a</p> <p>3 reduced copy.</p> <p>4 (Exhibit Respondent No. 486 marked and</p> <p>5 admitted)</p> <p>6 Q (BY MR. JARRETT) One last question, Mr. Bates</p> <p>7 On this example of the Nissan -- the used, as it</p> <p>8 affected your overall picture of profitability, what</p> <p>9 would be the amount of inflated profit?</p> <p>10 A On the books, it would show 6,000.</p> <p>11 Q And that would be the 5,000, which is your</p> <p>12 write-down, plus the 1,000, which was the actual gross.</p> <p>13 Correct?</p> <p>14 A In your scenario, yes.</p> <p>15 Q Now, let's, if we could, turn to Exhibit C-173.</p> <p>16 And I need to bring back to your recollection -- when we</p> <p>17 were looking at Exhibit C-161, I had said to you, and --</p> <p>18 if you recall, your total write-downs for that given</p> <p>19 year of 2012 was \$813,447.</p> <p>20 A I believe that's right.</p> <p>21 Q Okay. And so in 2013 -- this is the year-end</p> <p>22 statement that you submit to Nissan, is it not?</p> <p>23 A Yes.</p> <p>24 Q Now, if you would, call out the lower portion</p> <p>25 of the first page.</p>
338	<p>1 your books when it became -- the vehicle was reduced</p> <p>2 is -- in that less vehicle inventory column, you would</p> <p>3 write down and only put it on your 13-month statement</p> <p>4 as -- you would write down that cost, and it would be</p> <p>5 this amount, wouldn't it?</p> <p>6 JUDGE BENNETT: And would you specify what</p> <p>7 "this amount" is? That's not going to read into the</p> <p>8 record.</p> <p>9 MR. JARRETT: Oh, I'm sorry, Your Honor.</p> <p>10 Q (BY MR. JARRETT) This \$15,000 would be the</p> <p>11 amount that was shown. For each and every vehicle, this</p> <p>12 would roll up where you did this event and every one of</p> <p>13 those vehicle that you wrote down and used for that year</p> <p>14 would roll up into an aggregate amount, which would be</p> <p>15 shown on, I believe, Line 42 of your Month 13 financial</p> <p>16 statement. Right?</p> <p>17 A Of the amount of write-down, that's true.</p> <p>18 Q Right.</p> <p>19 And that amount of write-down, at the end</p> <p>20 of the day for that year, would effectively reduce your</p> <p>21 overall dealership's net profitability, did it not?</p> <p>22 A For that year -- for that tax year, yes.</p> <p>23 MR. JARRETT: And, Your Honor, the same</p> <p>24 provision. I would do that and move for the admission</p> <p>25 of this as an exhibit.</p>	340	<p>1 When it came to the reporting of the,</p> <p>2 quote, inflated profits, I believe it's your testimony</p> <p>3 that those inflated profits are reflected in the months</p> <p>4 of January, February, March, and April of the following</p> <p>5 year. Is that right?</p> <p>6 A That is when they would show it, yes. It</p> <p>7 would -- we try to turn inventory in a 90-day period.</p> <p>8 So that's when that would be in effect.</p> <p>9 Q But would you agree with me, sir, that as to</p> <p>10 every vehicle that was written down, whether new or</p> <p>11 used, it actually does show up in the month of the -- of</p> <p>12 the actual month it's sold, whether it's January or</p> <p>13 whether you still carry the vehicle and retail it in</p> <p>14 December?</p> <p>15 A That's true.</p> <p>16 Q And so it's not just that January, February,</p> <p>17 March and April are not showing the true financial</p> <p>18 profit or loss. The entire dealer financial statement</p> <p>19 submitted to Nissan is not completely accurate as to any</p> <p>20 of these 12 months for which there's a vehicle you've</p> <p>21 written down and sold in one of those months. True?</p> <p>22 A It would -- yes, it has an effect. But again,</p> <p>23 as to the accuracy of my statements, they are as</p> <p>24 accurate as -- as they can be and -- and we still be</p> <p>25 legal with the IRS.</p>

Attachment 10

345	<p>1 And those cars are not titled, generally,</p> <p>2 are they?</p> <p>3 A No, they're not.</p> <p>4 Q And so when you told him that, he under --</p> <p>5 would have understood they're untitled cars. Correct?</p> <p>6 A Correct.</p> <p>7 Q And you then asked him, "Can we now do this</p> <p>8 with the rest of our one year prior new Nissans?"</p> <p>9 Correct?</p> <p>10 A That's correct.</p> <p>11 Q And all he told you was, "I don't know why that</p> <p>12 wouldn't work."</p> <p>13 That's right?</p> <p>14 A That's correct.</p> <p>15 Q He never told you what process to use to do it,</p> <p>16 did he?</p> <p>17 A No.</p> <p>18 Q He never told you what legal requirements might</p> <p>19 be applicable to you, did he?</p> <p>20 A Again, the only thing he told us was that I</p> <p>21 would have the understanding that we had to -- as we did</p> <p>22 in used cars, had to recover any overage of written-down</p> <p>23 amount whenever we sold the car.</p> <p>24 Q And you never asked Mr. Gautier what legal</p> <p>25 requirements might be applicable that you needed to</p>	347	<p>1 A That was the goal, yes.</p> <p>2 Q And that was the goal because you didn't want</p> <p>3 to be in a higher tax bracket, did you?</p> <p>4 A We tried to stay in a tax bracket that we were</p> <p>5 comfortable with and still felt like we were paying our</p> <p>6 share of taxes.</p> <p>7 Q And then as a result of what happened -- I</p> <p>8 believe your testimony is that before Nissan raised it</p> <p>9 to your attention, one of your very own experts, a</p> <p>10 gentleman by the name of Carl Woodward, he brought it to</p> <p>11 your attention. Is that true?</p> <p>12 A Brought what to my attention?</p> <p>13 Q Brought it to your attention that your</p> <p>14 dealership may have had issues relevant to the</p> <p>15 write-downs?</p> <p>16 A He said that we -- from -- in his opinion, that</p> <p>17 we had -- were probably too aggressive in what we did or</p> <p>18 how we did it.</p> <p>19 Q And by "too aggressive," did you -- did he</p> <p>20 elaborate on that any to you, sir?</p> <p>21 A Well, he had seen the write-downs take place</p> <p>22 before, but we may have been overaggressive in the</p> <p>23 amounts that we took.</p> <p>24 Q And did Mr. Woodward tell you, at any time,</p> <p>25 that he's never seen a franchise dealer take new vehicle</p>
346	<p>1 follow either, did you?</p> <p>2 A No, I did not.</p> <p>3 Q And when you made all of your write-downs,</p> <p>4 whether they be new or used, you did not read any IRS</p> <p>5 regulation or rule regarding how to do or the method by</p> <p>6 which to conduct a lower-of-cost-or-market write-down,</p> <p>7 did you?</p> <p>8 A No, I did not.</p> <p>9 Q And you didn't keep any documents that showed</p> <p>10 how you did the write-downs?</p> <p>11 A There was no documents to keep.</p> <p>12 Q You do understand that as a taxpayer --</p> <p>13 taxpayers by IRS regulation -- all taxpayers have to</p> <p>14 keep their records for at least three years?</p> <p>15 A We do.</p> <p>16 Q Do you understand the IRS, relative to these</p> <p>17 write-downs, requires that records be established to</p> <p>18 substantiate how the write-downs occurred? Were you</p> <p>19 aware of that, sir?</p> <p>20 A No, I wasn't.</p> <p>21 Q And isn't it true that in each and every</p> <p>22 instance, when you were taking a write-down of either</p> <p>23 new or used, the entire goal and plan for you to do this</p> <p>24 was so that your dealership would only have to show</p> <p>25 taxable income of no greater than \$75,000 a year?</p>	348	<p>1 inventory write-downs in the manner you did --</p> <p>2 A No.</p> <p>3 Q -- for over 20 years under a</p> <p>4 lower-of-cost-or-market method.</p> <p>5 A Did he tell me he's never seen that before?</p> <p>6 No.</p> <p>7 Q Did he tell you that he hasn't seen it</p> <p>8 practiced in over 20 years as a lower-of-cost-or-market</p> <p>9 method?</p> <p>10 A I don't recall a timeframe, if he gave me one.</p> <p>11 But they -- he -- has he seen it? Yes. But not lately.</p> <p>12 Q And when Mr. Woodward prepared each of his</p> <p>13 reports, did you read them and review them?</p> <p>14 A I did.</p> <p>15 Q Now, after that, at some point in time, your</p> <p>16 dealership hired a tax attorney out of Washington, D.C.,</p> <p>17 a gentleman by the name of Mr. Les Schneider. Correct?</p> <p>18 A In the course of this, yes.</p> <p>19 Q And Mr. Schneider has told you that you're not</p> <p>20 to write down any type of new vehicle inventory for tax</p> <p>21 purposes under this method. Is that --</p> <p>22 A He --</p> <p>23 MR. COFFEY: Objection. That misstates</p> <p>24 what Mr. Schneider said.</p> <p>25 JUDGE BENNETT: Overruled. I'll allow it.</p>

Attachment 10

<p style="text-align: right;">429</p> <p>1 financial statements -- you know that your financial 2 statements submitted to Nissan are materially different 3 than the financial figures reported to Nissan as 4 compared to your Month 13s. Agreed? 5 A They have to be, yes. 6 Q And because that happens and that exists, you 7 can't say today whether either set of statements are 8 truthful and accurate? 9 A I believe what I submit to the factory is as 10 accurate as -- as I can make them and maintain what is 11 required of me from the IRS. 12 Q But can you answer my question with a yes or 13 no? 14 A No, I can't. 15 Q And why can't you, sir? 16 A Because the facts are that I have to do what 17 I'm doing in order to satisfy my obligation with the 18 IRS. So my financial statements have to show the way 19 they show. 20 Q And do you also agree that as to Nissan 21 forewarned your dealership, had you reviewed the 22 document, the all-dealer bulletin, you knew that 23 Nissan's position was what was submitted to it needed to 24 match what was submitted to the government? 25 A Nissan still does not require that I submit a</p>	<p style="text-align: right;">431</p> <p>1 MR. JARRETT: I do want to object to the 2 leading nature of the questions. I would ask that 3 counsel not lead his own witness. 4 JUDGE BENNETT: I'm not sure that that was 5 necessarily leading; he was laying a predicate. But 6 just do watch the phrasing of your questions. But you 7 can go ahead and answer that. 8 Q (BY MR. COFFEY) Let me ask you this: Did in 9 fact -- as a paraphrase, did I correctly capture the 10 thought that you left your direct testimony with? 11 A Yes, which was simply that the recaptured 12 income or profit was necessary to be reported on my 13 12th-month statements in order to satisfy my obligation 14 to the IRS from the written down amounts that I had took 15 the year before. 16 Q And you got that information from Mr. Gautier? 17 A That's who was -- who was directing me in this, 18 yes. 19 Q Okay. But Mr. Gautier never did explain to you 20 either the existence or the meaning of Exhibit 312, 21 which are those Treasury regs? 22 A We never talked about Treasury regs at all. 23 Q Let's kind of go back in time. As I understand 24 it, you took over operating the dealership, what, about 25 10 years ago, 12 years ago maybe?</p>
<p style="text-align: right;">430</p> <p>1 13th-month statement. 2 Q That's not what I asked. You knew, had you 3 read the document, that's what Nissan expected. 4 A I have since read the document, and they don't 5 require it, to see a 13-month statement. 6 MR. JARRETT: I'll pass the witness, Your 7 Honor. 8 JUDGE BENNETT: Do you want to take a very 9 short break before you begin or are you ready to begin? 10 MR. COFFEY: I'm ready to go, but it's up 11 to the Court. 12 JUDGE BENNETT: Because we can go for 25, 13 30 minutes and then take our break. So go ahead. 14 MR. COFFEY: Sounds good. 15 CROSS-EXAMINATION 16 BY MR. COFFEY: 17 Q Where do we begin, Mr. Bates? Let's start with 18 your last statement. In order for you to satisfy your 19 obligations to the IRS, you have to prepare your 20 financial statements the way you do. Please explain to 21 the Court what that means. 22 A Well, we've covered it -- 23 MR. JARRETT: Your Honor -- 24 JUDGE BENNETT: Hold on. We have an 25 objection.</p>	<p style="text-align: right;">432</p> <p>1 A Give or take. 2 Q Okay. As far as these inventory write-downs 3 are concerned, did you simply continue a practice which 4 pre-existed while your dad was the dealer principal? 5 A Yes, I just more or less picked up where he 6 left off. 7 Q Okay. You read Mr. Gautier's deposition, I 8 believe, did you not? 9 A I did. 10 Q And, in fact, you were present during his 11 deposition? 12 A I was. 13 Q Do you recall him stating to the effect that he 14 got the dealership on lower of cost or market back when 15 he left that accounting firm many years prior to you 16 taking over the operations? 17 A Yes. 18 Q Did you materially change the way your father 19 had always written down the vehicles? 20 A No. 21 MR. JARRETT: Objection; vague. 22 JUDGE BENNETT: Overruled. 23 Q (BY MR. COFFEY) Now, that would not be true, 24 however, as to new vehicles because that practice began 25 under you, did it not?</p>

Attachment 10

544

SOAH DOCKET NO. 608-14-3211.LIC

MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

BATES NISSAN, INC.,	)	STATE OFFICE OF
Complainant,)	
)	
v.)	
)	
NISSAN NORTH AMERICA, INC.,	)	ADMINISTRATIVE HEARINGS
Respondent.)	

HEARING ON THE MERITS

Thursday, September 17, 2015

BE IT REMEMBERED THAT at 8:30 a.m., on Thursday, the 17th day of September 2015, the above-entitled matter came on for hearing at the State Office of Administrative Hearings, William P. Clements, Jr., Building, 300 West 15th Street, Room 404, Austin, Texas, before CRAIG BENNETT, Administrative Law Judge, and the following proceedings were reported by Lorrie A. Schnoor and Kim Pence, Certified Shorthand Reporters.

Volume 3

Pages 544 - 779

Attachment 10

597	<p>1 referred to you by NNA, were they aware that your 2 dealership was under threat of termination? 3 A I'm sure they are, yes. 4 Q How do you know that? 5 A Well, they -- well, the first one that I made 6 -- he was -- just made reference to the pressure that I 7 was under from the factory. We never actually talked 8 about termination, per se; we talked about just the fact 9 that -- that there was pressure being applied. The 10 second offer was a fellow -- was a fellow Nissan dealer, 11 and we actually sat in my office and talked about the 12 termination proceeding. 13 Q How did he know about the termination 14 proceeding? 15 A I -- I don't know. I would have -- 16 MR. JARRETT: Objection, hearsay. 17 JUDGE BENNETT: Overruled. I think he's 18 indicated he has no idea. 19 A I don't know how he initially -- I would guess 20 from the factory, but I don't know. 21 Q (BY MR. COFFEY) Do you feel like you were in 22 an arm's length position with these -- or prospective 23 purchasers, considering the fact that you were under 24 notice of termination? 25 A I think that in some ways that the offers were</p>	599	<p>1 on the record then, and you may call your next witness. 2 MR. JARRETT: Your Honor, we call 3 Mr. Buster Gautier. 4 JUDGE BENNETT: Okay. Mr. Gautier, if 5 you'll take a seat at that table down there? If you'll 6 raise your right hand? 7 (Witness sworn) 8 JUDGE BENNETT: Okay. I just ask that you 9 use your microphone as much as possible, pull it in 10 closely, speak loudly and clearly. And, if you would, 11 state and spell your name for the record. 12 THE WITNESS: I'm Buster G. Gautier, 13 G-A-U-T-I-E-R. 14 JUDGE BENNETT: Okay. You may proceed. 15 MR. JARRETT: Thank you. 16 JUDGE BENNETT: Oh, and actually, 17 Mr. Gautier did not prefile testimony in this case, did 18 he? 19 MR. JARRETT: No. That is true, Your 20 Honor. 21 JUDGE BENNETT: Okay. That's -- well, I 22 wanted to make sure. I'm going to try and take care of 23 that with every witness now at the beginning rather than 24 waiting. Okay. Go ahead. 25</p>
598	<p>1 made as kind of a fire sale kind of thing or, you know, 2 a distress sale kind of offer, which I'm still not -- I 3 don't feel that. And that's not the -- the condition 4 that the sale -- or the prospective sale has even looked 5 at, in my opinion. 6 MR. COFFEY: Pass the witness, Your Honor. 7 FURTHER REDIRECT EXAMINATION 8 BY MR. JARRETT: 9 Q Mr. Bates, you don't know what was in the mind 10 of the buyer who made these offers, do you? 11 A No, I don't. 12 Q And you don't know what their intent is as to 13 whether they were giving you a fire sale price, I 14 believe is how you would frame it? 15 A No. Again, that was my opinion. 16 MR. JARRETT: Pass the witness. 17 MR. COFFEY: I have nothing further, Your 18 Honor. 19 JUDGE BENNETT: Okay. Mr. Bates, thank 20 you very much for your two and a half days of time, and 21 you're free to step down. 22 Let's go off the record for a minute. 23 (Discussion off the record) 24 (Recess: 9:53 a.m. to 10:14 a.m.) 25 JUDGE BENNETT: Okay. Well, let's go back</p>	600	<p>1 BUSTER G. GAUTIER (ADVERSE), 2 having been first duly sworn, testified as follows: 3 DIRECT EXAMINATION 4 BY MR. JARRETT: 5 Q Mr. Gautier, sitting at the end of the counsel 6 table for Bates Nissan is a gentleman by the name 7 of Mr. Davis. Have you ever met Mr. Davis before? 8 A I met him yesterday. 9 Q And when you met him yesterday, was it just to 10 exchange cordialities? 11 A Yes. 12 Q Has Mr. Davis ever called you to discuss what 13 you know, how -- what you did and why you did what you 14 did for Bates Nissan in preparing its tax returns? 15 A No. 16 Q Has he ever had any -- has he ever -- or has he 17 ever called, written you or done anything to try to 18 communicate with you as to any amount of work that you 19 performed on behalf of Bates Nissan? 20 A No. 21 Q And have you ever met a gentleman by the name 22 of Mr. Carl Woodard? 23 A I spoke to him on the phone, I believe, and 24 maybe an email or two. 25 Q And what was the nature of your conversation</p>

Attachment 10

605	<p>1 write-downs, that would be provided to you in the third</p> <p>2 or fourth week of January in a given year?</p> <p>3 A Normally.</p> <p>4 Q And was it your knowledge that throughout that</p> <p>5 timeframe Mr. Bobby Bates' intent was to provide</p> <p>6 inventory write-downs to you that would drop his</p> <p>7 dealership's taxable income each year to \$75,000?</p> <p>8 A Yes.</p> <p>9 Q And you also knew from your work that Bates</p> <p>10 Nissan did not submit 13th-month financials to Nissan?</p> <p>11 A I was not aware of that until this January or</p> <p>12 February.</p> <p>13 Q So prior to this January or February of 2015,</p> <p>14 it had been your understanding that Bates Nissan had</p> <p>15 provided Month 13 financials to Nissan?</p> <p>16 A Yes.</p> <p>17 Q And are you generally aware as an enrolled</p> <p>18 agent that when a business creates an adjusted financial</p> <p>19 statement that the IRS expects the business to</p> <p>20 provide -- if it's a motor vehicle dealership -- to</p> <p>21 provide both the adjusted and nonadjusted to the</p> <p>22 manufacturer?</p> <p>23 A I was -- I was not aware of that.</p> <p>24 Q Nonetheless, you did know that -- or your</p> <p>25 assumption was that Bates Nissan had been providing its</p>	607	<p>1 the year end of December 31, 2013. Do you see that,</p> <p>2 sir?</p> <p>3 A Yes.</p> <p>4 Q And let's now go to the bottom of the first</p> <p>5 page and blow that section out, please.</p> <p>6 And given your earlier testimony, you</p> <p>7 understood that when Bates Nissan would submit this and</p> <p>8 other annual statements to Nissan, that the profits that</p> <p>9 would be reflected, for instance, in the months of</p> <p>10 January through April of that year -- do you see that,</p> <p>11 sir?</p> <p>12 A Yes.</p> <p>13 Q That those profits shown to the right in the</p> <p>14 column that those would include amounts for which Bates</p> <p>15 Nissan had recaptured or recovered prior write-downs?</p> <p>16 A Yes.</p> <p>17 Q And you knew that those amounts were not a true</p> <p>18 reflection of the actual -- total actual profit dollars</p> <p>19 earned in those months by Bates Nissan?</p> <p>20 A Would you repeat that?</p> <p>21 Q You would understand from that that the amount</p> <p>22 shown, for instance, January, that the \$168,520, that</p> <p>23 that included some of the recaptured or recovered</p> <p>24 amounts from the prior year's write-downs?</p> <p>25 A Yes.</p>
606	<p>1 Month 13s to Nissan?</p> <p>2 A Yes.</p> <p>3 Q Who told you in January or February that it had</p> <p>4 not been provided to Nissan?</p> <p>5 A I believe it was Lorri Chumbley.</p> <p>6 Q And do you happen to recall why she told you</p> <p>7 that?</p> <p>8 A I think I asked her if she had filed</p> <p>9 Month 13th.</p> <p>10 Q And why did you ask her that?</p> <p>11 A I don't even remember.</p> <p>12 Q Now, you knew that the next year's monthly</p> <p>13 financial statements that were provided to Nissan would</p> <p>14 record on those statements as profits new and used</p> <p>15 vehicle sales that had been written down on the prior</p> <p>16 Month 13 financial?</p> <p>17 A Yes.</p> <p>18 Q And the recapturing of that profit onto the</p> <p>19 next year's financial statement, you knew that it would</p> <p>20 show Nissan more profit than what the dealership had</p> <p>21 actually earned in true dollars?</p> <p>22 A Yes.</p> <p>23 Q Let's go to Exhibit R-287, please, and let's</p> <p>24 blow up the -- this is the Nissan financial statement</p> <p>25 that Mr. Bates' dealership provided to the company for</p>	608	<p>1 Q And that recaptured or recovered amount,</p> <p>2 whatever amount that is for that entry, those are not</p> <p>3 true dollars?</p> <p>4 A Yes.</p> <p>5 Q Do you understand that?</p> <p>6 Now, we can take that down.</p> <p>7 As an enrolled agent, sir, you understand</p> <p>8 that IRS regulations are written so that a common man</p> <p>9 can know the distinctions between a lawful tax avoidance</p> <p>10 versus strategies that amount to either tax fraud or</p> <p>11 tax evasion?</p> <p>12 A Sometimes they're very difficult to understand.</p> <p>13 Q But you -- nevertheless, you know that the IRS</p> <p>14 endeavors to write those for the common man to</p> <p>15 understand?</p> <p>16 A Yes.</p> <p>17 Q But in applying those, I take it your</p> <p>18 understanding is sometimes it can be difficult to do?</p> <p>19 A Yes.</p> <p>20 Q And as an enrolled agent, you know from IRS</p> <p>21 provisions and your past experience in this area and</p> <p>22 through your continuing education courses, that when tax</p> <p>23 evasion is found, that the IRS can make a determination</p> <p>24 that the taxpayer did something in violation of its</p> <p>25 rule, but did not necessarily know its action was</p>

Attachment 10

629	<p>1 this point." Let's stop right there, sir.</p> <p>2 When you wrote that, you knew at the time</p> <p>3 what you were referring to was the net profit of Bates</p> <p>4 Nissan prior to your receipt of any new and used vehicle</p> <p>5 inventory reductions. Is that true?</p> <p>6 A Yes.</p> <p>7 Q But as of that point in time, you had already</p> <p>8 calculated all of the depreciation and other items that</p> <p>9 would go to adjust Bates Nissan's tax return for that</p> <p>10 year. Is that true?</p> <p>11 A I would think so.</p> <p>12 Q And at this stage, the only -- the only thing</p> <p>13 left in your mind that you were going to have to do to</p> <p>14 prepare the 13th -- the 2013 tax return for filing was</p> <p>15 to receive and apply the reductions in the vehicle</p> <p>16 inventory as to new and used?</p> <p>17 A Yes.</p> <p>18 Q Now, let's read further. "We've been trying to</p> <p>19 keep it at \$75,000 to used" -- you said "used," but --</p> <p>20 "to used up the use up the 15% and 25% tax brackets." A</p> <p>21 little choppy wording --</p> <p>22 A Yes.</p> <p>23 Q -- but that's the way it read. Correct?</p> <p>24 A Right.</p> <p>25 Q And -- now, there was a conscious knowledge</p>	631	<p>1 A He eventually furnished me with the</p> <p>2 write-downs. I don't recall if we had a telephone</p> <p>3 conversation before I received the write-downs or not.</p> <p>4 Q Now, let's go to the next paragraph where you</p> <p>5 wrote, "Eventually, these inventory write-downs are</p> <p>6 going to catch up with us, since we'll be showing more</p> <p>7 profits on the cars when they are sold in the next</p> <p>8 year." Did I read that correctly?</p> <p>9 A Yes.</p> <p>10 Q What did you mean, sir, by that?</p> <p>11 A What we're doing is -- is taking a reduction in</p> <p>12 one year, but then we're going to have to recapture it</p> <p>13 the next year or when that car is sold. So all we're</p> <p>14 doing is postponing the income tax on that amount of</p> <p>15 write-down until that car is sold.</p> <p>16 Q What did you mean by the use of the words</p> <p>17 "write-downs are going to catch up with us"?</p> <p>18 A They are -- if the business ended the next</p> <p>19 year, those write-downs were going to be included in</p> <p>20 that last year's tax return, and that's when we would be</p> <p>21 paying the income tax on those write-downs.</p> <p>22 Q And isn't it true, sir, that at this point in</p> <p>23 time -- by 2013, you had seen each year from 2010</p> <p>24 through 2013, every year up to that point, increasing</p> <p>25 amounts of new and used vehicle inventory reduction</p>
630	<p>1 between yourself and Mr. Bates that his company</p> <p>2 endeavored each and every tax year to keep that taxable</p> <p>3 income at or around \$75,000. You knew that?</p> <p>4 A Yes.</p> <p>5 Q And you were informing by this -- you were</p> <p>6 informing Mr. Bates that he needed to give you</p> <p>7 sufficient inventory reductions for 2013, if he could,</p> <p>8 to lower that amount to that \$75,000 --</p> <p>9 A Yes.</p> <p>10 Q -- of taxable income?</p> <p>11 And you -- let's read further. "The next</p> <p>12 \$25,000 is taxed at 34%, and amounts above \$100,000, up</p> <p>13 to \$335,000 are taxed at 39%. Then amounts over 335,000</p> <p>14 drop back down to the 34% tax rate." Did I read that</p> <p>15 correctly?</p> <p>16 A Yes.</p> <p>17 Q And so here your intent was to just inform</p> <p>18 Mr. Bates as to the tax consequence of what income tax</p> <p>19 he would have to pay if he did not reduce it down to the</p> <p>20 75 grand. Was that your purpose?</p> <p>21 A Yes.</p> <p>22 Q In response to this email, did Mr. Bates get</p> <p>23 back with you, either verbally or in writing, as to</p> <p>24 answering that specific question of your email about</p> <p>25 trying to get it down?</p>	632	<p>1 amounts taken for tax purpose each year?</p> <p>2 A Yes.</p> <p>3 Q And in your view and your mind, it had now had</p> <p>4 gotten to the point that you understood, based on the</p> <p>5 scope and size of his business, that he was exhausting</p> <p>6 the amount of new and used inventory that he could</p> <p>7 continue to write-down in order to achieve his goal of</p> <p>8 reaching that \$75,000 per year taxable income amount.</p> <p>9 Right?</p> <p>10 A Yes.</p> <p>11 Q And in fact, for tax year 2013, at the end of</p> <p>12 the day, after all the reductions he provided to you,</p> <p>13 the actual taxable income for that year was over</p> <p>14 \$101,000. Do you recall that?</p> <p>15 A Yes.</p> <p>16 Q And so by that point in time, you had known</p> <p>17 that the size and scope of Mr. Bates' dealership, he was</p> <p>18 now unable to continue to write-down inventory to do</p> <p>19 that very purpose of achieving that tax goal of \$75,000</p> <p>20 each year?</p> <p>21 A Yes.</p> <p>22 Q And is that not, sir, what you meant by "these</p> <p>23 write-downs are going to catch up with us"?</p> <p>24 A Yes.</p> <p>25 Q And by this email, you were warning Mr. Bates</p>

Attachment 10

661	<p>1 Q And I think there might be any number of</p> <p>2 sources of replacement value -- for example, auction</p> <p>3 values, if you can buy that car at auction for, let's</p> <p>4 say, 25 to 30 percent less than invoice, then that might</p> <p>5 be a replacement value that you could use for</p> <p>6 determining your write-downs?</p> <p>7 A Yes.</p> <p>8 Q Another place that you might be able to find</p> <p>9 replacement vehicles is if the manufacturer, at the end</p> <p>10 of the year, decides to offer vehicles that it could not</p> <p>11 wholesale to its dealers in some either additional</p> <p>12 allocation or offer them at auction or something like</p> <p>13 that. Would you agree with that?</p> <p>14 A Yes.</p> <p>15 Q Okay. When you were talking about</p> <p>16 Mr. Schneider's letter -- and let's get that in front of</p> <p>17 us.</p> <p>18 MR. JARRETT: C-205.</p> <p>19 MR. COFFEY: Thank you very much, David.</p> <p>20 Q (BY MR. COFFEY) C-205, sir. Are you there?</p> <p>21 I believe you testified that you did not</p> <p>22 input into this letter.</p> <p>23 A That's true.</p> <p>24 Q That's correct? Do you recognize Mr. Schneider</p> <p>25 as an expert in the area of inventory valuations?</p>	663	<p>1 Q Okay. Because now Bates Nissan is declaring an</p> <p>2 additional \$726,000 or so in taxable income. Right?</p> <p>3 A Right.</p> <p>4 Q And that's based, I guess, on the submission to</p> <p>5 the IRS that, Hey, we may not have done it right in the</p> <p>6 past. We're going to do it right in the future and</p> <p>7 here's how we're going to make up if we did it wrong in</p> <p>8 the past. Is that --</p> <p>9 A Yes.</p> <p>10 Q Okay. So he's basically telling the IRS here</p> <p>11 is \$726,000 in additional taxable income. Our deal</p> <p>12 under the Treasury regs under which we're making this</p> <p>13 application allows us to pay the tax on that over four</p> <p>14 years. Do you agree?</p> <p>15 A Yes.</p> <p>16 Q Okay. Do you have any idea of what the tax</p> <p>17 will be on that? Maybe a couple hundred, 250, something</p> <p>18 like that?</p> <p>19 A Yes.</p> <p>20 Q Okay. Do you consider a 3115 like</p> <p>21 Mr. Schneider filed, do you consider that some sort of</p> <p>22 admission of tax fraud or anything?</p> <p>23 A No.</p> <p>24 Q Okay. Basically, it's the taxpayer trying to</p> <p>25 do the right thing when his inventory valuation method</p>
662	<p>1 A I really don't know him.</p> <p>2 Q Okay. All right. When you were testifying</p> <p>3 about that \$726,000 being -- I don't know what the</p> <p>4 proper use -- term to use -- a reversal maybe of the</p> <p>5 seven -- of the amount, the cumulative amount of</p> <p>6 reductions as of year 2013, is that basically what you</p> <p>7 understood it was?</p> <p>8 A Yes.</p> <p>9 Q Okay. Do you understand why Mr. Schneider</p> <p>10 would have done that when he's asking the IRS for</p> <p>11 permission to change the dealership's inventory</p> <p>12 accounting method from what it was in the past to what</p> <p>13 he says in the letter it will be in the future?</p> <p>14 A Right.</p> <p>15 Q You understand that?</p> <p>16 A Yes.</p> <p>17 Q And why is that?</p> <p>18 A Well, he's wanting us to use the actual Blue</p> <p>19 Book value, is what I understand, to where before, we</p> <p>20 were using loan values and maybe even below loan values.</p> <p>21 So now we're going back to what IRS actually allows.</p> <p>22 Q Okay. And do you think -- as a tax preparer,</p> <p>23 do you think that is the right thing for Mr. Schneider</p> <p>24 to do for Bates Nissan?</p> <p>25 A Yes.</p>	664	<p>1 has been called into question.</p> <p>2 A Yes.</p> <p>3 Q When you were reviewing R-316 through 318,</p> <p>4 which would be various reduction sheets, do you recall</p> <p>5 when you were reviewing those, that testimony?</p> <p>6 A Yes.</p> <p>7 Q And I think counsel brought it to your</p> <p>8 attention that we saw increases in the amount of</p> <p>9 reductions over a period of months, and I think it was</p> <p>10 in 2013. Do you recall that?</p> <p>11 A Yes.</p> <p>12 Q Did you notice when those came through your</p> <p>13 office for purposes of preparing the 13-month statement</p> <p>14 that those increases were occurring over a relatively</p> <p>15 short period of time?</p> <p>16 A Yes.</p> <p>17 Q Did you think anything about that at the time?</p> <p>18 A No.</p> <p>19 Q If you thought there was anything wrong with</p> <p>20 that, you would certainly have gone to Bates Nissan and</p> <p>21 said, Hey, get me more information on how you justified</p> <p>22 these reductions. Right?</p> <p>23 A Yes.</p> <p>24 Q Okay. And, in fact, that's true about anything</p> <p>25 that you have ever done because you are an honest</p>

Attachment 10

705	<p>1 that's not an asset that is constituted as a depreciable 2 asset. Right? 3 A Right. 4 Q And that asset has not become a used asset, in 5 your view, has it? 6 A No. 7 Q It still remains a new asset. Correct? 8 A Yes. 9 Q And it remains a new asset because that vehicle 10 still is untitled. Correct? 11 A Yes. 12 Q You've had no discussion with Mr. Bobby Bates 13 at any time throughout the course of your tax 14 preparation work for Bates Nissan on whether Mr. Bates 15 could, should, or could not or did not or ever could 16 possibly even be allowed to write down inventory that it 17 had already been sold? 18 A No. 19 Q And you don't know what Bobby Bates knew or 20 didn't know about LIFO practices of the past ten to 20 21 years? 22 A No. 23 Q And you don't know if Bobby Bates knows 24 anything about LIFO or doesn't know anything about LIFO? 25 A No, I don't know.</p>	707	<p>1 Q And intentionally by Bates Nissan? 2 A Yes. 3 Q And what they provided you, you never 4 understood to be a mistake by Bates Nissan? 5 A No. 6 Q Or that the quality or the character of the 7 information provided to you was somehow mistaken in its 8 contents or character? 9 A No. 10 MR. JARRETT: Just let me collect my 11 thoughts for just a second. 12 JUDGE BENNETT: That's fine. 13 Q (BY MR. JARRETT) Since Tuesday of this week, 14 have you had any discussion with Mr. Bobby Bates? 15 A About the case? 16 Q Yes, sir. 17 A No. 18 Q Thank you. 19 MR. JARRETT: Pass the witness. 20 RECROSS-EXAMINATION 21 BY MR. COFFEY: 22 Q Mr. Gautier, when counsel asks you whether or 23 not the acts of Bates Nissan were willful and 24 intentional, did that mean to you, yes, they took those 25 acts intentionally? In other words, it was not a</p>
706	<p>1 Q And, sir, you don't know anything about vehicle 2 auctions, do you? 3 A Not -- not a whole lot. I do know that Bates 4 used to go to vehicle auctions to buy used cars. 5 Q You don't know anything about whether Bates 6 ever, at any point in time, whether it be Robert, Jimmy, 7 or Bobby, ever went to any auction to determine a 8 reduction value for its new vehicle inventory? 9 A No. 10 Q And Mr. Bobby Bates had never advised you 11 whether he could do that or should do that or was it 12 permissible for him to do it? 13 A No. 14 Q No discussion whatsoever at all? 15 A No. 16 Q And you understood that at all times, the 17 write-downs that Bobby Bates had -- and through his 18 dealership had provided to you were write-downs that, as 19 you understood them, were deliberate, willful, 20 intentional acts of Bates Nissan? 21 A Would you repeat that? 22 Q That the -- whatever they gave you to use on 23 the tax form, you understood it to be information 24 supplied to you willfully by Bates Nissan? 25 A Yes.</p>	708	<p>1 mistake? 2 A Yes, I kind of had him repeat that. 3 Q But you don't mean to say when you agreed to 4 willful and intentional language that there was anything 5 wrong -- 6 A No. 7 Q -- with what Bobby Bates did? 8 A No. 9 Q Now, let's go back to this testimony where you 10 said you're not accusing Nissan of saying that new 11 inventory could not be written down. Your original 12 testimony, when I was questioning you, as I recall it, 13 was that you thought you may have come to that 14 understanding at the deposition where Nissan's counsel 15 was asking you questions. Is that right? 16 A Yes. 17 Q But now, after questioning by Nissan's counsel, 18 you admit to the fact or you concede the fact that, 19 Well, I'm not absolutely certain that it was Nissan 20 which gave me that understanding; it might have been 21 somebody else? 22 A Right. 23 Q But do you believe that your first impression, 24 your first recollection of it being Nissan who gave you 25 that understanding, is probably the correct one?</p>

Attachment 10

780

SOAH DOCKET NO. 608-14-3211.LIC

MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

BATES NISSAN, INC.,	)	STATE OFFICE OF
Complainant,)	
)	
v.)	
)	
NISSAN NORTH AMERICA, INC.,)	
Respondent.	)	ADMINISTRATIVE HEARINGS

HEARING ON THE MERITS

Friday, September 18, 2015

BE IT REMEMBERED THAT at 8:31 a.m., on Friday, the 18th day of September 2015, the above-entitled matter came on for hearing at the State Office of Administrative Hearings, William P. Clements, Jr., Building, 300 West 15th Street, Room 404, Austin, Texas, before CRAIG BENNETT, Administrative Law Judge, and the following proceedings were reported by Dalia F. Inman and Steven Stogel, Certified Shorthand Reporters.

Volume 4

Pages 780 - 1101

Attachment 10

781	<p>1 PROCEEDINGS</p> <p>2 FRIDAY, SEPTEMBER 18, 2015</p> <p>3 (8:31 a.m.)</p> <p>4 JUDGE BENNETT: Okay. Let's go ahead and</p> <p>5 go back on the record, then, and we will resume with</p> <p>6 Nissan's direct case.</p> <p>7 MR. DONLEY: Thank you, Your Honor.</p> <p>8 Nissan will call as an adverse witness Robert Davis.</p> <p>9 JUDGE BENNETT: Have a seat up there,</p> <p>10 Mr. Davis.</p> <p>11 THE WITNESS: Thank you.</p> <p>12 (Witness Davis sworn)</p> <p>13 JUDGE BENNETT: And, Mr. Davis, you did</p> <p>14 file a report, not prefiled testimony, though, so I</p> <p>15 don't know that we need to do --</p> <p>16 MR. DONLEY: I believe the parties agreed</p> <p>17 that the reports are the prefiled testimony.</p> <p>18 JUDGE BENNETT: Right. So, I guess --</p> <p>19 MR. DONLEY: I would ask to still have him</p> <p>20 sworn to that.</p> <p>21 JUDGE BENNETT: That's fine.</p> <p>22 MR. DONLEY: Thank you, Your Honor.</p> <p>23 JUDGE BENNETT: Mr. Davis, you prepared an</p> <p>24 initial expert report and also a rebuttal expert report</p> <p>25 in this case. Are you familiar with those?</p>	783	<p>1 A Yes, sir, it has been thus far in my career.</p> <p>2 Q Yes, sir. And that's been for your entire</p> <p>3 career?</p> <p>4 A Yes, sir. Yes, sir.</p> <p>5 Q And, Mr. Davis, just to kind of get into the</p> <p>6 thick of things, write-downs on new or used motor</p> <p>7 vehicles -- and for new motor vehicles I'm talking about</p> <p>8 prior year models. Okay? Are you with me?</p> <p>9 A Yes, sir. I understand.</p> <p>10 Q All right. So write-downs of new or used motor</p> <p>11 vehicles, based on a, quote, rule of thumb. Okay? So</p> <p>12 based on a rule of thumb, that wouldn't be based on any</p> <p>13 GAP principles, would it, sir?</p> <p>14 A No, sir. Judgment is involved. But with no</p> <p>15 other evidence, a rule of thumb would not be a way to do</p> <p>16 it.</p> <p>17 Q And a rule of thumb would not be appropriate</p> <p>18 under any tax laws or regulations either, would it, sir?</p> <p>19 A No, sir, not in the pure form the way you asked</p> <p>20 question.</p> <p>21 Q And you do not hold the opinion, do you,</p> <p>22 Mr. Davis, that Bates Nissan can take write-downs on new</p> <p>23 and used motor vehicles that in good faith it knows not</p> <p>24 to be accurate, do you, sir?</p> <p>25 A If they knew in good faith that it was not</p>
782	<p>1 THE WITNESS: Yes, sir.</p> <p>2 JUDGE BENNETT: Okay. And the information</p> <p>3 that is contained in your report, would you adopt under</p> <p>4 oath at this time as being true and correct?</p> <p>5 THE WITNESS: Yes, sir.</p> <p>6 JUDGE BENNETT: Okay. Then I think that</p> <p>7 will be sufficient.</p> <p>8 MR. DONLEY: Thank you, Your Honor. May I</p> <p>9 proceed?</p> <p>10 JUDGE BENNETT: You may.</p> <p>11 PRESENTATION ON BEHALF OF RESPONDENT (CONTINUED)</p> <p>12 ROBERT DAVIS (ADVERSE),</p> <p>13 having been previously duly sworn, testified as follows:</p> <p>14 DIRECT EXAMINATION</p> <p>15 BY MR. DONLEY:</p> <p>16 Q Good morning, Mr. Davis. How are you?</p> <p>17 A Good morning. How are you, Mr. Donley?</p> <p>18 Q We meet again.</p> <p>19 A Yes, sir. Absolutely.</p> <p>20 Q Seems like we've had several cases here lately,</p> <p>21 this being one of them.</p> <p>22 A Yes, sir. Yes, sir.</p> <p>23 Q Now, your work as a CPA and as an expert</p> <p>24 witness is always on behalf of franchise dealers.</p> <p>25 Correct?</p>	784	<p>1 accurate, then they should not have used those</p> <p>2 write-downs.</p> <p>3 Q And you would give me that same answer if Bates</p> <p>4 Nissan knew it had no support for those write-downs.</p> <p>5 Correct?</p> <p>6 A The support is needed for the write-downs for</p> <p>7 tax purposes. The support for GAP is the rules really</p> <p>8 don't talk about what support is needed for that.</p> <p>9 The -- and, of course, Nissan is looking for GAP-based</p> <p>10 financials, not tax-based financials.</p> <p>11 MR. DONLEY: Your Honor, if I may, and I</p> <p>12 don't mean to be complaining early on. But I've got a</p> <p>13 limited amount of time. I'm going to ask him leading</p> <p>14 questions throughout that I think will call for a yes or</p> <p>15 no as opposed to any kind of narrative. If a narrative</p> <p>16 is necessary, I would ask that Mr. Coffey ask those</p> <p>17 questions and get any narrative he wants to get. Could</p> <p>18 we do that, Your Honor?</p> <p>19 JUDGE BENNETT: Mr. Davis, when you're</p> <p>20 asked a question that calls for a yes or no answer, you</p> <p>21 basically have three options. You can say yes; you can</p> <p>22 say no; or you can indicate, I can't answer that</p> <p>23 question the way it's asked with a yes or no. And</p> <p>24 occasionally that may be appropriate in some</p> <p>25 circumstances if you believe an explanation is needed to</p>

Attachment 10

785	<p>1 modify an answer, for example, in the way the question 2 was asked.</p> <p>3 But generally, if you can answer his 4 questions with a yes or no, you should limit your 5 answers to a yes or no.</p> <p>6 THE WITNESS: Thank you, Your Honor. 7 MR. DONLEY: Thank you, Judge.</p> <p>8 Q (BY MR. DONLEY) Mr. Davis, let me go back to 9 my question.</p> <p>10 You do not hold the opinion, do you, sir, 11 that Bates Nissan can take a write-down on a new or used 12 motor vehicle that it has no support for, in other 13 words, no support for the write-down?</p> <p>14 A Can you ask the question differently? I'm 15 trying to use one of the options that --</p> <p>16 Q I can.</p> <p>17 You do not hold the opinion that Bates 18 Nissan can take a write-down on a new or used motor 19 vehicle that it has no support for under GAP principles?</p> <p>20 A No, I don't believe that it can.</p> <p>21 Q All right. And you also do not hold the 22 opinion that Bates Nissan can take a write-down on new 23 or used motor vehicles that it has no support for under 24 tax laws or tax regulations, do you, sir?</p> <p>25 A No, I don't believe it can on that either.</p>	787	<p>1 sophisticated business people, are they not?</p> <p>2 A Yes, sir, in the operation of the car business.</p> <p>3 Q Yes, sir. And you would agree with me that 4 Bates Nissan is in and of itself a sophisticated new 5 dealership business, is it not?</p> <p>6 A Yes, sir.</p> <p>7 Q Another question for you, Mr. Davis. 8 Would you agree with me that if you had a 9 new prior model year vehicle that cost \$20,000 and you 10 believed you could still sell it for \$20,000 or more, it 11 would not be appropriate to write that vehicle down to 12 \$15,000 if \$15,000 is less than its replacement cost? 13 Do you agree with that?</p> <p>14 A That's a correct statement, I believe.</p> <p>15 Q And for replacement costs, you would have to 16 look at what you would term -- you would have to find a 17 market, would you not?</p> <p>18 A Yes, sir.</p> <p>19 Q And I believe you've given us three markets you 20 would consider, and that's closed auctions, Nissan 21 leftover allocation, and dealer trades. Correct?</p> <p>22 A Yes, sir. Those are three I enumerated in my 23 deposition.</p> <p>24 Q And in your report -- well, maybe not. Just in 25 your deposition. Correct?</p>
786	<p>1 Q And Bates Nissan would even be in trouble with 2 the IRS if it has no documents to support those 3 write-downs, correct, sir? Because you've got to keep 4 your tax documents for three years, do you not?</p> <p>5 A Yes, sir, that would be a correct statement.</p> <p>6 Q And it's commonly known by all taxpayers, is it 7 not, that if you're going to include things on your tax 8 returns, you've got to keep those records for three 9 years, do you not?</p> <p>10 A You need to keep the records for three years to 11 support the positions you have on the tax return, yes, 12 sir.</p> <p>13 Q Yes, sir. And for the write-downs that Bates 14 Nissan took that are at issue in this case, there's no 15 records whatsoever to support any of those write-downs, 16 are there, sir?</p> <p>17 A That's my understanding.</p> <p>18 Q Now, Bates is roughly a 50-, 19 60-million-dollar-a-year business?</p> <p>20 A I don't know the answer to that question.</p> <p>21 Q You would agree with me that the operation of a 22 new motor vehicle business, a new car business, that's a 23 sophisticated business to operate, is it not?</p> <p>24 A Yes, sir.</p> <p>25 Q And those that operate them are generally</p>	788	<p>1 A I believe it was just in the deposition, 2 Mr. Donley.</p> <p>3 Q I think that's right.</p> <p>4 And for leftover allocations, did you hear 5 Mr. Bates, when he testified, that whatever vehicles he 6 got from Nissan he always paid invoice? Did you hear 7 that?</p> <p>8 A I don't recall specifically, but that would not 9 surprise me.</p> <p>10 Q That sounds correct, doesn't it?</p> <p>11 A Yes, sir.</p> <p>12 Q And for dealer trades, those are always traded 13 among dealers at invoice?</p> <p>14 A Yes, sir.</p> <p>15 Q And when we're taking at invoice, that's cost, 16 isn't it?</p> <p>17 A No, sir.</p> <p>18 Q So what are a dealer pays on an invoice is not 19 that dealer's cost?</p> <p>20 A No, sir.</p> <p>21 Q Okay. For a replacement cost, when you look at 22 a market, you also have to find a market with same 23 quantities that you deal in. Correct?</p> <p>24 A Not necessarily.</p> <p>25 Q Not necessarily.</p>

Attachment 10

789	<p>1 Not necessarily when? I'm trying to</p> <p>2 figure out your qualification on that.</p> <p>3 A All right. Can I provide a longer answer now?</p> <p>4 Q I'm asking for what your qualification -- you</p> <p>5 said "not necessarily." Not necessarily why?</p> <p>6 A All right. The -- the reason I said not</p> <p>7 necessarily is that the -- some courts have held that a</p> <p>8 market can constitute one vehicle being available for</p> <p>9 sale. There have been other court cases that said if a</p> <p>10 market is permanently out of inventory, that market can</p> <p>11 no longer be considered; or if a taxpayer doesn't have</p> <p>12 access to that market, it can no longer be considered.</p> <p>13 But when a market doesn't exist, then the</p> <p>14 regulations provide for some alternative methods.</p> <p>15 Q And here, for the new and used motor vehicles</p> <p>16 we're talking about, a market exists. Correct?</p> <p>17 A Typically, I believe a market would exist</p> <p>18 especially in the -- in the dealer trade arena, being</p> <p>19 able to use other dealers' inventories, if you will.</p> <p>20 Q Let me be clear about what I meant by market at</p> <p>21 that point.</p> <p>22 What I meant by market at that point,</p> <p>23 these new and used motor vehicles we're talking about</p> <p>24 here, they were freely bought and sold in the</p> <p>25 marketplace, were they not?</p>	791	<p>1 dealer clients?</p> <p>2 A About 100 relationships, yes, sir.</p> <p>3 Q And that, if I remember, is about 300 rooftops,</p> <p>4 which mean they have 300 individual dealerships?</p> <p>5 A That's a good estimate. And that's what I've</p> <p>6 said in my report, I believe.</p> <p>7 Q That's right.</p> <p>8 A Yes, sir.</p> <p>9 Q And so for those hundred dealers with their 300</p> <p>10 rooftops, none of those dealers have attempted to take</p> <p>11 write-downs like we see Bates Nissan took between 2010</p> <p>12 and 2013 on new motor vehicles. Correct?</p> <p>13 A Not in the manner that Bates Nissan took them.</p> <p>14 Q Yes, sir. And the same would be true for used</p> <p>15 motor vehicles. None of your dealership clients have</p> <p>16 taken used or markdowns on used motor vehicles from 2010</p> <p>17 to 2013 in the manner in which we see Bates Nissan has</p> <p>18 done it. True?</p> <p>19 A I couldn't answer that definitively. I can</p> <p>20 tell you why.</p> <p>21 Q You don't have a definitive answer on that?</p> <p>22 A Not in a yes or no, because some clients, I</p> <p>23 don't know.</p> <p>24 Q Okay. Those clients that you do know, they</p> <p>25 don't write them down like Bates Nissan did. True?</p>
790	<p>1 A Yes, sir. Yes, sir.</p> <p>2 Q And if you're going to mark a vehicle down to a</p> <p>3 replacement cost, you got to keep your documents that</p> <p>4 support that markdown, do you not?</p> <p>5 A Yes, sir, you should.</p> <p>6 Q And you advise all of your dealer clients to</p> <p>7 keep those documents. Right?</p> <p>8 A Yes, sir, I do.</p> <p>9 Q And it's common that those who have to provide</p> <p>10 tax returns, they know to keep their documents for that</p> <p>11 tax return. Right?</p> <p>12 A I've seen dealers that have not been aware of</p> <p>13 that, that become clients, and we educate them.</p> <p>14 Q You've had dealers that didn't know to keep</p> <p>15 their documents that support their tax returns, sir?</p> <p>16 A No, that support the write-downs in particular.</p> <p>17 Q But you don't have any dealers that write down</p> <p>18 new motor vehicles, do you, sir?</p> <p>19 A No, sir. We discuss singular instances. But</p> <p>20 in general, the way it's been presented in this case, I</p> <p>21 don't have anyone doing that.</p> <p>22 Q All right. So just to be clear, then, you</p> <p>23 don't have any -- and currently you have -- let's be a</p> <p>24 little clear here.</p> <p>25 Currently you have over a hundred new</p>	792	<p>1 A Can you expand upon your question?</p> <p>2 Q Let me go at it a little differently.</p> <p>3 You wouldn't advise any of your clients to</p> <p>4 use judgment in writing down new motor vehicles, would</p> <p>5 you?</p> <p>6 A I would encourage them to have support and not</p> <p>7 use judgment as the only factor. That's correct.</p> <p>8 Q And, in fact, Mr. Davis, you have never advised</p> <p>9 any of your clients to use judgment in marking down new</p> <p>10 motor vehicles, have you, sir?</p> <p>11 A I think judgment is involved. But I do believe</p> <p>12 you have to have support for what you decided.</p> <p>13 Q But my question was a little bit different.</p> <p>14 You have never advised one of your clients</p> <p>15 to simply use their judgment in writing down new motor</p> <p>16 vehicles, have you, sir?</p> <p>17 A As a sole method, judgment alone, no.</p> <p>18 Q That's right. And you don't contend any of the</p> <p>19 write-downs at issue in this case were proper, do you,</p> <p>20 sir, for any purpose?</p> <p>21 When I say "write-downs," I'm talking</p> <p>22 about the new and used motor vehicles at issue in this</p> <p>23 case.</p> <p>24 A New and used.</p> <p>25 Q Yes, sir.</p>

Attachment 10

793	<p>1 A I think what I said in deposition when you and</p> <p>2 I were in deposition, is that if some of them had come</p> <p>3 to the correct price in accordance with the rules for</p> <p>4 GAP and tax, it may have been – it would've been a</p> <p>5 coincidence.</p> <p>6 Q That's right. It would've simply been a</p> <p>7 coincidence, like lightning striking, wouldn't it, sir?</p> <p>8 A In a colloquialism type of way, I understand</p> <p>9 what you mean.</p> <p>10 Q Yes, sir. You agree with that?</p> <p>11 A I don't know about the odds comparison between</p> <p>12 lightning striking. But I know what you're trying to</p> <p>13 say.</p> <p>14 Q And the fact of the matter is, you didn't do</p> <p>15 anything to analyze any of the write-downs to determine</p> <p>16 if they were proper, did you, sir?</p> <p>17 A Specifically for each vehicle write-down, no, I</p> <p>18 did not.</p> <p>19 Q And that -- whether it was new or used, you</p> <p>20 didn't do that, did you, sir?</p> <p>21 A That's a correct statement.</p> <p>22 Q And just to jump to a different topic just for</p> <p>23 a moment, the financial statement issues in this case,</p> <p>24 you didn't do anything to analyze the financial</p> <p>25 statements to determine whether or not they were</p>	795	<p>1 Q And you didn't ask for any?</p> <p>2 A Yes, I did ask for them.</p> <p>3 Q So you did ask for some from Mr. Starnes, but</p> <p>4 he failed to provide them to you?</p> <p>5 A The way it happened, if --</p> <p>6 Q Can you answer my question, sir?</p> <p>7 A Ask it again. Maybe you didn't want to know</p> <p>8 how it happened.</p> <p>9 Q You said you asked for documents on that closed</p> <p>10 auction from Mr. Starnes.</p> <p>11 A Yes.</p> <p>12 Q And he did not provide them to you. Is that</p> <p>13 true?</p> <p>14 A That's correct.</p> <p>15 Q Okay. So we don't have the documents from that</p> <p>16 closed auction to enter into evidence and show the</p> <p>17 Administrative Law Judge, do we, sir?</p> <p>18 A That's correct.</p> <p>19 Q And that closed auction was one that occurred</p> <p>20 sometime earlier this year, in 2015?</p> <p>21 A Yes, sir.</p> <p>22 Q So we're not talking about a closed auction</p> <p>23 that occurred between 2010 and 2013, are we, sir?</p> <p>24 A No, sir.</p> <p>25 Q And you've never attended a closed auction,</p>
794	<p>1 accurate and reliable, did you, sir?</p> <p>2 A Can you be more specific?</p> <p>3 Q Yes, sir. I'll ask the question again.</p> <p>4 You didn't undertake any analysis</p> <p>5 whatsoever to determine whether or not the financial</p> <p>6 statements provided to Nissan from 2010 to 2013 were</p> <p>7 accurate and reliable, did you, sir?</p> <p>8 A No, sir, not in the way I think you're asking.</p> <p>9 No, sir.</p> <p>10 Q Now, in regard to auction values -- there's</p> <p>11 some of that in your deposition too. Right?</p> <p>12 A Yes, sir, there's some mention of that.</p> <p>13 Q And you said where you've got some of your</p> <p>14 information regarding closed auctions was Mr. Chris</p> <p>15 Starnes?</p> <p>16 A Yes, sir.</p> <p>17 Q You said you had a conversation with him.</p> <p>18 Right?</p> <p>19 A Yes, sir.</p> <p>20 Q And Mr. Starnes told you he had looked at some</p> <p>21 information on the Internet regarding a closed auction?</p> <p>22 A Yes, sir.</p> <p>23 Q But he didn't provide you any documents</p> <p>24 regarding that closed auction, did he, sir?</p> <p>25 A No, he did not.</p>	796	<p>1 have you?</p> <p>2 A That's a correct statement.</p> <p>3 Q And you're not an expert on auctions or auction</p> <p>4 values, are you?</p> <p>5 A No, I don't believe so.</p> <p>6 Q Yes, sir. And you don't know how many auctions</p> <p>7 Mr. Starnes, closed or otherwise, might've attended.</p> <p>8 A Only through testimony this week in this</p> <p>9 courtroom.</p> <p>10 Q Right. And I don't believe I heard Mr. Starnes</p> <p>11 testify about many auctions yesterday. Do you, sir?</p> <p>12 A Oh, I'm sorry. I was thinking Mr. Bates. My</p> <p>13 apologies.</p> <p>14 Q Yes, sir. Well, can you answer that question,</p> <p>15 then we'll talk about Mr. Bates and auctions.</p> <p>16 We don't know how many auction Mr. Starnes</p> <p>17 has attended, do we, sir?</p> <p>18 A No, sir.</p> <p>19 Q And we don't know if he attended any during the</p> <p>20 relevant time period, 2010 to 2013, do we, sir?</p> <p>21 A No, sir.</p> <p>22 Q And that would include closed or open auctions.</p> <p>23 Right?</p> <p>24 A Yes, sir, I would assume so. I don't -- I</p> <p>25 don't differentiate.</p>

Attachment 10

805	<p>1 A That's correct.</p> <p>2 Q All right. Now I want to focus on C-7. And it</p> <p>3 looks like you've got some documents in front of you.</p> <p>4 What documents do you have in front of you, sir?</p> <p>5 A A notebook of several. I just happened to open</p> <p>6 to C-7.</p> <p>7 Q You've got a hard copy in front of you?</p> <p>8 A Yes. I have electronic and hard, yes, sir.</p> <p>9 Q All right. Let's go to the fourth page --</p> <p>10 let's wait just a second.</p> <p>11 MR. DONLEY: Ready, Judge?</p> <p>12 JUDGE BENNETT: Yeah.</p> <p>13 Q (BY MR. DONLEY) I want to go to Page 4 of 17</p> <p>14 of C-7. Are you with me, sir?</p> <p>15 A I'm there.</p> <p>16 Q I want to look up at the top. And those are</p> <p>17 your conclusions. Right?</p> <p>18 A Yes, sir.</p> <p>19 Q And you say that -- No. 1 is the use of LCM by</p> <p>20 Bates Nissan as required under GAP. Correct?</p> <p>21 A Yes, sir.</p> <p>22 Q But you're not claiming that anything Bates</p> <p>23 Nissan did with regard to writing down new and used</p> <p>24 motor vehicles was in accordance with GAP, are you, sir?</p> <p>25 A I'm claiming they made an attempt; and if they</p>	807	<p>1 them on new motor vehicles?</p> <p>2 A No, sir.</p> <p>3 Q And you would give me the same answer for used,</p> <p>4 would you not?</p> <p>5 A In the -- in the -- no, sir.</p> <p>6 Q You would not?</p> <p>7 Sir, are you claiming, then, that Nissan's</p> <p>8 accounting manual is what caused Bates Nissan to take</p> <p>9 the write-downs in the manner that it did?</p> <p>10 A Oh, no, sir, not in that fashion. I'm sorry.</p> <p>11 I must've misunderstood what you were trying to get at.</p> <p>12 Q That's okay. If you don't understand, let me</p> <p>13 know.</p> <p>14 A Thanks.</p> <p>15 Q And then No. 3, under your conclusions, is the</p> <p>16 use of LCM by Bates is allowed by the Internal Revenue</p> <p>17 Code. Did I get that right?</p> <p>18 A Yes, sir.</p> <p>19 Q And related Treasury regulations, revenue</p> <p>20 rulings, and procedures. But the way that Bates Nissan</p> <p>21 wrote down the motor vehicles at issue in this case,</p> <p>22 that did not comply with the Internal Revenue Code,</p> <p>23 related Treasury regulations, revenue rulings and</p> <p>24 procedures, did it, sir?</p> <p>25 A That's a correct statement.</p>
806	<p>1 hit some of the vehicles correctly, I think we may be</p> <p>2 back to your lightning thing.</p> <p>3 Q Lightning struck, and it was a coincidence.</p> <p>4 Right?</p> <p>5 A To have -- to have possibly gotten a value in</p> <p>6 the range that would've been acceptable for GAP --</p> <p>7 Q Can you tell us of even one motor vehicle that</p> <p>8 coincidentally met GAP?</p> <p>9 A No. I didn't do that analysis.</p> <p>10 Q Okay. Now, No. 2, you talk about Nissan's</p> <p>11 accounting manual; correct?</p> <p>12 A Yes, sir.</p> <p>13 Q And you're not claiming there's anything in</p> <p>14 Nissan's accounting manual that caused Bates Nissan to</p> <p>15 take the write-downs that they took on new and used</p> <p>16 motor vehicles that are at issue in this case, are you,</p> <p>17 sir?</p> <p>18 A Can you be more specific, perhaps --</p> <p>19 Q I'll try.</p> <p>20 A -- divide it.</p> <p>21 Q I'll break it down by new and used, if that</p> <p>22 helps.</p> <p>23 You're not claiming there's anything in</p> <p>24 Nissan's accounting manual that caused Bates Nissan to</p> <p>25 take the write-downs that it took in the manner it took</p>	808	<p>1 Q And then let's go to No. 4. Now, No. 4, you</p> <p>2 say, Bates Nissan is correct in its belief that prior</p> <p>3 year models decrease in value. Right?</p> <p>4 A If you read the rest of the sentence --</p> <p>5 Q Well, I just paraphrased it. Because what I</p> <p>6 was going to say is, that's your Exhibit A?</p> <p>7 A That's my Exhibit A, yes, sir.</p> <p>8 Q And we're going to get there, okay, so we'll</p> <p>9 hold that one.</p> <p>10 A Okay.</p> <p>11 Q Well, let's talk about that just for a moment.</p> <p>12 You're Exhibit A, which we'll get into specifically,</p> <p>13 what you attempted to do was to take Black Book values</p> <p>14 and compare that to new vehicle values. Correct?</p> <p>15 A Yes, sir.</p> <p>16 Q And you and I know that Black Book, those are</p> <p>17 values only for used motor vehicles. Correct?</p> <p>18 A That's a correct statement.</p> <p>19 Q And indeed, the blacks books that you used for</p> <p>20 your analysis was for December 2013 and December 2014.</p> <p>21 Correct? You want to see them to confirm that?</p> <p>22 A Yeah. I can look here.</p> <p>23 Q I'm going to help you because I'm going to get</p> <p>24 the exhibit out. Give me just one moment. I tell you</p> <p>25 what, I can do it a little easier.</p>

Attachment 10

809	<p>1 A The answer to your question the way you asked</p> <p>2 it, Mr. Donley, is no.</p> <p>3 Q Which black book -- let me let you tell me.</p> <p>4 Which black books did you use for your</p> <p>5 analysis for Exhibit A?</p> <p>6 A I used December '13 and January '14.</p> <p>7 Q That's where I got off. You used December '13</p> <p>8 and January '14.</p> <p>9 A Yes, sir.</p> <p>10 Q Gotcha. My apologizes.</p> <p>11 So you didn't each use a Black Book for</p> <p>12 any time period between 2010 and 2013, did you, except</p> <p>13 for the December 2013. Fair?</p> <p>14 A That's a fair statement, yes, sir.</p> <p>15 Q And black books are issued how often?</p> <p>16 A Oh, my gosh. I think it may be as frequently</p> <p>17 as every week.</p> <p>18 Q Okay. And you picked the one at the very end</p> <p>19 of December, 2013?</p> <p>20 A Yes, sir.</p> <p>21 Q And for your Exhibit A, which we'll look at,</p> <p>22 you were looking at, also, new motor vehicles that were</p> <p>23 model year 2013?</p> <p>24 A Yes, sir.</p> <p>25 Q Let's go to No. 5 of your conclusions. You say</p>	811	<p>1 through it and ask for your agreement or disagreement,</p> <p>2 if you disagree with me. Okay?</p> <p>3 A All right. That's fine.</p> <p>4 Q All right. What I put up at the top of this</p> <p>5 chart is year one, two, and three. Do you see that?</p> <p>6 A Yes, sir.</p> <p>7 Q And then down the left-hand side, I put, up at</p> <p>8 the top, recovered profit. Right?</p> <p>9 A Yes, sir.</p> <p>10 Q Current year profit. And then under that,</p> <p>11 total profit. Do you see that?</p> <p>12 A I see that.</p> <p>13 Q And then following down that column, I have</p> <p>14 Bates taxable income goal. Right?</p> <p>15 A Yes, sir.</p> <p>16 Q Because the one thing we know, because</p> <p>17 Mr. Bates has testified to it, is that the taxable</p> <p>18 income goal year after year of the time period at issue</p> <p>19 in this case was \$75,000. Right?</p> <p>20 A That's a correct statement.</p> <p>21 Q Yes, sir. And by the way, you don't advise any</p> <p>22 of your dealer clients to shoot for a certain amount of</p> <p>23 taxable income, do you?</p> <p>24 A Can you phrase the question differently?</p> <p>25 Q Yes, sir.</p>
810	<p>1 Bates Nissan LCM adjustments did not accumulate over</p> <p>2 time. The LCM adjustments were reversed when the</p> <p>3 affected vehicles were sold. Right?</p> <p>4 A Yes, sir.</p> <p>5 Q Well, let's see what else occurred with regard</p> <p>6 to those and see if we can get a little more</p> <p>7 clarification.</p> <p>8 MR. DONLEY: Your Honor, may I go to</p> <p>9 the --</p> <p>10 JUDGE BENNETT: You may.</p> <p>11 MR. DONLEY: Thank you.</p> <p>12 Q (BY MR. DONLEY) Now, you were here when I</p> <p>13 arrived this morning, were you not?</p> <p>14 A I was. We were the early birds.</p> <p>15 Q You saw me go over here and make a chart,</p> <p>16 didn't you; but you didn't get to see what it was.</p> <p>17 Right?</p> <p>18 A That's right. That wouldn't be fair to do</p> <p>19 that.</p> <p>20 Q I understand. But you knew I was making</p> <p>21 something. So now let's let you see what I made.</p> <p>22 A All right.</p> <p>23 Q This is the chart that I came in this morning</p> <p>24 and prepared, Mr. Davis. And I want to see if you agree</p> <p>25 with what I put on this chart, so I'm going to walk</p>	812	<p>1 You have over a hundred new motor vehicle</p> <p>2 dealer clients, do you not?</p> <p>3 A That's a correct statement.</p> <p>4 Q And not one of them do you get on the phone and</p> <p>5 say, I advise you to see what you can do to get to a</p> <p>6 particular amount of taxable income? That's not the</p> <p>7 kind of advice you provide as a CPA, is it, sir?</p> <p>8 A That's not the nature of a conversation we</p> <p>9 would have. It is typically more in the line of, I want</p> <p>10 to pay the least amount of taxes possible.</p> <p>11 Q Based on doing things lawfully?</p> <p>12 A That's correct.</p> <p>13 Q And correct and in accordance with the IRS code</p> <p>14 and regulations and Treasury regs. Fair?</p> <p>15 A That's a correct statement.</p> <p>16 Q All right. And then following down, at the</p> <p>17 bottom I've got write-downs. Okay?</p> <p>18 A I see that.</p> <p>19 Q Now, what I did in year one, because we're</p> <p>20 starting with the first year. Okay? So we don't have</p> <p>21 any recovered profit, and we'll talk about that a little</p> <p>22 more in just a moment. But what we do have for the</p> <p>23 first year is current year profit of 475,000. Do you</p> <p>24 see that?</p> <p>25 A I see that.</p>

Attachment 10

813	<p>1 Q And if all I have for that year is 475,000, 2 that means my total profit is 475,000. Right? 3 A Yes, sir. In your example, that's correct. 4 Q In my example. 5 And if I'm a dealer and I'm going to 6 report that to Nissan, what I'm going to report on my 7 financial statements that are sent to Nissan January to 8 December, so this will be at year-end of December, I'm 9 going to tell Nissan I made 475,000, right, based on 10 this hypothetical. Fair? 11 A So far, given the facts that you've brought up 12 so far, yes, sir. 13 Q Yes, sir. And then if I'm Bates Nissan, what 14 I'm doing, I'm trying to take that total profit and get 15 it down to a taxable income of 75,000. Right? 16 A Yes, sir, I believe that's their -- 17 Q Right? That's what they do? 18 A Yes, sir. Yes, sir. 19 Q And for purposes of my hypothetical, I'll agree 20 with you. I'm leaving out all other kinds of 21 adjustments and those things. I'm trying to keep it 22 simple. Okay? I just want to focus on the write-downs. 23 Are you with me? 24 A I'm with you. 25 Q And so now if all Bates Nissan has to get from</p>	815	<p>1 Q All right. And so just assume -- so that 2 400,000 goes into profit. It's recovered profit for the 3 next year. Right? 4 A Yes, sir. 5 Q And now assume with me that Bates Nissan is 6 looking -- they make another 475,000 the next year, the 7 same amount. I just made a simple example. Okay? 8 A Sure. 9 Q So they've got current year profit again for 10 year two of 475,000. So now total profit for year two 11 is 875,000 in my example. Right? 12 A That is correct. 13 Q And on the financial statements, it's the 14 875,000 that would be reported to Nissan. Correct? 15 A The way that Bates did it, yes. 16 Q The way that Bates did it. That's what they 17 reported. Right? 18 A Yes. 19 Q Because they would have reported the recovered 20 profit and the current year profit and reported to 21 Nissan 875,000. Right? 22 A Yes, sir. That would've been their month 12 23 financial end-year example. 24 Q Yes, sir. So December 31, at the end of the 25 year, that's what they would've reported to Nissan,</p>
814	<p>1 475 to 75,000 are the write-downs on new and used motor 2 vehicles, it has to write down \$400,000, does it not? 3 A That's correct, to achieve the \$75,000. 4 Q Now, Mr. Bates testified, and there's been 5 plenty of statements made throughout this case, that 6 when that occurs, that \$400,000 is going to be 7 recovered, recovered profit -- are you with me now? 8 A Yes, sir. 9 Q -- in year two. Right? 10 A Yes, sir, assuming all those vehicles left 11 inventory through normal sale. 12 Q Let's just assume they do. 13 A Good. 14 Q Do you know of any of the vehicles at issue in 15 this case that didn't leave inventory in the course of a 16 normal sale? 17 A Some of them might have not been sold to a 18 customer. It might've been dealer trade or something. 19 But they left inventory, if that's the -- 20 Q I'm just asking if you were aware of any, not 21 if you assumed. 22 Are you aware of any that didn't leave in 23 the normal course? 24 A Not specifically for what we're doing here, no, 25 sir.</p>	816	<p>1 875,000? 2 A In your hypothetical, I believe that to be the 3 case. 4 Q Now, Bates Nissan again wants to get to 5 \$75,000 in taxable -- that's its taxable income goal 6 again for year two. Right? 7 A Yes, sir. 8 Q Now, what Bates Nissan in my example has to do 9 is not only write down enough to cover the current year 10 profit of 475, they've got to write down at least 11 325,000, depending on how you want to look at the bucket 12 of dollars -- they've got to write down at least 325,000 13 of the recovered profit for a total write-down of 14 800,000. Right? 15 A Yes, that's correct math. 16 Q And that's the way that the gross profits were 17 misstated when they were provided to Nissan because that 18 \$400,000 was not made in year two, was it, sir? 19 A Now, that -- I couldn't answer that question. 20 MR. DONLEY: If you would pull up 21 Exhibit C-8. I'm not going to be able to see it, but 22 I've got it in my hand. We'll have it up on the screen. 23 Pull up C-8. 24 Q (BY MR. DONLEY) And, Mr. Davis, do you 25 recognize C-8 as your expert supplemental and rebuttal</p>

Attachment 10

817	<p>1 report?</p> <p>2 A Yes, I do.</p> <p>3 Q So that's the second report you issued in this</p> <p>4 case?</p> <p>5 A Yes, sir.</p> <p>6 Q Turn over with me to Page 14 of 17. Are you</p> <p>7 with me, sir?</p> <p>8 A Yes, sir.</p> <p>9 Q Now, that last paragraph, if you would, call it</p> <p>10 out for me. Do you see that last paragraph there, sir?</p> <p>11 A Yes, sir.</p> <p>12 Q Now, you say in that last paragraph of C-8 on</p> <p>13 Page 14 that Mr. Liner -- that's Mr. Bryne Liner who's</p> <p>14 sitting right behind me in the blue shirt. Right?</p> <p>15 A Yes, sir. We've met before.</p> <p>16 Q You have? And you read his reports, didn't</p> <p>17 you?</p> <p>18 A I did.</p> <p>19 Q You say, "Mr. Liner also acknowledges the fact</p> <p>20 that the overstated LCM adjustments have caused</p> <p>21 overstated gross profits in the subsequent year when the</p> <p>22 effected vehicles were sold." Did I read that</p> <p>23 correctly?</p> <p>24 A Yes.</p> <p>25 Q And then you say, "This is correct, but it's</p>	819	<p>1 a number.</p> <p>2 Q Yes, sir. And the same is true for used motor</p> <p>3 vehicles. Correct?</p> <p>4 A Yes, sir.</p> <p>5 Q And so there's nothing in the tax code about</p> <p>6 being aggressive, is there, sir?</p> <p>7 A No, sir. It's something that has judgment</p> <p>8 involved in certain aspects of it.</p> <p>9 Q What I gave you in this -- and let me just be a</p> <p>10 little more clear, that the 400,000 in write-downs for</p> <p>11 new and used motor vehicles done exactly the way that</p> <p>12 Bates Nissan did it that is at issue in this case.</p> <p>13 Okay?</p> <p>14 A Okay.</p> <p>15 Q And you said if that's so, you agree that</p> <p>16 that's overstated gross profit in year two based on what</p> <p>17 occurred in year one on the write-downs, did you not?</p> <p>18 A I did.</p> <p>19 Q You agreed with that statement by Mr. Liner?</p> <p>20 A I did.</p> <p>21 Q And you still agree with it. Right?</p> <p>22 A Yes, I do.</p> <p>23 Q Yes, sir. And so the 875,000, then, we talked</p> <p>24 about total profits in year two, they're overstated, arc</p> <p>25 they not?</p>
818	<p>1 again perplexing that this should be an issue for</p> <p>2 Nissan." But you agreed that what Mr. Liner stated was</p> <p>3 correct, didn't you, sir?</p> <p>4 A Yes, sir.</p> <p>5 Q Yes, sir. And what you were talking about here</p> <p>6 when you said it was correct is that the overstated LCM</p> <p>7 adjustment caused overstated gross profits. And the</p> <p>8 overstated LCM judgment is this, which caused the</p> <p>9 400,000 in year two, which caused the \$875,000 in year</p> <p>10 two to be overstated. Right?</p> <p>11 A I see what you mean, yes, sir.</p> <p>12 Q You agree with me, don't you?</p> <p>13 A As long as you make the assumption that the</p> <p>14 \$400,000 write-down on the bottom of the first column --</p> <p>15 Q On year one?</p> <p>16 A -- is too aggressive.</p> <p>17 Q Well, not too aggressive. If it's not in</p> <p>18 accordance with GAP and it's not in accordance with the</p> <p>19 tax regs, tax code, and Treasury regs. Right? Let me</p> <p>20 go at that differently.</p> <p>21 A All right.</p> <p>22 Q The tax code doesn't say you can write down new</p> <p>23 motor vehicles as long as you're not too aggressive,</p> <p>24 right, sir?</p> <p>25 A It's got a process that you go through to reach</p>	820	<p>1 You said just a few moments ago, yes; but</p> <p>2 maybe I misunderstood.</p> <p>3 A Yeah, I know. I'm thinking. Hang on a second.</p> <p>4 Yes, I'll agree with that statement.</p> <p>5 Q All right. And then let's continue on in year</p> <p>6 two, that \$800,000 of write-down you now need in year</p> <p>7 two to get to 75,000 in taxable income -- because that's</p> <p>8 the goal. Right?</p> <p>9 A Yes, sir, that was their goal.</p> <p>10 Q Now that \$800,000 in write-downs just done --</p> <p>11 done just like Bates Nissan did it in this case for new</p> <p>12 and used motor vehicles, that \$800,000 now becomes</p> <p>13 recovered profit in year three, doesn't it?</p> <p>14 A It does.</p> <p>15 Q And just to keep the example simple, current</p> <p>16 year profit in year three, I put down at 475,000. And</p> <p>17 then we've got total profit for year three of</p> <p>18 1.275 million. Correct?</p> <p>19 A In your example, yes.</p> <p>20 Q And that's the amount that would've been</p> <p>21 reported to Nissan on the 12th month financial</p> <p>22 statement. Correct?</p> <p>23 A Yes, the way we're working this example.</p> <p>24 Q Yes, sir. And because of the way that Bates</p> <p>25 Nissan did its write-downs, that 1.275 million is</p>

Attachment 10

821	<p>1 overstated, just like you agreed on Page 14 of 17 of</p> <p>2 C-8. Correct?</p> <p>3 A The way you're working the example, that's</p> <p>4 correct.</p> <p>5 Q Yes, sir. And then to get -- now we've got to</p> <p>6 get the second -- are you okay? There's some water.</p> <p>7 A Yeah. Hang on.</p> <p>8 Q Go ahead.</p> <p>9 A Sometimes you get a little dry.</p> <p>10 Okay.</p> <p>11 Q And now for year three we know, once again,</p> <p>12 Bates Nissan's goal is to get to only \$75,000 in taxable</p> <p>13 income. Right?</p> <p>14 A That's correct.</p> <p>15 Q And so now it's got to write down 1.2 million,</p> <p>16 does it not?</p> <p>17 A Yes, sir, the way this is working.</p> <p>18 Q Right. And the way I'm working it, it's got to</p> <p>19 write down that much in new and used motor vehicles,</p> <p>20 just like it has testified it did in this case. Right?</p> <p>21 A Yes, sir.</p> <p>22 Q All right. And when it does that, we get back</p> <p>23 to the 75K. But that 1.2 million is some part of the</p> <p>24 475,000 in current year profit. Right?</p> <p>25 A I lost you. Try that again.</p>	823	<p>1 Q When gross profits are overstated, then what</p> <p>2 happens is not only are the gross profits overstated on</p> <p>3 the financial statements submitted to Nissan, but the</p> <p>4 department profits for new and used are overstated.</p> <p>5 Right?</p> <p>6 A Yeah. If you make the first assumption, then</p> <p>7 No. 1 is correct, No. 2 is correct.</p> <p>8 Q The rest follows, doesn't it?</p> <p>9 And the net working capital on the</p> <p>10 financial statements submitted to Nissan are incorrect</p> <p>11 and overstated. Right?</p> <p>12 A Which statement?</p> <p>13 Q Any -- let's take a December 31, the 12th</p> <p>14 month. Let's start there. Certainly there it's</p> <p>15 misstated. Right?</p> <p>16 A You and I would have to explore this some more</p> <p>17 before I answer that question for --</p> <p>18 Q Are you not -- I'm sorry. Did you finish?</p> <p>19 A -- before I answer that question. Because I</p> <p>20 have some definite ideas about the balance sheet KPIs.</p> <p>21 Q So you're not certain about three net working</p> <p>22 capital?</p> <p>23 A That's correct.</p> <p>24 Q How about the effective net worth, would you</p> <p>25 agree with me when you overstate the gross profits, like</p>
822	<p>1 Q The 1.2 million, part of that is the 475,000 in</p> <p>2 current year profit. Right?</p> <p>3 A Yes, sir.</p> <p>4 Q And part of that is the \$800,000 in recovered</p> <p>5 profit that came over from the write-downs that didn't</p> <p>6 meet GAP and didn't meet any of the Treasury regs or</p> <p>7 rules from year two. Right?</p> <p>8 A Yes, sir, I understand.</p> <p>9 Q You agree with that, don't you?</p> <p>10 A The way your example works, that's correct.</p> <p>11 Q Yes, sir. And when Bates Nissan did this, and</p> <p>12 it reported these total profit dollars that we talked</p> <p>13 about to Nissan on the 12th month, what happened then</p> <p>14 was because -- and you've you agreed with me -- those</p> <p>15 profit numbers are misstated. Right? They're</p> <p>16 overstated in my example. Right?</p> <p>17 A I've agreed that they weren't supported and --</p> <p>18 and because of that, you know, we've got the -- we've</p> <p>19 got the overstatement issue because we don't have</p> <p>20 support for it.</p> <p>21 Q You agreed in your report it caused the gross</p> <p>22 profits to be overstated?</p> <p>23 A Yes, sir. Yes, sir.</p> <p>24 Q Do you stick by that?</p> <p>25 A Yes, sir. I'll go with the report.</p>	824	<p>1 on my example a few moments ago on the financials</p> <p>2 submitted to Nissan, effective net worth is also</p> <p>3 misstated?</p> <p>4 A I can't give you an answer to that question</p> <p>5 either.</p> <p>6 Q Would you -- I'm sorry.</p> <p>7 A I said either.</p> <p>8 Q Okay. How about overall dealership net</p> <p>9 profits? You would agree with me on that one? That one</p> <p>10 is going to be misstated if the gross profits are</p> <p>11 misstated. Correct?</p> <p>12 A I just think we have to explore it further</p> <p>13 before I give you a yes or no answer.</p> <p>14 Q You're just not sure?</p> <p>15 A Not the way you phrased it.</p> <p>16 Q Let's go back for a moment.</p> <p>17 A Okay.</p> <p>18 Q What we've only talked about so far is the</p> <p>19 December 31 statement generally. Right?</p> <p>20 A Right. Not month 13, but month 12.</p> <p>21 Q Month 12.</p> <p>22 A Okay. I just want to make sure we're on the</p> <p>23 same page.</p> <p>24 Q That's the December 31st?</p> <p>25 A All right.</p>

Attachment 10

825	<p>1 Q That's what they're always dated?</p> <p>2 A Yes, sir, I understand.</p> <p>3 Q Okay. So we're on the same wavelength?</p> <p>4 A And we're assuming that the write-downs -- that</p> <p>5 Nissan totally disagrees with those write-downs.</p> <p>6 Q No, no. What I'm saying is that they're not</p> <p>7 compliant with GAP; they're not compliant with tax code</p> <p>8 the tax regulations, or Treasury regulations. And I</p> <p>9 thought you had already agreed with that?</p> <p>10 A That's correct.</p> <p>11 Q Okay. That's what I'm saying. Are you with me</p> <p>12 now?</p> <p>13 A I'm with you --</p> <p>14 Q Yes, sir.</p> <p>15 A -- for that. Some write-down may have been</p> <p>16 allowed, but we don't know what that amount would've</p> <p>17 been.</p> <p>18 Q Well, there's no evidence here any of the</p> <p>19 write-downs would've been allowed, is there, sir? Only</p> <p>20 if lightning struck and it was a coincidence. Right?</p> <p>21 A Well, that would've been if -- you were talking</p> <p>22 about whether the number being correct or not. If you</p> <p>23 had all information available to you, some write-down,</p> <p>24 if you had done it correctly under the regs, may have</p> <p>25 actually occurred.</p>	827	<p>1 Q So you don't know what was in his mind, do you,</p> <p>2 sir?</p> <p>3 A No. That was an assumption on my part based</p> <p>4 upon preparing hundreds of 3115s.</p> <p>5 Q So you don't know what was in his mind, do you,</p> <p>6 sir?</p> <p>7 A No, sir.</p> <p>8 Q I'm going to ask to the extent you can, if you</p> <p>9 would just answer my questions yes or no, if you would,</p> <p>10 please.</p> <p>11 A Yeah. We may have departed from that. I'm</p> <p>12 sorry.</p> <p>13 Q I'm on the clock.</p> <p>14 A Yes, sir, I get it.</p> <p>15 Q All right. Now, this 400,000 in year two,</p> <p>16 going back to my first chart.</p> <p>17 A Yes.</p> <p>18 Q All right. That 400,000, if any of that is</p> <p>19 recovered in January, now the January financial</p> <p>20 statement submitted to Nissan is also overstated on</p> <p>21 gross profits, is it not?</p> <p>22 A The January financial statement would be</p> <p>23 overstated in gross profits.</p> <p>24 Q As would February, March, April, May. Every</p> <p>25 month of the year would be overstated once any of the</p>
826	<p>1 Q Do you think that Mr. Schneider, when he sent</p> <p>2 his letter to the IRS, had the information he needed?</p> <p>3 A To do it the way he did it, I believe he</p> <p>4 thought he did, yes.</p> <p>5 Q Because he ultimately said there's over</p> <p>6 \$726,000 off. Right?</p> <p>7 A 726,531.</p> <p>8 Q And that was the entire write-down for that</p> <p>9 prior year, which I believe was 2013, if I remember</p> <p>10 correctly?</p> <p>11 A Yes, sir.</p> <p>12 Q So he took the whole amount, didn't he?</p> <p>13 A That's correct.</p> <p>14 Q He didn't even suggest to the IRS that any of</p> <p>15 those amounts were correct, did he, sir?</p> <p>16 A He didn't. And I believe he took the whole</p> <p>17 thing because there was no documentation.</p> <p>18 Q He didn't have any documents either?</p> <p>19 A There was no documents to show, for example,</p> <p>20 what the application of Revenue Ruling 67.107 would've</p> <p>21 provided for a used vehicle write-down. So he didn't</p> <p>22 have that, so he assumed that he couldn't support it, I</p> <p>23 believe in my mind, and so he took zero.</p> <p>24 Q Did you ever talk to Mr. Schneider about that?</p> <p>25 A Not that in particular.</p>	828	<p>1 vehicles that were written down as part of this 400K,</p> <p>2 once those vehicles are sold, now every financial</p> <p>3 statement thereafter have overstatements in them, don't</p> <p>4 they?</p> <p>5 A And they decrease in capacity as the year goes</p> <p>6 along as a percentage of the whole, yes, sir.</p> <p>7 Q And January through December, those are the</p> <p>8 financial statements that were submitted to Nissan.</p> <p>9 Right?</p> <p>10 A Yes, sir.</p> <p>11 Q Yes, sir. Now, you would agree with me that</p> <p>12 Nissan is entitled to receive accurate financial</p> <p>13 statements from its dealers. Correct?</p> <p>14 A Yes, sir. For the most part.</p> <p>15 Q So they're only entitled to receive accurate</p> <p>16 financial statements for the most part?</p> <p>17 A I think --</p> <p>18 Q I just need a -- is that your answer? I want</p> <p>19 to make sure I understand it.</p> <p>20 A My answer is larger than a yes or no.</p> <p>21 Q Is Nissan entitled to receive reliable</p> <p>22 financial statements from its dealers?</p> <p>23 A It is entitled, but it hasn't set itself up</p> <p>24 very well to get totally reliable financial information.</p> <p>25 Q Is it entitled to receive complete financial</p>

Attachment 10

829	<p>1 information?</p> <p>2 A Same answer.</p> <p>3 Q And if the financial statements that a dealer</p> <p>4 provides to Nissan are not accurate, doesn't a dealer</p> <p>5 need to go back and fix that so that the financial</p> <p>6 information submitted to Nissan is accurate?</p> <p>7 A I'm trying to figure out how to answer your</p> <p>8 question in a way that you're going to allow me to</p> <p>9 answer it.</p> <p>10 Q It's a simple question, sir. If a dealer knows</p> <p>11 that a financial statement it submitted to Nissan is not</p> <p>12 accurate, doesn't that dealer have an obligation to</p> <p>13 correct that and submit an accurate financial statement</p> <p>14 to Nissan?</p> <p>15 A I will say that most dealers would make a</p> <p>16 correction in an ensuing month rather than resubmitting</p> <p>17 a statement.</p> <p>18 Q But a dealer has the obligation to make that</p> <p>19 correction, ever how they do it, and submit it to</p> <p>20 Nissan, do they not?</p> <p>21 A I think that I would want to get correct</p> <p>22 information to Nissan. The concept of the optional</p> <p>23 13th period statement introduces some -- I guess some</p> <p>24 oddities to that, if you will.</p> <p>25 Q I didn't say anything about a 13th month</p>	831	<p>1 But it does cause some aberrations on some of the</p> <p>2 monthly financials.</p> <p>3 Q And once it causes aberration on some of the</p> <p>4 monthly financials, then it rolls into the next</p> <p>5 financial and the next financial and the next financial,</p> <p>6 doesn't it, sir?</p> <p>7 A In the year-to-date columns it does in a</p> <p>8 decreasing amount as a percentage of the whole.</p> <p>9 Q But it makes every one of them in a given year</p> <p>10 inaccurate and unreliable, doesn't it?</p> <p>11 A It makes certain -- it makes them inaccurate --</p> <p>12 it makes certain aspects of that statement unreliable,</p> <p>13 depending upon which KPIs you're trying to deal with.</p> <p>14 Q And it's two things. The year-to-date is</p> <p>15 tainted as well as the current month. Correct?</p> <p>16 A The current month, again, we're dealing with,</p> <p>17 like, going January through the year.</p> <p>18 Q Through March. You're right.</p> <p>19 A Right. Once --</p> <p>20 Q And so the current month -- I think I'm going</p> <p>21 to get you there, but if I didn't, you give me that</p> <p>22 answer.</p> <p>23 But the current month is wrong, and the</p> <p>24 year-to-date in that statement is wrong. Correct?</p> <p>25 A That's right. The current month items rectify</p>
830	<p>1 statement, did I, sir?</p> <p>2 A No, sir, you didn't.</p> <p>3 Q If a dealer knows its January statement</p> <p>4 submitted to Nissan --</p> <p>5 MR. COFFEY: Judge, would Mr. Donley</p> <p>6 please allow the witness to complete his answer before</p> <p>7 starting in on another question where the witness has</p> <p>8 indicated that the question cannot be answered with a</p> <p>9 simple yes or no.</p> <p>10 JUDGE BENNETT: Well, if the witness</p> <p>11 indicates it can't be answered with a simple yes or no,</p> <p>12 he can leave it at that, unless Mr. Donley wants to</p> <p>13 follow up and ask him further.</p> <p>14 MR. DONLEY: Fair enough. I am trying to</p> <p>15 mind my clock, Judge, with all due respect. Thank you.</p> <p>16 Q (BY MR. DONLEY) So if a dealer knows its</p> <p>17 January statement submitted to Nissan is not accurate</p> <p>18 and reliable, shouldn't that -- doesn't that dealer have</p> <p>19 an obligation to somehow correct that January statement</p> <p>20 and the information submitted to Nissan?</p> <p>21 A Yes. I can -- I can go with that answer.</p> <p>22 It's -- it's difficult in the case of these write-downs,</p> <p>23 because the statement -- the statements tend to correct</p> <p>24 themselves by the end of the first quarter, it looks</p> <p>25 like, from the evidence as the inventory clears out.</p>	832	<p>1 themselves once you work out of those inventories.</p> <p>2 So -- that were written down from the prior year. So if</p> <p>3 I can put a fact in your hypothetical?</p> <p>4 Q No, sir. I'm not going to let you put a fact</p> <p>5 in my hypothetical.</p> <p>6 But once you have -- once you have a</p> <p>7 problem in the monthly financial statement, now it</p> <p>8 starts carrying over into the year-to-date and each of</p> <p>9 the subsequent financials. Correct?</p> <p>10 A That statement is correct.</p> <p>11 Q Okay. In other words, you agree with that?</p> <p>12 A That statement is correct.</p> <p>13 Q Okay. And you didn't go back and do an</p> <p>14 analysis to determine if any of the financial statements</p> <p>15 were accurate and reliable, did you, sir?</p> <p>16 A Oh, no, sir.</p> <p>17 Q And you didn't ask Mr. Bates if his financial</p> <p>18 statements submitted to Nissan were accurate and</p> <p>19 reliable?</p> <p>20 A No, I didn't ask that question of him.</p> <p>21 Q Or Ms. Chumbley?</p> <p>22 A No, sir.</p> <p>23 Q In fact, you didn't ask anybody at Bates Nissan</p> <p>24 whether or not the financial statements submitted to</p> <p>25 Nissan were accurate and reliable?</p>

Attachment 10

877	<p>1 too. True?</p> <p>2 A That's correct.</p> <p>3 Q Mr. Davis, you have not seen any documents that</p> <p>4 suggest that Bates Nissan did anything other than make</p> <p>5 up the write-downs in this case in its head, put them</p> <p>6 down on a piece of paper, and send them to Mr. Gautier</p> <p>7 to be included in a tax return, have you, sir?</p> <p>8 A I disagree with that statement.</p> <p>9 Q Bring up Page 204 of his deposition for me.</p> <p>10 Do you recall I asked you that question in</p> <p>11 your deposition?</p> <p>12 A I'm fixing to, I think.</p> <p>13 MR. DONLEY: Let's go to Line 19 through</p> <p>14 23 and blow that up.</p> <p>15 Q (BY MR. DONLEY) Sir, in your deposition at</p> <p>16 Page 204 -- and by the way, you swore under oath in your</p> <p>17 deposition, did you not?</p> <p>18 A I understand. I'll stick with my answer.</p> <p>19 Q In your deposition?</p> <p>20 A Yes.</p> <p>21 Q Well, let's read it and make sure we get it on</p> <p>22 the record correctly?</p> <p>23 A Okay. We'll get it right. Go ahead.</p> <p>24 Q I asked you this question in your deposition.</p> <p>25 I said, "Have you seen any document that suggests that</p>	879	<p>1 MR. DONLEY: Your Honor, I'll pass the</p> <p>2 witness.</p> <p>3 JUDGE BENNETT: Okay.</p> <p>4 CROSS-EXAMINATION</p> <p>5 BY MR. COFFEY:</p> <p>6 Q Mr. Davis, have you ever contended in these</p> <p>7 proceedings -- you still can't hear me?</p> <p>8 A (Witness shakes head)</p> <p>9 Q Okay. Mr. Davis, can you hear me now?</p> <p>10 A A little better.</p> <p>11 Q Not that well?</p> <p>12 MR. DONLEY: You're a little soft-spoken.</p> <p>13 Q (BY MR. COFFEY) How about now?</p> <p>14 A We're getting there. Let's try that.</p> <p>15 Q Okay. Have you ever contended in these</p> <p>16 proceedings that Bates Nissan was following the Treasury</p> <p>17 regs when it wrote down new and used motor vehicles?</p> <p>18 A No, sir.</p> <p>19 Q Have you ever contended in these proceedings</p> <p>20 that Bates Nissan was following GAAP when it wrote down</p> <p>21 new and used motor vehicles?</p> <p>22 A No, sir.</p> <p>23 Q Have you -- have you, however, contended that</p> <p>24 Bates Nissan was using what was -- what was in its mind</p> <p>25 a rational basis for the write-downs it took?</p>
878	<p>1 Bates Nissan did anything other than make up these</p> <p>2 values in its head, put them down on a piece of paper,</p> <p>3 and send them to Mr. Gautier to be included in the tax</p> <p>4 return?"</p> <p>5 And you answered, "No, sir."</p> <p>6 Did you not?</p> <p>7 A The pure "yes" or "no" answer, it would be</p> <p>8 "no." I could add some -- some explanation to it, but</p> <p>9 basically no.</p> <p>10 Q Sir, my -- I thought you said, even before I</p> <p>11 read it, you stick with the answer you gave me in your</p> <p>12 deposition, do you not?</p> <p>13 A I did.</p> <p>14 Q And you still do?</p> <p>15 A Yes. I could add some explanation to it, but I</p> <p>16 can stick with this.</p> <p>17 Q Sir, you said, "No, sir." Do you stick with</p> <p>18 "no, sir" or not? You swore to that answer under oath,</p> <p>19 did you not?</p> <p>20 A I did.</p> <p>21 Q Did you tell the truth in your deposition when</p> <p>22 you answered that question?</p> <p>23 A Yes.</p> <p>24 Q Do you stick with that answer?</p> <p>25 A Yes, sir. That's fine.</p>	880	<p>1 MR. DONLEY: Objection, Your Honor. It's</p> <p>2 inconsistent with his expert report.</p> <p>3 He has stated in his expert report what he</p> <p>4 relied upon and what it was, and he's testified to that,</p> <p>5 so it's also asked and answered. That's the reason why</p> <p>6 yesterday, Your Honor, I was bringing up are these</p> <p>7 experts going to be stuck with their reports so that we</p> <p>8 don't start going into all these things beyond what he's</p> <p>9 already testified to, one, in his deposition and what's</p> <p>10 in his reports.</p> <p>11 JUDGE BENNETT: I'm going to overrule</p> <p>12 that. You certainly can impeach him if his report says</p> <p>13 something different, and show that on additional</p> <p>14 examination.</p> <p>15 MR. DONLEY: Very good.</p> <p>16 JUDGE BENNETT: But I'm generally going to</p> <p>17 allow this line of questioning.</p> <p>18 MR. COFFEY: Thank you, Your Honor.</p> <p>19 Q (BY MR. COFFEY) Can you -- yes, are you</p> <p>20 contending, however, that Bates Nissan, at least in its</p> <p>21 own mind, had a rational basis for the write-downs it</p> <p>22 took?</p> <p>23 A I think that Bates Nissan, like many of my</p> <p>24 clients that are -- when they become new to me, have the</p> <p>25 wrong idea about how they can do write-downs, and it's</p>

Attachment 10

893	<p>1 yes, there very well could have been, a much higher</p> <p>2 likelihood on the used side than the new side, that</p> <p>3 there would have been some inventory that's above market</p> <p>4 on the books.</p> <p>5 I did not do any particular analysis of</p> <p>6 that, but just my experience working for so many decades</p> <p>7 with car dealers would lend me to believe that.</p> <p>8 Q In fact, lightning might have stricken many,</p> <p>9 many times across the spectrum of used and new vehicles,</p> <p>10 might it not?</p> <p>11 A Well, as far as -- as far as having the</p> <p>12 possibility of getting a value that is less than cost on</p> <p>13 the financial statement, this would have happened quite</p> <p>14 a number of times, I believe, again, with no particular</p> <p>15 analysis, just experience. But as far as the numbers</p> <p>16 that were chosen versus the actual numbers chosen by</p> <p>17 Bates Nissan versus what, going through, say, Revenue</p> <p>18 Ruling 67-107 to come up with a value -- and again,</p> <p>19 we're talking taxes, not GAAP -- actually hitting the</p> <p>20 number on the head might have been a more seldom</p> <p>21 occasion, certainly. But the presence of needing to</p> <p>22 write down vehicles is a high likelihood.</p> <p>23 Q Now, in your opinion, why would Mr. Schneider</p> <p>24 have simply declared all of the write -- well, first,</p> <p>25 before we get to that.</p>	895	<p>1 A Not that I've seen. There may have been</p> <p>2 selected vehicles that the work has been done on, but</p> <p>3 not -- not in total, I don't believe.</p> <p>4 Q Well, it sounds to me, from what you just</p> <p>5 testified to about what Mr. Schneider did, that he may</p> <p>6 very well have left money lying on the table.</p> <p>7 Do you agree?</p> <p>8 A That -- in terms of having a smaller</p> <p>9 re-inclusion into income is what you mean?</p> <p>10 Q Yes, sir.</p> <p>11 A And I'm trying not to be technical, but the</p> <p>12 term -- I guess I am. The term -- the \$726,531 in the</p> <p>13 accounting industry is known as a 481a adjustment.</p> <p>14 That's the amount that's spread over four years.</p> <p>15 Q Right.</p> <p>16 A If Mr. Schneider or somebody else had gone back</p> <p>17 and done the application of Revenue Ruling 67-107 of</p> <p>18 used vehicles, it is -- it's highly likely that the</p> <p>19 amount brought back into income could have been reduced.</p> <p>20 Q And I take it from your testimony that the</p> <p>21 reason he would not have done that is because it would</p> <p>22 be a very complicated analysis. You would have to go</p> <p>23 back and resurrect data, which would be very hard to</p> <p>24 find, and that is probably the reason why he didn't do</p> <p>25 that?</p>
894	<p>1 That accumulated write-down, if you will,</p> <p>2 in 2013 that was declared as -- as income, is that</p> <p>3 cumulative of prior year write-downs? In other words,</p> <p>4 does that pick up a period of year's write-downs which</p> <p>5 end up accumulated in 2013?</p> <p>6 A I'm really unable to say because you have to do</p> <p>7 a determination of market value in accordance with GAAP</p> <p>8 or in accordance with the tax regulations, okay, to see</p> <p>9 if an accumulation has occurred or if that number --</p> <p>10 again, back to Mr. Donley's lightning comment -- you</p> <p>11 know, if that number actually reflected the market at</p> <p>12 that time.</p> <p>13 Q So we don't really know whether or not</p> <p>14 write-downs accumulated over time, even separate and</p> <p>15 apart from the recapture of the income attributable to</p> <p>16 those write-downs?</p> <p>17 A We don't specifically know that without the</p> <p>18 proper market analysis, which, of course, we do not have</p> <p>19 because that -- those -- that work -- that work wasn't</p> <p>20 done, okay, by the client, if you will, and have support</p> <p>21 like we talked about that would be -- either be in a</p> <p>22 file as a part of a production of financial statements</p> <p>23 or in a file to actually support tax deductions.</p> <p>24 Q And that work wasn't done by Nissan either, was</p> <p>25 it?</p>	896	<p>1 MR. DONLEY: Your Honor, can we just</p> <p>2 preface that in his opinion?</p> <p>3 MR. COFFEY: In his opinion. Exactly.</p> <p>4 MR. DONLEY: Mr. -- no, no. Mr. Davis'</p> <p>5 opinion.</p> <p>6 MR. COFFEY: Right. That's what I said.</p> <p>7 MR. DONLEY: Okay. Thank you.</p> <p>8 JUDGE BENNETT: Yeah, in your opinion as</p> <p>9 to why that work might not have been done, or those</p> <p>10 adjustments.</p> <p>11 A It would have taken a while to pull the vehicle</p> <p>12 deals, because those cars would have been sold by now,</p> <p>13 and pull out that data to get that information.</p> <p>14 In all honesty, it might not quite -- take</p> <p>15 quite as much time as one would think. The -- obviously</p> <p>16 we do a lot of that work. So we have software that does</p> <p>17 that and stuff like that, but from the means, say, of</p> <p>18 Mr. Schneider or Mr. Gautier, it may have been harder</p> <p>19 from them. But it would have taken some time. There's</p> <p>20 no doubt about that.</p> <p>21 CLARIFYING EXAMINATION</p> <p>22 BY JUDGE BENNETT:</p> <p>23 Q I have a question along those lines, and that</p> <p>24 is, if you're looking at it after the fact, looking</p> <p>25 backward, would it ever be proper to go back and make an</p>

Attachment 10

897	<p>1 adjustment -- a downward adjustment if, in fact, you</p> <p>2 ended up selling the vehicle for your cost or some</p> <p>3 amount higher?</p> <p>4 Like, would it ever be appropriate to make</p> <p>5 an after-the-fact adjustment reducing the cost when, in</p> <p>6 fact, you knew that it sold for a higher amount later?</p> <p>7 Because -- and let me preface it.</p> <p>8 I understand why at the time you make the</p> <p>9 adjustment, you don't know what the vehicle is going to</p> <p>10 sell for. So you're making, presumably, a good-faith</p> <p>11 adjustment to reduce its value, to take a write-down,</p> <p>12 but if you're looking at it after the fact, you would</p> <p>13 never write it down to less than what you actually sold</p> <p>14 it for, would you?</p> <p>15 A And you actually asked that, I think,</p> <p>16 yesterday, of Mr. Starnes in sort of a similar fashion.</p> <p>17 Thanks for the opportunity to explain a little bit.</p> <p>18 The -- on -- basically what the -- what</p> <p>19 the two main tax regulations call for -- do we want to</p> <p>20 stick with tax for the moment? Is that where you want</p> <p>21 to --</p> <p>22 Q Ycs.</p> <p>23 A Okay. Well, the two main tax regulations, when</p> <p>24 you squeeze them together, not the subnormal goods</p> <p>25 piece, but normal goods in either having a market or no</p>	899	<p>1 that replacement cost was essentially going to be the</p> <p>2 cost of the vehicle, that invoiced cost.</p> <p>3 I haven't been aware of any indication</p> <p>4 that somehow there had been an opportunity for Bates to</p> <p>5 replace the vehicle at less than the invoice cost of the</p> <p>6 vehicle. So, in my mind, the replacement cost and the</p> <p>7 invoice cost were essentially equivalent, which was the</p> <p>8 cost that they were carrying at the time.</p> <p>9 A I had put down three potential markets as far</p> <p>10 as -- and actually, Mr. Donley and I, sort of, explored</p> <p>11 this.</p> <p>12 The -- if I go to another dealer and find</p> <p>13 that car, essentially it's going to be that invoice</p> <p>14 cost, the way you said.</p> <p>15 If I manage to have something left over on</p> <p>16 the far-flung lot that Nissan still has, that they still</p> <p>17 have that car, it's going to be at invoice.</p> <p>18 If I can go and find a, in essence, new</p> <p>19 vehicle that is rolling across an auction block that's</p> <p>20 still on an open MSO with a full warranty, perhaps</p> <p>21 Nissan is trying to run that car through an auction,</p> <p>22 these closed auctions we're talking about, and then if</p> <p>23 that closed auction price is less than cost -- we've</p> <p>24 heard Mr. Bates talk about a range of discount, 20,</p> <p>25 30 percent -- that can be used as a cost. That would</p>
898	<p>1 market to be able to determine what's known as</p> <p>2 replacement costs is what's driving the regulations.</p> <p>3 So if I have a way to determine what I can</p> <p>4 replace that car for as of December 31st through some</p> <p>5 mechanism, if that replacement can be purchased for less</p> <p>6 than what my cost is, I can write down my cost to that</p> <p>7 new replacement value. So that's the first step. All</p> <p>8 right?</p> <p>9 Now, if I -- and that ostensibly --</p> <p>10 let's -- let's use it for a second. Maybe what I can</p> <p>11 replace that cost for is less than what a consumer could</p> <p>12 go buy it for. And I'm trying to distinguish between</p> <p>13 replacement cost and sales price, because that's what</p> <p>14 you brought up just a moment ago.</p> <p>15 And the idea that I can go replace that</p> <p>16 car for less than ostensibly what a consumer could</p> <p>17 purchase it for is going to drive my lower of cost or</p> <p>18 market downward, perhaps lower than what I would sell</p> <p>19 that car for, allowing for a normal gross profit upon</p> <p>20 its ultimate sale.</p> <p>21 Q Well, and I understand that.</p> <p>22 A Okay.</p> <p>23 Q But I guess in this case, when we talk about</p> <p>24 that replacement cost, my understanding -- maybe you can</p> <p>25 correct me if you think my understanding is wrong, but</p>	900	<p>1 get me lower. One out of the three examples.</p> <p>2 On the used car side, the difference is --</p> <p>3 is that under that Revenue Ruling 67-107, I get to use</p> <p>4 average wholesale. So that's going to be typically what</p> <p>5 dealers are moving cars between each other at, which</p> <p>6 is -- is going to be different.</p> <p>7 Even if you look in the book and see the</p> <p>8 retail number, the retail number is going to be higher.</p> <p>9 And let's pretend for a second that's going to be</p> <p>10 approximately what the sales price would be. So that</p> <p>11 spread still exists, and the IRS allows me to use that</p> <p>12 wholesale cost rather than that retail cost in the</p> <p>13 revenue ruling.</p> <p>14 Does that help you?</p> <p>15 Q Yeah. No, I -- I understand that.</p> <p>16 A Okay.</p> <p>17 Q And from the standpoint of the used vehicles, I</p> <p>18 get that.</p> <p>19 I guess from the new vehicle standpoint --</p> <p>20 well, there's no evidence, that you're aware of, are</p> <p>21 you, that Bates used -- or was ever able to evaluate a</p> <p>22 replacement cost that -- and use that for its new</p> <p>23 vehicles as the basis of any mark-downs or write-downs</p> <p>24 that it took?</p> <p>25 A What I've heard in this, it's -- the judgment,</p>

Attachment 10

901	<p>1 the years of experience, that type thing, but as far as</p> <p>2 saying, "Here is the auction data" -- and I think</p> <p>3 Mr. Donley and I explored this a little bit, too --</p> <p>4 "Here is the -- here is the auction data. We found a</p> <p>5 closed auction. That is what this car rolled over the</p> <p>6 auction block for and sold at this price," that's not</p> <p>7 out there.</p> <p>8 Q Well, and the reason I ask is because --</p> <p>9 A Right.</p> <p>10 Q -- if, as you've indicated, there are a few</p> <p>11 potential options to have a replacement -- to determine</p> <p>12 a replacement cost or obtain a replacement cost, at</p> <p>13 least a couple of those would result in basically an</p> <p>14 invoice cost?</p> <p>15 A That's correct.</p> <p>16 Q And so if you were going to do something other</p> <p>17 than that, wouldn't you think you would have to support</p> <p>18 that by showing how you went to this other market or had</p> <p>19 an option available to you that resulted in a lower cost</p> <p>20 other than the invoice cost?</p> <p>21 A Absolutely, Your Honor.</p> <p>22 Q And in this case, there's no evidence that was</p> <p>23 ever done, is there?</p> <p>24 A No, sir. I haven't seen any evidence</p> <p>25 indicating that that was done. Instead, it was the</p>	903	<p>1 vehicles higher than what you're writing them down to,</p> <p>2 then presumably you have to have a basis to write them</p> <p>3 down or show why your replacement cost is less than what</p> <p>4 you actually expect to sell them on the open market.</p> <p>5 Correct?</p> <p>6 A Right. So let's just -- I'll tell you what I</p> <p>7 do with my clients. All right? I'm going to -- so</p> <p>8 we'll pretend you're a car dealer for a second, and you</p> <p>9 want to use lower of cost or market for used vehicles,</p> <p>10 and I'm going to tell you that you need to take your</p> <p>11 pricing guide, all right, whether it be Blue Book, Black</p> <p>12 Book -- there are several of them, and use that</p> <p>13 consistently from year to year. That's also in some of</p> <p>14 the revenue material that I can't flip from book to</p> <p>15 book.</p> <p>16 And then I'm going to take that, copy the</p> <p>17 pages so that I can see that average wholesale value in</p> <p>18 accordance with that revenue ruling and put it with my</p> <p>19 schedule of inventory and basically be able to say, "I</p> <p>20 had the car in stock at 15,000. Here is the book.</p> <p>21 Average wholesale is \$13,000 for this car." Circle the</p> <p>22 13,000, whatever you want to do, put it with that, and</p> <p>23 that becomes my record I can hand to the Service in case</p> <p>24 they question my values.</p> <p>25 What I sold that car later for in this</p>
902	<p>1 impression, you know, of Mr. Bates that he felt like</p> <p>2 that that was the average discount of those cars that do</p> <p>3 run across that auction block.</p> <p>4 Q Okay. And I appreciate you clarifying the</p> <p>5 other --</p> <p>6 A Sure.</p> <p>7 Q -- in regard to the used cars, especially,</p> <p>8 because I understand my example was fairly rudimentary</p> <p>9 and that there can be scenarios where it makes sense to</p> <p>10 write down your inventory costs, even when you know</p> <p>11 you're going to sell it for a higher amount, in that</p> <p>12 circumstance, and I appreciate you clarifying that.</p> <p>13 Let me ask you this, I guess, though --</p> <p>14 and this is really the heart of what I was trying to get</p> <p>15 at with Mr. Gautier and since you -- you're addressing</p> <p>16 it, I'll ask you as well.</p> <p>17 Ultimately, if you -- if you're going to</p> <p>18 make those adjustments and you're relying on one of</p> <p>19 those bases to lower your invoice cost, for example,</p> <p>20 the --</p> <p>21 A This is on new vehicles?</p> <p>22 Q On used vehicles now.</p> <p>23 A On used? Okay.</p> <p>24 Q Yeah. We're going to the used vehicles now.</p> <p>25 Then if you know you're likely to sell the</p>	904	<p>1 case would then be non-determinative of that value.</p> <p>2 Q All right.</p> <p>3 A Did I answer your question?</p> <p>4 Q Yes. No, and I understand that.</p> <p>5 Now, in making those sorts of adjustments</p> <p>6 or write-downs, you would have to do that for each</p> <p>7 individual vehicle. Correct?</p> <p>8 A You have to -- the regulations call for it</p> <p>9 being done item by item, yes, sir.</p> <p>10 Q And in doing it item by item, you'd have to</p> <p>11 take into account the vehicle's condition, but I assume</p> <p>12 also the vehicle's -- I guess I'm not familiar with the</p> <p>13 wording used in the car industry, but basically the</p> <p>14 vehicle specifications. Meaning, if a vehicle had</p> <p>15 leather versus cloth interior, you have to take into</p> <p>16 account the vehicle's condition but also its</p> <p>17 specifications. Right?</p> <p>18 MR. DONLEY: The -- the revenue is</p> <p>19 "options," Judge.</p> <p>20 JUDGE BENNETT: It's options. Yeah,</p> <p>21 that's --</p> <p>22 MR. DONLEY: I didn't mean to interrupt.</p> <p>23 JUDGE BENNETT: No. That's the word I</p> <p>24 should have used, you're correct.</p> <p>25 MR. DONLEY: Just trying to help.</p>

Attachment 10

<p style="text-align: right; margin-bottom: 0;">941</p> <p>1 dealership and even the shorter time frame. 2 Q Okay. And I think you mentioned in passing 3 that the actual calculation for determining net working 4 capital and net cash position is listed right under the 5 blank on the statement? 6 A Sure. Yes, it's listed there for all three of 7 these to help the reader. 8 Q Right. And then Effective Net Worth, tell us 9 what that means. 10 A Effective Net Worth here is we're going to take 11 net worth of the dealership, and we're going to add back 12 60 percent of the LIFO reserves. And the reason that 13 it's 60 percent is they're assuming that if those LIFO 14 reserves liquidate, you may -- you remember before lunch 15 we are talking about an inadvertent liquidation of LIFO 16 reserves, if I didn't follow the regulations, and I said 17 I immediately have to pay the tax back on that. 18 Well, in this particular explanation here, 19 this formula, they're actually taking that tax 20 obligation and taking that out of the net worth now as 21 if that had occurred. 22 MR. COFFEY: Now, if we could, let's go 23 ahead and bring up the same box on C-175, and put it 24 side by side with the box that we have pulled up from 25 173.</p>	<p style="text-align: right; margin-bottom: 0;">943</p> <p>1 1,196,093. There's that approximate 700,000-dollar 2 drop. You get a very similar thing on effective net 3 worth. 4 The net cash position actually went up. 5 I'm going to say that some of that is the effect of just 6 the transactions that are happening. The interesting -- 7 you know, but in January. 8 The interesting part about this in showing 9 this apparent decrease in the financial health is that 10 it gives -- it gives Nissan the opportunity, if we have 11 fallen below our net working capital standard, to 12 communicate with the dealer or anything else that may 13 worry them as a result of the decrease in health really 14 as a result of those write-downs on that statement that 15 they didn't get in month 13; but now they've, in 16 essence, been notified indirectly through these KPIs at 17 the end of January that something, well, fairly major in 18 the tune of 700,000 has happened. 19 The -- does that answer your question? 20 Q It does. 21 Do we know of any other KPIs that Nissan 22 might use for business decisions other than the three 23 that are identified on these financial statements? 24 A Well, I'm going to assume that there are some 25 other KPIs. We had a list of things that Mr. Donley and</p>
<p style="text-align: right; margin-bottom: 0;">942</p> <p>1 That's fine. Thank you. 2 Q (BY MR. COFFEY) Okay. Mr. Davis, we can see 3 that those metrics have changed between 173 and 175. Is 4 that right? 5 A That's correct. You would expect them to 6 change from month to month. 7 Q Can you tell us how that happens? 8 A Well, the numbers, naturally, move from month 9 to month. But in this particular case, the point that I 10 think you're trying to illustrate is that we've got the 11 month 12 statement from December of '13, and then I have 12 the January statement at the end of 2014. The missing 13 statement, if you will, is that 13th month statement. 14 Q Okay. 15 A And on that 13th month statement, if you 16 recall, in -- in 2013, the write-down was \$726,531. 17 It's that figure that we see in so many places on the 18 3115 and so on and so forth. 19 When that got applied to the balance 20 sheet, and all of these are balance sheet ratios, it 21 really decreased the appearance of the financial health 22 of the balance sheet of Bates Nissan. 23 The -- two of the three measurements are 24 fairly -- you can see it fairly easily. On net working 25 capital, you've got 1,816,573. And it goes to</p>	<p style="text-align: right; margin-bottom: 0;">944</p> <p>1 I explored before lunch. Do you mind if I flip to that? 2 Is that okay? 3 Q Yes. 4 A All right. 5 MR. DONLEY: It was just one page in front 6 of the one you had up there, Mr. Davis. If it helps. 7 THE WITNESS: All right. 8 Q (BY MR. COFFEY) And let the record reflect 9 that you're referring to R-489. Correct? 10 A That's right. I'm referring to R-489. 11 And so what has happened -- and let's lay 12 that aside for just a second. I want to look at the 13 items on the screen again from C-173 to C-175. 14 We've said that as the write-down happened 15 in month 13, we saw the drop in some of these key 16 performance indicators. And then those key performance 17 indicators, if you make the assumption that none of 18 those write-downs should've happened, that what will 19 happen is as those increased gross profits on those 20 vehicles that were written down actually hit the 21 financial statement, several things happened. 22 Up here inside the KPIs on the screen, 23 they returned to a value that -- I'm not going to say 24 that Nissan expects, but that doesn't reflect something 25 happening with write-downs.</p>

Attachment 10

945	<p>1 But as a result of those numbers moving</p> <p>2 back towards, perhaps even the December values, as those</p> <p>3 cars became sold, that was a result of the profitability</p> <p>4 that came in. And like what we talked about --</p> <p>5 Mr. Donley and I explored earlier, it came back into the</p> <p>6 statement through the gross profits, departmental gross</p> <p>7 profits. The income statement measuring KPIs --</p> <p>8 basically it's -- it moves the balance sheet KPIs back</p> <p>9 towards more what you would expect without any --</p> <p>10 without any write-downs being in the statement. Because</p> <p>11 if you make the assumption that all the cars are gone by</p> <p>12 -- from the prior year by March or April, then in</p> <p>13 essence, the inventory doesn't have any reduction in</p> <p>14 value associated with it anymore. And these net working</p> <p>15 capital, net cash position, effective net worth, will</p> <p>16 then not be affected by the prior year's write-downs.</p> <p>17 Does that help you?</p> <p>18 Q It does indeed.</p> <p>19 Now, are these KPIs that we're talking</p> <p>20 about, do they adjust every month as the dealer turns in</p> <p>21 his monthly financial statement?</p> <p>22 A Yes, they do. It's a formula calculated on the</p> <p>23 statement.</p> <p>24 Q Now, Nissan has expressed the concern that</p> <p>25 because of the write-downs Bates has been taking, it</p>	947	<p>1 KPIs have been affected by the write-downs, I do</p> <p>2 believe.</p> <p>3 Q And have they extrapolated from that to any</p> <p>4 specific business decision that might've been affected</p> <p>5 by the change in the KPIs?</p> <p>6 A I don't recall, but I don't remember any. I</p> <p>7 might be not remembering something --</p> <p>8 Q Okay.</p> <p>9 A -- inside one of Nissan's expert's reports.</p> <p>10 Q Now, you recall the testimony from Mr. Bates to</p> <p>11 the effect that Nissan does not audit its financial</p> <p>12 records? Do you recall hearing that testimony?</p> <p>13 A I do recall hearing that testimony. I can</p> <p>14 combine that up with the fact that some manufacturers do</p> <p>15 because I get phone calls when they have questions. So</p> <p>16 I know that some manufacturers do go in the field or do</p> <p>17 office examinations of financials. But I can't</p> <p>18 remember -- and perhaps by coincidence, I can't remember</p> <p>19 in my years having received a call from a Nissan store.</p> <p>20 But it could happen. Or perhaps they were able to solve</p> <p>21 that on their own without contacting me.</p> <p>22 Q Do we know what percentage of Nissan's dealers</p> <p>23 use the LCM method for either new or used or both?</p> <p>24 A No, I don't know that.</p> <p>25 Q We haven't seen that anywhere in the record,</p>
946	<p>1 skews the profit picture of the dealership, as I</p> <p>2 understand it. Is that correct? Is that what you</p> <p>3 understand the complaint to be?</p> <p>4 A That's part of my understanding. Yes.</p> <p>5 Q And I think the further complaint is, because</p> <p>6 the profit picture of the dealership is skewed, it could</p> <p>7 affect business decisions that Nissan might make based</p> <p>8 upon the composites incorporating these KPIs for all</p> <p>9 their dealers. Is that your understanding as well?</p> <p>10 A Possibly. That might be a reasonable</p> <p>11 assumption to make.</p> <p>12 That data has now become part of the</p> <p>13 overall data for Nissan. And then depending upon --</p> <p>14 I've already said, I don't know exactly how they use</p> <p>15 that data internally -- it has the possibility of</p> <p>16 affecting a decision.</p> <p>17 Q Have you seen anything in these proceedings</p> <p>18 where Nissan has claimed that a specific business</p> <p>19 decision was skewed by the fact that Bates Nissan took</p> <p>20 these write-downs?</p> <p>21 A Not that I can recall. I don't think so.</p> <p>22 Q Have you seen anything in these proceedings</p> <p>23 where Nissan has said this particular KPI has been</p> <p>24 affected by the write-downs taken by Bates Nissan?</p> <p>25 A Some of the experts have talked about how the</p>	948	<p>1 have we?</p> <p>2 A No.</p> <p>3 Q I have we seen anywhere in the record an analysis</p> <p>4 of the degree to which LCM dealers are properly applying</p> <p>5 LCM from either a tax basis or from a GAP basis?</p> <p>6 A For Nissan dealers?</p> <p>7 Q Yes, sir.</p> <p>8 A No, I don't believe I've seen any information</p> <p>9 like that in what I've read.</p> <p>10 Q Have we seen any evidence in this case at all</p> <p>11 of the degree to which Nissan has been able to</p> <p>12 demonstrate that its database of financial data derived</p> <p>13 from these monthly and yearly financial statements is an</p> <p>14 uncorrupted database, reliable, all of the information</p> <p>15 in which is accurate and complete to some identifiable</p> <p>16 degree?</p> <p>17 A I haven't seen any specific assertions about</p> <p>18 that. I mean, certainly -- certainly, if there is a</p> <p>19 database, these financial statements, since they're</p> <p>20 electronically submitted, I assume, are part of that</p> <p>21 have database. And so it's just one dealer.</p> <p>22 Q Okay. So you have one dealer inputting</p> <p>23 allegedly false information into Nissan's database. Do</p> <p>24 you know how many Nissan dealers there are nationwide?</p> <p>25 A I didn't have firsthand knowledge of that. I</p>

Attachment 10

957	<p>1 personal experience, it's something that typically is</p> <p>2 not getting recorded monthly, at least for the car</p> <p>3 dealers that I work with.</p> <p>4 Q Is monthly reappraisal a GAP requirement?</p> <p>5 A If I'm going to issue a financial statement to</p> <p>6 Nissan in accordance with GAP, GAP states that I need to</p> <p>7 use a lower cost to market. So it's going to be</p> <p>8 somewhat of a burdensome procedure to go through monthly</p> <p>9 to do that. And it's -- I was somewhat mystified by the</p> <p>10 fact that if I had to do it monthly, according to this,</p> <p>11 then why is there a reference in the business bulletins</p> <p>12 that I'm supposed to do it in month 13, indicating that</p> <p>13 perhaps Nissan, you know, is okay with waiting also.</p> <p>14 So perhaps again, some confusion there as</p> <p>15 to -- if I were going to try to advise my clients on the</p> <p>16 outcome and ramifications of this case as to which</p> <p>17 instruction to follow, if you will. Because if I do it</p> <p>18 every month, then December is going to be correct, and I</p> <p>19 don't have to do it in month 13.</p> <p>20 Q I noticed in the language that you just read,</p> <p>21 that Nissan is talking about vehicle write-downs as</p> <p>22 depreciation. Do you see that?</p> <p>23 A I do.</p> <p>24 Q Well, we had -- earlier in this case, before</p> <p>25 the answer to the discovery document was changed, we had</p>	959	<p>1 what it reflects, so...</p> <p>2 MR. COFFEY: Thank you, sir.</p> <p>3 Q (BY MR. COFFEY) Okay. Let's see if we have</p> <p>4 anything else here.</p> <p>5 One last set of questions, Mr. Davis.</p> <p>6 Should Nissan require the filing of</p> <p>7 13-month statements by its LCM dealers?</p> <p>8 A If it wants the complete financial picture and</p> <p>9 it -- and I need to deal with the fact that Nissan</p> <p>10 believes that a 13th period statement with any</p> <p>11 adjustment on it is now considered to be an adjusted</p> <p>12 financial statement under the document that dealers sign</p> <p>13 with Nissan, then to me it would just seem easier to do</p> <p>14 that. I mean, what we have right now -- to do that --</p> <p>15 in other words, require that filing.</p> <p>16 Right now we've got this -- sort of this</p> <p>17 muddled affair, if you will, of Nissan saying that these</p> <p>18 statements are optional. And then in this case we've</p> <p>19 decided that perhaps they should've been sent in because</p> <p>20 they have an adjustment on them. You know, perhaps it</p> <p>21 would be better if Nissan had said, Hey, if you use a</p> <p>22 13th statement and you put an adjustment on it, send it</p> <p>23 in; if you don't, you don't have to.</p> <p>24 But there really is the need, in my mind,</p> <p>25 to have some clarification for the dealer body so that</p>
958	<p>1 used the term "depreciation" in lieu of write-downs to</p> <p>2 refer to Bates' write-downs. Do you recall that?</p> <p>3 MR. DONLEY: Your Honor, may I? This is</p> <p>4 what Mr. Jarrett brought up the other day. Mr. Coffey</p> <p>5 brought it up, and Mr. Jarrett tried to respond. And it</p> <p>6 was a withdrawn discovery response, I think. And now</p> <p>7 he's going right back into it.</p> <p>8 I agree it's not relevant, but it seems</p> <p>9 like why are we doing this all over again when he made</p> <p>10 the objection the other day that it was on the discovery</p> <p>11 response?</p> <p>12 JUDGE BENNETT: Yeah. I had the thought,</p> <p>13 when you were asking the question, that because it was</p> <p>14 withdrawn and I didn't allow questions, I'm not going to</p> <p>15 allow you to question on it either. It's not fair to</p> <p>16 have you be able to ask questions and Mr. Jarrett not be</p> <p>17 able to.</p> <p>18 MR. COFFEY: That's fair enough, Judge.</p> <p>19 But could I at least point out to the Court that</p> <p>20 Mr. Lincir wrote a whole report on how wrong it is to use</p> <p>21 the term "depreciation" in reference to a vehicle</p> <p>22 write-down. So we just wanted to demonstrate to the</p> <p>23 Court that, hey, mistakes happen, even in Nissan's</p> <p>24 documents. That's all.</p> <p>25 JUDGE BENNETT: Okay. It does reflect</p>	960	<p>1 they can try to conform to Nissan's needs.</p> <p>2 Q Thank you, Mr. Davis.</p> <p>3 MR. COFFEY: That's all we have. Your</p> <p>4 Honor.</p> <p>5 JUDGE BENNETT: Okay.</p> <p>6 MR. DONLEY: May I precede, Your Honor?</p> <p>7 JUDGE BENNETT: You may.</p> <p>8 MR. DONLEY: Thank you. May I go up to</p> <p>9 the chart?</p> <p>10 JUDGE BENNETT: You may.</p> <p>11 REDIRECT EXAMINATION</p> <p>12 BY MR. DONLEY:</p> <p>13 Q Mr. Davis, I heard some testimony you gave just</p> <p>14 a few minutes ago to Mr. Coffey about net working</p> <p>15 capital and effective net worth. Do you remember that?</p> <p>16 A Yes, sir.</p> <p>17 Q And that's what we have on R-489. Correct?</p> <p>18 A Yes, sir.</p> <p>19 Q And we created R-489 after you and I had a</p> <p>20 discussion about R-490. Correct?</p> <p>21 A That's correct.</p> <p>22 Q And I asked you if those things on R-489 were</p> <p>23 overstated as a result of what you and I did on R-490.</p> <p>24 Do you remember that?</p> <p>25 A I remember us talking about No. 1 and No. 2,</p>

Attachment 10

961	<p>1 gross profits and department profits for new and used.</p> <p>2 Q Well, I'll remind you. We talked about the</p> <p>3 other ones too, but you said you didn't know at the</p> <p>4 time. Right?</p> <p>5 A That's correct. Because you were referring to</p> <p>6 a December statement, and I was referring to a January</p> <p>7 statement a few moments ago.</p> <p>8 Q Okay. Well, on a financial statement submitted</p> <p>9 to Nissan, because of what we saw on R-490, net working</p> <p>10 capital on financial statements submitted to Nissan was</p> <p>11 overstated. Correct?</p> <p>12 A I can't answer your question, again, the way</p> <p>13 you've asked it.</p> <p>14 Q Do you want me to use what statement so you can</p> <p>15 ask it, January or December?</p> <p>16 A We'll get different answers.</p> <p>17 Q Let's start with the January statement.</p> <p>18 Would it be overstated on a January</p> <p>19 statement?</p> <p>20 A Net working capital -- if you make the</p> <p>21 assumption that the write-downs were inappropriate and</p> <p>22 too large, the net working capital on January's</p> <p>23 statement, if you have not worked out of all of that</p> <p>24 inventory that had been written down, would be</p> <p>25 understated.</p>	963	<p>1 \$75,000 in taxable income. Correct? That was the</p> <p>2 rationale on Bates Nissan's mind?</p> <p>3 A That's what they were trying to achieve with</p> <p>4 the write-downs.</p> <p>5 Q Yes, sir. And when they were doing these</p> <p>6 write-downs, in the second year that we have on R-490 in</p> <p>7 that second year, when you brought over the write-down</p> <p>8 from one into year two as recovered profits -- do you</p> <p>9 remember we discussed that. Right?</p> <p>10 A Yes, sir, absolutely.</p> <p>11 Q When that happens, and then you have to do the</p> <p>12 write-down, and then you have to do the write-down in</p> <p>13 year two to get to 75,000, part of what you're writing</p> <p>14 down is the 400,000 you brought over from year one,</p> <p>15 right, the recovered profit based on my example?</p> <p>16 A That is a possibility. But you don't know for</p> <p>17 sure until you know what the write-downs should have</p> <p>18 been.</p> <p>19 Q I gave you the write-downs in my example, so I</p> <p>20 asked you a question about my example.</p> <p>21 In year two, to get to 75,000 in taxable</p> <p>22 income, at least part of that 400,000 of recovered</p> <p>23 profit from year one has to be written down. Right?</p> <p>24 A It's insufficient data to answer your question.</p> <p>25 But I'll be happy to expand if you would like.</p>
962	<p>1 Q It would be understated?</p> <p>2 A Yes.</p> <p>3 Q What about effective net worth, is it</p> <p>4 overstated or understated on the January statement based</p> <p>5 on those same parameters?</p> <p>6 A Same set of assumptions, I believe, it would be</p> <p>7 understated.</p> <p>8 Q And is it understated again -- both of those</p> <p>9 understated again in February if you haven't worked</p> <p>10 through that inventory issue?</p> <p>11 A Yes, probably to a lesser extent.</p> <p>12 Q March?</p> <p>13 A Until we get through the inventory, my answer</p> <p>14 would be the same.</p> <p>15 Q The same?</p> <p>16 A Yes, sir.</p> <p>17 Q And then you also testified on questions by</p> <p>18 Mr. Coffey about the rationale that Bates Nissan had for</p> <p>19 what it did. Correct? Do you remember that? The</p> <p>20 rationale in their mind, you said. Do you remember</p> <p>21 that?</p> <p>22 A Not specifically. But let's just go ahead and</p> <p>23 explore what you've got.</p> <p>24 Q The rationale in Bates Nissan mind for what it</p> <p>25 did on the new and used motor vehicles was to get to</p>	964	<p>1 Q No, sir.</p> <p>2 A All right.</p> <p>3 Q There's absolutely enough data here.</p> <p>4 In my example, there was \$400,000 of</p> <p>5 recovered profit and \$475,000 in current year profit in</p> <p>6 year two. Do you remember that?</p> <p>7 A I do remember that.</p> <p>8 Q 875,000 in total profit. Right?</p> <p>9 A Yes, sir.</p> <p>10 Q We want to get to 75,000. Now we've got to</p> <p>11 write down 800,000 in new and used vehicles to get</p> <p>12 there, right, based on my example?</p> <p>13 A That's correct.</p> <p>14 Q And to make that write-down, we're writing down</p> <p>15 at least some portion of the 400,000, are we not, that</p> <p>16 was brought over from year one that is now recovered</p> <p>17 profit in year two. Right?</p> <p>18 A I cannot answer that question. We've gone</p> <p>19 through it a couple of times. I'm happy to explain why</p> <p>20 I can't.</p> <p>21 Q If I'm right that part of that 400 -- by the</p> <p>22 way, let me ask you this. Do you stand by the testimony</p> <p>23 you gave me earlier on this chart?</p> <p>24 A Oh, in terms of the hypothetical?</p> <p>25 Q Yes, sir. That's what I'm on, is this</p>

Attachment 10

965	<p>1 hypothetical.</p> <p>2 A Right. Well --</p> <p>3 Q Do you stand by your testimony you gave earlier</p> <p>4 today?</p> <p>5 A I'm happy to have it reread if you want to,</p> <p>6 just to make sure.</p> <p>7 Q Well, is there any of it you're going to change</p> <p>8 now, sir?</p> <p>9 A Well, I would have to have instant recall and</p> <p>10 perfect recall to tell you.</p> <p>11 I struggled with this earlier, trying to</p> <p>12 explain to you why I said I couldn't necessarily agree</p> <p>13 or totally answer your question. And I'm offering to do</p> <p>14 it again now just to try to make it simpler for</p> <p>15 everybody that needs to understand.</p> <p>16 Q Sitting here right now, Mr. Davis, is there any</p> <p>17 testimony you gave me this morning on R-490 that you're</p> <p>18 willing to tell us you need to change?</p> <p>19 A Possibly. I'd have to see it again.</p> <p>20 Q You're just not sure now?</p> <p>21 A I would -- I'll just leave it at that. I have</p> <p>22 an explanation for why I'm hesitating to answer your</p> <p>23 question. I'd love to give it to you. And I think it</p> <p>24 would probably expedite matters.</p> <p>25 Q Let me ask you this: Is there any tax</p>	967	<p>1 your CPA firm. Do you remember that?</p> <p>2 A Yes.</p> <p>3 Q I think you testified to this this morning, but</p> <p>4 I want to make sure the record is clear just in case.</p> <p>5 None of your clients have ever done what</p> <p>6 Bates Nissan did with regard to writing down the new and</p> <p>7 used motor vehicles that we have in this case, correct,</p> <p>8 sir?</p> <p>9 A None of them do now across the entire history</p> <p>10 of 30 years. I think I have run across a couple that</p> <p>11 have done that, but we got a change pretty quick.</p> <p>12 Q You have some that used judgment and things</p> <p>13 like that for new motor vehicles. Is that what you're</p> <p>14 testifying to, sir?</p> <p>15 A When I picked them up as clients -- and this is</p> <p>16 really delving into the rusty part of my memory. When</p> <p>17 picked them up as clients, I seem to recall I've had a</p> <p>18 couple that were out there writing down new vehicles. I</p> <p>19 don't recall what support they had at the time, which is</p> <p>20 directly to the answer of your question.</p> <p>21 Q Now, in your deposition, you said when that</p> <p>22 occurred it was just a one-off vehicle. Right?</p> <p>23 A That still occurs talking about current now.</p> <p>24 Q Can you tell us that -- can you identify those</p> <p>25 clients you're talking about?</p>
966	<p>1 regulation, tax code, Treasury regulation that you know</p> <p>2 that would allow Bates Nissan to write off new and used</p> <p>3 motor vehicles in year two in order to take care of any</p> <p>4 portion of the recovered profit from year one?</p> <p>5 A Yes.</p> <p>6 Q What is it?</p> <p>7 A If the inventory at the end of year two</p> <p>8 actually has a decrease in value of \$800,000 under the</p> <p>9 regulations.</p> <p>10 Q Assuming it doesn't -- thank you for that.</p> <p>11 Assuming there's no documents like we have here, no</p> <p>12 basis for that at all, okay, then do you know of any tax</p> <p>13 reg, any tax code, any Treasury reg, or anything that</p> <p>14 allows that write-down of that \$400,000 in any regard by</p> <p>15 using new and used motor vehicles to do it?</p> <p>16 A No, sir.</p> <p>17 Thanks for letting me get that in to clear</p> <p>18 that up.</p> <p>19 Q In this particular case, Mr. Davis, it isn't</p> <p>20 that documents were lost or destroyed. The fact is</p> <p>21 there's never been any documents at all to support what</p> <p>22 Bates Nissan has done. Correct?</p> <p>23 A That's a correct statement.</p> <p>24 Q And there was some discussion between you and</p> <p>25 Mr. Coffey about your clients, your current clients at</p>	968	<p>1 A I don't want to identify which clients may have</p> <p>2 done that. You and I have had that conversation in</p> <p>3 exchanges previously.</p> <p>4 Q I think you changed an answer maybe from this</p> <p>5 morning. I think now that you say you've got clients</p> <p>6 that have done this, I'm entitled to know who they are.</p> <p>7 A The clients on the one-off example or clients</p> <p>8 on the new vehicle write-down?</p> <p>9 Q The new vehicle write-downs that you would</p> <p>10 claim that is like what Bates Nissan has done in this</p> <p>11 case.</p> <p>12 A I'll tell you I do not recall those. It's a</p> <p>13 general impression you have from history, but I do not</p> <p>14 recall which ones they were.</p> <p>15 Q How about those clients who wrote down used</p> <p>16 motor vehicles like Bates Nissan has done in this case?</p> <p>17 A Well, when you say "like Bates Nissan," you're</p> <p>18 only speaking to just not having sufficient</p> <p>19 documentation?</p> <p>20 Q Well, no sufficient documentations based on</p> <p>21 either judgment, experience, loan, loan to wholesale,</p> <p>22 something in between, any of those things; that kind of</p> <p>23 combination of testimony that we've gotten with regard</p> <p>24 to the used motor vehicles.</p> <p>25 A Thank you.</p>

Attachment 10

1037	<p>1 their operational effectiveness, which -- you know,</p> <p>2 there were six of those in this case. At each one of</p> <p>3 those intervals is an opportunity to avoid notice of</p> <p>4 termination.</p> <p>5 Q So nobody at Nissan, once a notice of</p> <p>6 termination issues, has the power to retract it for any</p> <p>7 reason?</p> <p>8 MR. JARRETT: Objection; misstates the</p> <p>9 testimony.</p> <p>10 JUDGE BENNETT: Overruled. I'll allow her</p> <p>11 to answer.</p> <p>12 A In my tenure, I did not see a notice of</p> <p>13 termination retracted.</p> <p>14 Q (BY MR. ALANIZ:) But who would be the person</p> <p>15 that would have that power? I mean, they could choose</p> <p>16 not to exercise it for many reasons. I just want to</p> <p>17 know who has that power to make that decision.</p> <p>18 A To retract an NOT?</p> <p>19 Q Correct.</p> <p>20 A I would assume that the RVP would have to --</p> <p>21 and I'm making an assumption, because I've never seen</p> <p>22 one in my tenure, so I'm making -- I'm doing a</p> <p>23 hypothetical here. But I would assume that the RVP</p> <p>24 would be able to make a suggestion back to national.</p> <p>25 But it's a termination. It's finality.</p>	1039	<p>1 you would, state and spell your name for the record.</p> <p>2 THE WITNESS: My name is Patrick Steiner,</p> <p>3 S-T-E-I-N-E-R, first name Patrick, P-A-T-R-I-C-K.</p> <p>4 JUDGE BENNETT: And you filed prefiled</p> <p>5 testimony in this case. Correct?</p> <p>6 THE WITNESS: I did.</p> <p>7 JUDGE BENNETT: And you recall the answers</p> <p>8 that you gave -- I mean, I don't expect you to know all</p> <p>9 of them, but you do recall giving answers in the</p> <p>10 prefiled testimony in this case. Correct?</p> <p>11 THE WITNESS: I do.</p> <p>12 JUDGE BENNETT: And if you were asked all</p> <p>13 those same questions under oath today, would your</p> <p>14 answers be the same?</p> <p>15 THE WITNESS: They would.</p> <p>16 JUDGE BENNETT: Okay. And has that been</p> <p>17 marked as an exhibit?</p> <p>18 MR. JARRETT: It will be, Your Honor, and</p> <p>19 prospectively it will be marked as R-492.</p> <p>20 (Exhibit Respondent No. 492 marked)</p> <p>21 MR. JARRETT: If you wouldn't mind, we'll</p> <p>22 go ahead and move to admit R-492.</p> <p>23 JUDGE BENNETT: And R-492 is admitted.</p> <p>24 (Exhibit Respondent No. 492 admitted)</p> <p>25 JUDGE BENNETT: And you'll just need to</p>
1038	<p>1 MR. ALANIZ: That's it, Your Honor. I</p> <p>2 pass the witness.</p> <p>3 JUDGE BENNETT: Anything further?</p> <p>4 MR. JARRETT: No, Your Honor.</p> <p>5 JUDGE BENNETT: Okay. Thank you very</p> <p>6 much. You're free to step down. Off the record.</p> <p>7 (Recess: 3:43 p.m. to 4:07 p.m.)</p> <p>8 JUDGE BENNETT: Let's go ahead and go back</p> <p>9 on the record. And I think you first wanted to offer</p> <p>10 the exhibit of the last witness' prefiled?</p> <p>11 MR. JARRETT: That's correct, Your Honor.</p> <p>12 At this time Nissan would move to offer R-491.</p> <p>13 MR. COFFEY: No objection.</p> <p>14 JUDGE BENNETT: Okay. R-491 is admitted.</p> <p>15 (Exhibit Respondent No. 491 admitted)</p> <p>16 JUDGE BENNETT: And then if you will, call</p> <p>17 your next witness.</p> <p>18 MR. JARRETT: Your Honor, Nissan North</p> <p>19 America calls Mr. Patrick Steiner.</p> <p>20 JUDGE BENNETT: Okay. Mr. Steiner, if</p> <p>21 you'll raise your right hand.</p> <p>22 (Witness sworn)</p> <p>23 JUDGE BENNETT: Okay. And if you would,</p> <p>24 use the microphone as much as possible. You can pull it</p> <p>25 closer to you. Speak loudly and clearly. And then, if</p>	1040	<p>1 ensure that a copy is provided to the -- a record copy</p> <p>2 to the court reporter.</p> <p>3 MR. JARRETT: Thank you.</p> <p>4 JUDGE BENNETT: And you may proceed now --</p> <p>5 or, actually, turning the witness over?</p> <p>6 MR. JARRETT: With that, we'll pass for</p> <p>7 cross.</p> <p>8 JUDGE BENNETT: Thank you.</p> <p>9 PATRICK STEINER,</p> <p>10 having been previously duly sworn, testified as follows:</p> <p>11 CROSS-EXAMINATION</p> <p>12 BY MR. COFFEY:</p> <p>13 Q Mr. Steiner, my name is David Coffey. I</p> <p>14 represent Bates Nissan, and you and I have spoken over</p> <p>15 the phone in deposition, if you'll recall, on two</p> <p>16 occasions, I believe. This is the first time that we've</p> <p>17 actually spoken face to face.</p> <p>18 And you have filed two notices of</p> <p>19 termination in this case. Correct?</p> <p>20 A Correct.</p> <p>21 Q Okay. And in both cases you were the</p> <p>22 decision-maker on whether or not those notices of</p> <p>23 termination would issue. Is that correct?</p> <p>24 A That's correct.</p> <p>25 Q They were, however, concurred in by several</p>

Attachment 10

<p style="text-align: right;">1089</p> <p>1 what to write it down to. We only sell vehicles to the 2 dealers that are new, that are undamaged, and have low 3 miles on them. That's a new vehicle. There's nothing 4 that meets that criteria other than what comes from me, 5 and that's an invoice. 6 Q Before you accused Bates Nissan of willfully 7 and intentionally violating the tax law because they 8 wrote down new vehicles, did you check with your lawyers 9 to see whether or not it is lawful and permissible to 10 write down new vehicles? 11 MR. JARRETT: Your Honor, I object to the 12 extent it calls for the disclosure of attorney-client 13 communications. 14 MR. COFFEY: Fair enough. I'll withdraw 15 that question, Your Honor. 16 Q (BY MR. COFFEY) The reason you believe that 17 Bates Nissan willfully and intentionally violated the 18 tax law is because they wrote down new vehicles, and 19 you've never seen that done before. Is that -- 20 A Yes. 21 Q -- your testimony? 22 A Yes. 23 Q Okay. And, in fact, that's consistent with the 24 fact that Nissan doesn't even have a place on its 25 financial statement to write down new motor vehicles?</p>	<p style="text-align: right;">1091</p> <p>1 intentionally filed false and fraudulent financial 2 information with Nissan? 3 A Yes. 4 Q And how do you come to that determination? 5 A The financial statements that we received were 6 not accurate, and they were willfully submitted. 7 Q And how were they not accurate? 8 A They -- the information that was reported in 9 terms of capitalization, gross, the first few months of 10 profitability versus the volume that was sold was not 11 accurate. 12 Q Is that a function of the fact that Bates wrote 13 down used and new motor vehicles in your opinion, or are 14 you saying he just fudged the numbers that he provided 15 you as far as capitalization, profitability, et cetera, 16 is concerned? 17 A To the best of my knowledge, it had nothing to 18 do with used vehicles. This is just a new vehicle 19 conversation. 20 Q So it just had to do with new vehicles. In 21 other words, because he wrote down new vehicles, that 22 was equivalent to filing false and fraudulent financial 23 information with Nissan? 24 A Yes. 25 Q And I'm going to go out on a limb here, but the</p>
<p style="text-align: right;">1090</p> <p>1 A That's correct. 2 Q But you don't know whether or not it is lawful 3 and permissible under the tax laws to do so? 4 A There's no basis from what I saw in the 5 documentation through discovery to do what happened. 6 Q That's not my question, sir. You don't know 7 what -- 8 A But -- 9 Q Sir -- go ahead. Finish your answer. I want 10 you to have a full opportunity. 11 A That's okay. Go ahead. 12 Q Okay. But you don't know whether, under the 13 tax laws, it is lawful and permissible to write down new 14 vehicles when they are one prior model year? 15 A I'm not a lawyer. I don't know the tax law. 16 Q So you don't know the answer to that question? 17 A I don't know the answer to your question. 18 Q Okay. Now, is it your position that Bates 19 Nissan willfully and intentionally filed false and 20 fraudulent financial information with Nissan? 21 A I missed just a portion of that question. Can 22 you repeat it for me, please? 23 Q I'll be happy to, sir. 24 Is it your position, or Nissan's position 25 if you prefer, that Bates Nissan willfully and</p>	<p style="text-align: right;">1092</p> <p>1 reason that you believe that is because since he wrote 2 down new motor vehicles, it changed the profit picture 3 of the dealership from your perspective, thus altering 4 the KPIs, the key performance indicators, from what they 5 should have been to what Bates Nissan caused them to be? 6 A Yes, sir. 7 Q Is that correct? 8 A Yes, sir. 9 Q Okay. And as I understand your theory or 10 Nissan's theory, those KPIs are important. Right? 11 They're key indicators of the operations and the 12 financial health of the dealership? 13 A Yes, sir. 14 Q Okay. And, in fact, when you use those KPI 15 numbers in your various composites, you make business 16 decisions based on those composites. Correct? 17 A Yes, sir. 18 Q And by writing down new motor vehicles and 19 filing financial statements with Nissan which reflect 20 those write-downs, that false information resulting from 21 that is going to skew your key performance indicators to 22 the point where you might make an invalid or erroneous 23 business decision. Is that your position? 24 A It's possible, yes. 25 Q But is that, in fact, the reason why we are</p>

Attachment 10

1093	<p>1 having this proceeding according -- based on your</p> <p>2 supplemental notice of termination, because you're</p> <p>3 concerned that Bates Nissan writing down new motor</p> <p>4 vehicles is going to skew your KPIs to the point where</p> <p>5 you might make an erroneous business decision?</p> <p>6 A No.</p> <p>7 Q No?</p> <p>8 A No.</p> <p>9 Q You're not concerned about that?</p> <p>10 A No.</p> <p>11 Q Then can you point to me what harm Nissan has</p> <p>12 suffered as a result of Bates Nissan writing down new</p> <p>13 vehicles?</p> <p>14 A Yeah. I think we described that in the notice</p> <p>15 of termination in 12(A)(8), (9), and (10). (8) refers</p> <p>16 to the fact that the KPIs that you're talking about are</p> <p>17 in effect and correct? Right?</p> <p>18 Q I don't answer questions, sir. I just ask</p> <p>19 them.</p> <p>20 A Fair enough.</p> <p>21 Q I have to ask you if the KPIs are effective.</p> <p>22 A That's fair. (9) refers to the submission of</p> <p>23 the information that's false or fraudulent, and then</p> <p>24 (10) refers to the fact that the information that we got</p> <p>25 back that he filed to us was not correct.</p>	1095	<p>1 Frankly, it was not an accurate picture of what was</p> <p>2 going on in the dealership, and it's very likely that</p> <p>3 some of the recommendations they made based on the bad</p> <p>4 information may have not been correct.</p> <p>5 Q Do you believe that Bates should not have</p> <p>6 recaptured those write-downs in the first three months</p> <p>7 of the year when the vehicles that were written down</p> <p>8 sold?</p> <p>9 A No. I don't believe it should have been</p> <p>10 captured that way to begin with.</p> <p>11 Q So you don't believe -- and I need a clear</p> <p>12 answer to this question.</p> <p>13 You don't believe that Bates Nissan should</p> <p>14 have recaptured the profit on the vehicles that it wrote</p> <p>15 down in the first three months of the year when those</p> <p>16 vehicles sold?</p> <p>17 MR. JARRETT: Objection, Your Honor.</p> <p>18 There's no foundation that this witness is a tax expert</p> <p>19 or even knows anything about taxes.</p> <p>20 MR. COFFEY: He's the one who made the</p> <p>21 decision, Judge.</p> <p>22 JUDGE BENNETT: Well, because I want a</p> <p>23 clear record -- I think the question is a little bit</p> <p>24 misleading, and I would ask that you rephrase it.</p> <p>25 Because he indicated he didn't think any of it should</p>
1094	<p>1 So you asked me the harm. The harm is</p> <p>2 that, frankly, those things happened. We use those</p> <p>3 things to make decisions with. If all the dealers</p> <p>4 provided us bad information, frankly, we wouldn't know</p> <p>5 the health of the franchise, the dealer, or we really</p> <p>6 wouldn't have a good handle on what was happening</p> <p>7 financially with our facilities.</p> <p>8 Q And we're going to go into that.</p> <p>9 Can you point to any business decision</p> <p>10 that you made which was adversely affected by the fact</p> <p>11 that Bates Nissan was writing down new motor vehicles</p> <p>12 from 2009 to 2013?</p> <p>13 A I don't -- no.</p> <p>14 Q You can't point to any decision?</p> <p>15 A No.</p> <p>16 Q Can you point to any KPI which was sufficiently</p> <p>17 polluted, if you will, or skewed or whatever term you</p> <p>18 want to use by the fact that Bates was writing down new</p> <p>19 motor vehicles, that it could have even theoretically</p> <p>20 caused you to make an erroneous business decision?</p> <p>21 A Sure. So the gross per vehicle on those</p> <p>22 vehicles in the first four months of the year were</p> <p>23 drastically inflated. The grosses later on in the year</p> <p>24 were much less. The consultations that my team was</p> <p>25 doing with the dealerships had bad information.</p>	1096	<p>1 have been done in the first place. And I understand</p> <p>2 what you're implying, but I think it leads to a</p> <p>3 misleading answer the way it's asked, so I think you</p> <p>4 need to rephrase the question.</p> <p>5 MR. COFFEY: I'll do my best, Judge.</p> <p>6 JUDGE BENNETT: And if it's not clear what</p> <p>7 I was saying, it's like if somebody says, "Well, I don't</p> <p>8 think you should have shot the person in the first place</p> <p>9 and then taken them to the hospital," and you say, "So</p> <p>10 you don't think you should have ever taken him to the</p> <p>11 hospital?"</p> <p>12 He's saying, "No. I didn't think they</p> <p>13 should have shot him in the first place."</p> <p>14 You have to give him a fair chance to</p> <p>15 answer the question, and I think he said he didn't</p> <p>16 believe any of it should have been done. So trying to</p> <p>17 pin it down just to the last part I think is unfair.</p> <p>18 MR. COFFEY: Okay.</p> <p>19 Q (BY MR. COFFEY) I think we've established that</p> <p>20 you don't think the new vehicle write-downs should have</p> <p>21 occurred. Right?</p> <p>22 A Correct.</p> <p>23 Q But now once they do occur, is a dealer</p> <p>24 required, to your knowledge, to recapture the profit</p> <p>25 attributable to those write-downs?</p>

Attachment 10

1097	1099
<p>1 A The direct answer is, yes, they need to follow 2 the GAAP guidelines, and they need to follow our 3 accounting manual. If they made an incorrect error and 4 they took it out, they do need to put it back in. But 5 my point to begin with, the whole process is not 6 correct. We don't even have a process or a procedure 7 for it or a line to put it on. It's not something that 8 we view as something that should happen. 9 Q So you agree, then, that if, in fact, the 10 dealer does write down new vehicles, he has to recapture 11 the profit attributable to the write-downs when he sells 12 the vehicle? 13 A No, I don't agree with that. 14 Q You don't agree that he has to recapture that 15 profit attributable to the write-down? 16 A I believe what I said -- 17 MR. JARRETT: Same objection, Your Honor. 18 A -- was that they need -- 19 JUDGE BENNETT: Overruled. I'll allow him 20 to clarify. 21 A They need to follow the GAAP principles, and 22 they need to follow the accounting manual that we 23 provide. We don't disclose or provide any guidance with 24 relation to that. 25 So asking me once they do it if they</p>	<p>1 come back on Monday? 2 JUDGE BENNETT: Yes. 3 MR. COFFEY: Okay. Then if he's coming 4 back on Monday, this is as good a time as any, Judge. 5 JUDGE BENNETT: Okay. Then let's go off 6 the record at this time. 7 (Proceedings recessed at 5:25 p.m.) 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25</p>
1098	1100
<p>1 should recapture it, it -- none of it makes sense. 2 Q (BY MR. COFFEY) Okay. So then it's not the 3 fact that they recapture the profit attributable to the 4 write-down that constitutes the false and fraudulent and 5 knowing financial data. It's the fact that they wrote 6 down the new vehicles to begin with? 7 A Correct. 8 Q So that is the -- when you boil it down to its 9 essence, it's not used vehicles. It's only new 10 vehicles, and the fact that they wrote them down at all 11 is what passes through the financial statements as 12 knowing and intentional filing of false financial data 13 with NNA? 14 A Correct. 15 JUDGE BENNETT: Anytime in the next five 16 minutes when you come to a natural break, that's when 17 we'll break. But we're going to wrap up here in about 18 five minutes. 19 MR. COFFEY: Okay. 20 JUDGE BENNETT: So whenever you're at a 21 good breaking point. 22 MR. COFFEY: We're going to wrap up for 23 the day? 24 JUDGE BENNETT: Yeah, for the day. 25 MR. COFFEY: Okay. But the witness will</p>	<p>1 CERTIFICATE 2 3 STATE OF TEXAS) 4 COUNTY OF TRAVIS) 5 6 We, Dalia F. Inman and Steven Stogel, 7 Certified Shorthand Reporters in and for the State of 8 Texas, do hereby certify that the above-mentioned matter 9 occurred as hereinbefore set out. 10 WE FURTHER CERTIFY THAT the proceedings of 11 such were reported by us or under our supervision, later 12 reduced to typewritten form under our supervision and 13 control, and that the foregoing pages are a full, true 14 and correct transcription of the original notes. 15 IN WITNESS WHEREOF, we have hereunto set our 16 hand and seal this 19th day of September 2015. 17 18 19 _____ 20 Dalia F. Inman 21 Certified Shorthand Reporter 22 CSR No. 7423-Expires 12/31/2015 23 24 Firm Certification No. 276 25 Kennedy Reporting Service, Inc. 7800 N. MoPac Expressway Suite 120 Austin, Texas 78759 512.474.2233</p>

Attachment 10

1102

SOAH DOCKET NO. 608-14-3211.LIC

MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

BATES NISSAN, INC.,	)	STATE OFFICE OF
Complainant,)	
)	
v.)	
)	
NISSAN NORTH AMERICA, INC.,	)	ADMINISTRATIVE HEARINGS
Respondent.)	

HEARING ON THE MERITS

Monday, September 21, 2015

BE IT REMEMBERED THAT at 8:30 a.m., on Monday, the 21st day of September 2015, the above-entitled matter came on for hearing at the State Office of Administrative Hearings, William P. Clements, Jr., Building, 300 West 15th Street, Room 404, Austin, Texas, before CRAIG BENNETT, Administrative Law Judge, and the following proceedings were reported by Lorrie A. Schnoor and Dalia F. Inman, Certified Shorthand Reporters.

Volume 5

Pages 1102 - 1406

Attachment 10

<p style="text-align: right;">1103</p> <p>1 PROCEEDINGS 2 MONDAY, SEPTEMBER 21, 2015 3 (8:30 a.m.) 4 JUDGE BENNETT: Let's go ahead and resume. 5 And we have Mr. Steiner. You can take a seat up there. 6 And we left off with the cross-examination 7 of Mr. Steiner, and you may proceed when you're ready. 8 MR. COFFEY: Thank you, Judge. 9 PRESENTATION ON BEHALF OF RESPONDENT (CONTINUED) 10 PATRICK STEINER, 11 having been previously duly sworn, testified as follows: 12 CROSS-EXAMINATION (CONTINUED) 13 BY MR. COFFEY: 14 Q Mr. Steiner, let's continue on with Exhibit 15 C-17. Those are the standard terms and provisions of 16 your contract. 17 A I'm sorry, Mr. Coffey, I can't hear you. 18 Q Can you hear me better now? 19 A No. 20 MR. COFFEY: I'm not sure this thing is 21 turned on, Judge. 22 THE REPORTER: You might turn the volume 23 up. 24 JUDGE BENNETT: You can try it now and 25 see.</p>	<p style="text-align: right;">1105</p> <p>1 believe we talked about, as I recall, B2(i) and the 2 listings that were there. 3 Q Okay. So elements of RSE. Is that what we're 4 saying? Not the concept of RSE but elements of RSE? 5 A Elements of RSE are in here, correct. 6 Q Okay. But in -- nowhere in the contract does 7 it incorporate the concept of RSE, just elements of RSE? 8 A Can you rephrase that for me, please, 9 Mr. Coffey? 10 Q Right. We spent a lot of time last Friday 11 discussing the concept of RSE, the fact that it was a 12 ratio compared with another ratio. It was intended to 13 be an indication of a dealer's penetration of his own 14 PMA in comparison to the regional dealer's penetration 15 of their PMAs on average. Do you remember that 16 testimony? 17 A I remember the testimony, but it's a measure of 18 his effectiveness, not penetration. 19 Q A measure of his effectiveness -- 20 A Correct. 21 Q -- okay. Well, what does that mean exactly? 22 A So as we discussed on Friday, the region is 23 used as a baseline in RSE. The total sales are looked 24 at by segment. The penetration by segment is then 25 determined to create an expected number that is then</p>
<p style="text-align: right;">1104</p> <p>1 MR. COFFEY: Is that better, Mr. Steiner? 2 THE WITNESS: A little bit. 3 MR. COFFEY: Maybe a little more? 4 JUDGE BENNETT: Got it up as loud as it'll 5 go. I'm not sure why that one is softer. We can always 6 try pulling another one around. There is one more at 7 the end. 8 MR. COFFEY: You let us know, Mr. Steiner, 9 if you can't hear me. Okay? 10 THE WITNESS: I will. 11 Q (BY MR. COFFEY) All right. And I was just 12 saying, let's continue on with Exhibit C-17, which are 13 the standard provisions of the dealer agreement. 14 A I have it. 15 Q Thank you, sir. And we'll start with Page 4. 16 That's Section 3 of the contract. 17 A I have it. 18 Q I think where we left off Friday was you were 19 identifying those parts of Section 3 which incorporate 20 the RSE concept. And I believe your last testimony was 21 that we could find at least the concept of RSE in 22 Paragraph B2(ii). Is that correct? 23 A What I recall from the question that was asked 24 last Friday was were there elements in the notice of 25 termination described in here. And that's where I</p>	<p style="text-align: right;">1106</p> <p>1 multiplied by the dealer's PMA by segment to reach a 2 number. That number of his sales divided by the 3 expected is his percentage of the region. So it's a -- 4 it's a number of percentages compared to a baseline. 5 Q And the baseline is the same metric for 6 regional dealers? 7 A The -- that baseline -- that methodology is 8 applied to all dealers. 9 Q Well, what I would like to boil this down to is 10 that you compare the dealer's ratio being sales in any 11 geography divided by competitive registrations within 12 the PMA. Right? 13 A No. 14 Q No? Okay. Then divided by an expectation 15 determined by the regional ratio multiplied against 16 competitive registrations within the dealer's PMA? 17 A I'm sorry. I'm confused. 18 Q I'm just trying to get this down to something 19 that we can all hold as a mental image in our minds: 20 This is what RSE is, this is what it's compared to. Why 21 don't you try again, because I'm not getting there 22 apparently. 23 A So first, we establish a regional -- a regional 24 expected sale. So we take the total by segment, we 25 divide it by the competitive registrations in that</p>

Attachment 10

<p style="text-align: right;">1135</p> <p>1 attributable to?</p> <p>2 A I can't answer that question.</p> <p>3 MR. COFFEY: Let's go ahead and pull up --</p> <p>4 let's go ahead and pull up his deposition from</p> <p>5 November 5, 2014. I'm going to get you an exhibit</p> <p>6 number in just a second, Mr. Dyer.</p> <p>7 JUDGE BENNETT: Let's go off the record</p> <p>8 for a minute while you figure out whatever it is you're</p> <p>9 going to pull up.</p> <p>10 (Discussion off the record)</p> <p>11 JUDGE BENNETT: Let's go ahead and go back</p> <p>12 on the record, then, and you may proceed with your</p> <p>13 question.</p> <p>14 MR. COFFEY: Thank you, Judge.</p> <p>15 Q (BY MR. COFFEY) Okay, Mr. Steiner. Do you</p> <p>16 have Page 115 of your deposition in front of you?</p> <p>17 A Yes, sir.</p> <p>18 Q In the top right-hand part of the page, do you</p> <p>19 see the question: "Does RSE even attempt to measure</p> <p>20 whether a dealer is actively and effectively promoting</p> <p>21 and selling?"</p> <p>22 A I'm sorry. Where is it?</p> <p>23 Q Top right-hand corner of the page.</p> <p>24 A Yeah.</p> <p>25 Q Just a few lines down.</p>	<p style="text-align: right;">1137</p> <p>1 A In a 1 percent range, no; in a broader</p> <p>2 spectrum, absolutely.</p> <p>3 Q Okay. And then I asked you: "How about within</p> <p>4 a 5 percent range? Is it sophisticated?"</p> <p>5 And you said?</p> <p>6 A "Consistently applied over time, yes."</p> <p>7 Q Okay. All right. Last Friday, we briefly</p> <p>8 explored the -- and we're on the supplemental notice of</p> <p>9 termination now. Okay? We're going to get off of RSE</p> <p>10 for a while.</p> <p>11 And Friday we discussed the degree to</p> <p>12 which Nissan could show any harm from the write-downs</p> <p>13 that Bates Nissan took over that four-year period,</p> <p>14 between '09 and 2013. Do you recall the questions --</p> <p>15 some questions that I asked you about that?</p> <p>16 A I recall -- I recall you asking some questions,</p> <p>17 yes.</p> <p>18 Q Okay. And we talked about the fact that as we</p> <p>19 understand the allegations being made, it is that these</p> <p>20 write-downs by Bates Nissan had the effect of corrupting</p> <p>21 the financial database on which Nissan makes its</p> <p>22 financial decisions, various decisions, from composite</p> <p>23 data derived from the financial database. Do you recall</p> <p>24 that line of questioning?</p> <p>25 A I do.</p>
<p style="text-align: right;">1136</p> <p>1 A On 115. Right?</p> <p>2 Q Yes, sir. I asked: "Does RSE even attempt to</p> <p>3 measure whether a dealer is actively and effectively</p> <p>4 promoting and selling?"</p> <p>5 A I see that, yes, sir.</p> <p>6 Q Okay. And what was your answer a couple of</p> <p>7 line down?</p> <p>8 A The question is too broad. So from my</p> <p>9 position, the RSE calculation measures the effectiveness</p> <p>10 or the result of what the dealership is doing in their</p> <p>11 internal processes and procedures.</p> <p>12 Q Policies and so forth?</p> <p>13 A Correct. So it -- so it's an objective</p> <p>14 measurement of the dealer's consistency applied to all</p> <p>15 PMA's.</p> <p>16 Q Okay. And then I go and ask you: "That being</p> <p>17 the case, is it" -- and by there, you understood that I</p> <p>18 meant RSE. Correct?</p> <p>19 A Yes, uh-huh.</p> <p>20 Q -- is RSE a sophisticated-enough measure to</p> <p>21 tell you whether there is any difference in the quality</p> <p>22 of a dealer's sales efforts between 99 percent RSE and</p> <p>23 100 percent RSE? Does it measure any difference in the</p> <p>24 quality of the sales effort?</p> <p>25 And what was your answer, sir?</p>	<p style="text-align: right;">1138</p> <p>1 Q Okay. And I believe at the end of that line of</p> <p>2 questioning, you had not pointed to any specific</p> <p>3 decision by Nissan that you thought was skewed or caused</p> <p>4 to go in a wrong direction as a result of those</p> <p>5 write-downs. But I believe you did say that: I cannot</p> <p>6 say that such a decision might not have been affected.</p> <p>7 Do you recall that language?</p> <p>8 A Yes.</p> <p>9 Q Now, you had the whole weekend to think about</p> <p>10 it. Can you point to any specific decision made by</p> <p>11 Nissan which would have been corrupted or skewed by the</p> <p>12 fact that Bates Nissan took those write-downs over that</p> <p>13 four-year period?</p> <p>14 A The -- I do not -- I do not know of a decision,</p> <p>15 but I know because the information was inaccurate, there</p> <p>16 may have been something else that was done.</p> <p>17 Q Something else that was done by Nissan?</p> <p>18 A Yes.</p> <p>19 Q Like what?</p> <p>20 A If the capital was out of line, if the net</p> <p>21 worth was out of line. If there were issues associated</p> <p>22 with the bad information, we may have taken different</p> <p>23 action.</p> <p>24 Q Do you know whether any of those things that</p> <p>25 you just mentioned were cause to go out of line as a</p>

Attachment 10

<p style="text-align: right;">1139</p> <p>1 result of the write-downs taken by Bates Nissan?</p> <p>2 A As the result of the write-downs taken by Bates</p> <p>3 Nissan, I don't think the 12th- or the 13th-month</p> <p>4 statements were correct, and I don't think I can make a</p> <p>5 decision or a basis of a decision from that information</p> <p>6 that would have been correct.</p> <p>7 Q So you're saying that when you made the</p> <p>8 termination decision, that might have been affected by</p> <p>9 the write-downs that Bates was taking?</p> <p>10 A I can't answer that question.</p> <p>11 Q So what you're telling us, then, is</p> <p>12 hypothetical? You're not pointing to any specific</p> <p>13 decision that you made or didn't make that might have</p> <p>14 been affected by the write-downs, but maybe --</p> <p>15 A I believe -- I'm sorry.</p> <p>16 Q That's all right -- but maybe one of your</p> <p>17 decisions might have been affected by it?</p> <p>18 A I believe that there were operational analysis</p> <p>19 that was done over the years through RPAs, through my</p> <p>20 team calling on the dealership, using the information</p> <p>21 that was provided, and they likely made some</p> <p>22 recommendations based on poor information.</p> <p>23 Q Okay. So they may have made some</p> <p>24 recommendations regarding Bates' capitalization?</p> <p>25 A Or the operation.</p>	<p style="text-align: right;">1141</p> <p>1 can point to that would have been done differently had</p> <p>2 Bates Nissan not taken those write-downs?</p> <p>3 A The harm to me is -- was pointed out in the</p> <p>4 supplemental notice of termination. It was in 8, 9, and</p> <p>5 10. And the fact that we're provided the information,</p> <p>6 we don't even have the ability to properly analyze the</p> <p>7 information because it's incorrect. So was there a</p> <p>8 decision that was made that would have been different?</p> <p>9 I don't know. I don't know what the right information</p> <p>10 is.</p> <p>11 Q Okay. Fair enough.</p> <p>12 Let's go, then, to the supplemental notice</p> <p>13 of termination.</p> <p>14 A Which exhibit is that?</p> <p>15 Q Yes, sir, that's C-34.</p> <p>16 MR. COFFEY: And if we could bring that up</p> <p>17 on the screen, and specifically Page 2, also known as</p> <p>18 Bates No. 2662.</p> <p>19 A I'm sorry, I have it.</p> <p>20 Q (BY MR. COFFEY) Yes, sir. Thank you.</p> <p>21 And we started to talk Friday about any</p> <p>22 material misrepresentations that might have been made by</p> <p>23 Bates Nissan, because your first bullet point looks to</p> <p>24 me like an accusation that Bates Nissan materially</p> <p>25 represented something about its ownership, management,</p>
<p style="text-align: right;">1140</p> <p>1 Q Or the operation of the dealership. Let's take</p> <p>2 those one at a time.</p> <p>3 A Uh-huh.</p> <p>4 Q What recommendations were made or not made --</p> <p>5 no, let's say what recommendations were made, in your</p> <p>6 opinion, as a result of any changes to the</p> <p>7 capitalization resulting from the write-downs that Bates</p> <p>8 Nissan took?</p> <p>9 A The change in capitalization was not accurate</p> <p>10 or reflective, so the review that we would have done</p> <p>11 with that information would have been inaccurate. The</p> <p>12 end result or the recommendation or no recommendation</p> <p>13 because it was in line, we wouldn't have known what the</p> <p>14 right number was to make a recommendation.</p> <p>15 Q Are you saying that you might have been able to</p> <p>16 consider termination for Bates Nissan based on</p> <p>17 capitalization if, in fact, you'd had the right numbers?</p> <p>18 A I'm saying that the information we received was</p> <p>19 inaccurate. How that would have affected a termination,</p> <p>20 I can't answer that question. That's a hypothetical. I</p> <p>21 don't know.</p> <p>22 Q Well -- and that's what I'm trying to get down</p> <p>23 to. Everything, in my view, that you've said so far</p> <p>24 about harm to Nissan has been hypothetical. I'm trying</p> <p>25 to get down to brass tacks. Is there anything that you</p>	<p style="text-align: right;">1142</p> <p>1 or capitalization. Do you agree that that's what the</p> <p>2 first bullet point --</p> <p>3 A Yes --</p> <p>4 Q -- is intended to communicate?</p> <p>5 A -- I do.</p> <p>6 Q And were you talking about capitalization as</p> <p>7 being materially misrepresented? Is that it?</p> <p>8 A Yes, and management.</p> <p>9 Q And management. Okay.</p> <p>10 So I think we fully discussed the degree</p> <p>11 to which capitalization, in your opinion, might have</p> <p>12 been misstated as a result of those write-downs, and you</p> <p>13 consider that a material misrepresentation by dealer?</p> <p>14 A I do.</p> <p>15 Q Okay. Do you -- is it your position that Bates</p> <p>16 Nissan intended to materially misrepresent to Nissan?</p> <p>17 A I don't know his intention.</p> <p>18 Q Okay. Let's talk, then, about management.</p> <p>19 You're not alleging material misrepresentation of</p> <p>20 ownership but of management. Is that correct?</p> <p>21 A It would actually be ownership and management.</p> <p>22 Q Ownership and management.</p> <p>23 Can you tell us how Bates Nissan</p> <p>24 materially misrepresented its ownership and/or</p> <p>25 management?</p>

Attachment 10

1147	<p>1 Q Okay. Does that include all of the allegations</p> <p>2 that you are making in Bullet Point No. 1 regarding</p> <p>3 material misrepresentations about ownership, management,</p> <p>4 or capitalization? And, again, we're back on Exhibit</p> <p>5 C-34, the standard provisions, Page 2.</p> <p>6 A And I'm sorry, one more time with the question,</p> <p>7 please, Mr. Coffey.</p> <p>8 Q Yes, sir. I just want to make sure that we</p> <p>9 have explored all of the allegations that you're making</p> <p>10 in Bullet Point No. 1. I want to make sure we have your</p> <p>11 full story of what you are alleging against Bates Nissan</p> <p>12 in terms of its ownership, management, and</p> <p>13 capitalization.</p> <p>14 A We've discussed the capitalization on Friday.</p> <p>15 Correct?</p> <p>16 Q And today, uh-huh. Friday and today.</p> <p>17 Basically what I'm asking: Is there anything further --</p> <p>18 A I'm sorry, Mr. Coffey. I understand your</p> <p>19 question. I'm trying to remember what we said about</p> <p>20 capitalization today, to answer your question fully have</p> <p>21 we discussed all the elements that are associated with</p> <p>22 this bullet point.</p> <p>23 Q Well, if I try to characterize your testimony,</p> <p>24 your lawyer is not going to be happy with me, so I have</p> <p>25 to leave it with you to decide whether or not you've</p>	1149	<p>1 Nissan's position on this is, in fact, that the</p> <p>2 capitalization, as described in the 12- and 13-month</p> <p>3 statements, were inaccurate and they were not complete</p> <p>4 and they were potentially false, misleading, and didn't</p> <p>5 have the right information.</p> <p>6 As long as I characterize the</p> <p>7 capitalization that way, then that's the only other</p> <p>8 point that I would make to the first bullet.</p> <p>9 Q Okay. And we're going to get to the so-called</p> <p>10 inaccuracies in the 12th- and 13-month statements, but</p> <p>11 we'll come back to that --</p> <p>12 A Okay.</p> <p>13 Q -- after we go through the rest of these bullet</p> <p>14 points.</p> <p>15 Okay. The next bullet point was any</p> <p>16 willful failure of dealer to comply with the provisions</p> <p>17 of any laws relating to the conduct of dealership</p> <p>18 operations. And that's a paraphrase, just because I</p> <p>19 wanted to cut to the chase, but do you agree that that</p> <p>20 is a fair characterization -- a fair characterization of</p> <p>21 Bullet Point No. 2?</p> <p>22 A Yes.</p> <p>23 Q All right. Now, can you tell me -- and I know</p> <p>24 you're not a lawyer, but can you tell me what laws the</p> <p>25 dealer has willfully failed to comply with?</p>
1148	<p>1 told the full story of the degree to which you are</p> <p>2 alleging a material misrepresentation regarding</p> <p>3 capitalization.</p> <p>4 MR. JARRETT: Your Honor, I do need to</p> <p>5 object to that. He's answered specific questions. So</p> <p>6 whatever questions Mr. Coffey had asked relative to</p> <p>7 capitalization, those have been answered. But to then</p> <p>8 now say, "Do I have your entire story?" in his</p> <p>9 characterization, that's not a proper question to be</p> <p>10 asking the witness.</p> <p>11 JUDGE BENNETT: I think it's appropriate</p> <p>12 to ask the witness if there's anything further beyond</p> <p>13 what's already been discussed. Now, whether the witness</p> <p>14 remembers what all has been discussed can certainly be a</p> <p>15 challenge; but you can still ask him, at least as he</p> <p>16 sits here today, whether he can think of anything</p> <p>17 further.</p> <p>18 And I think that's where we are, so why</p> <p>19 don't you rephrase it -- or restate it.</p> <p>20 Q (BY MR. COFFEY) Is there anything more you</p> <p>21 would like to say about your allegation in Bullet Point</p> <p>22 1 regarding material misrepresentations about ownership,</p> <p>23 management, or capitalization?</p> <p>24 A Just because I don't remember the complete</p> <p>25 testimony from a capitalization standpoint, my -- or</p>	1150	<p>1 A I can't tell you the laws specifically,</p> <p>2 Mr. Coffey.</p> <p>3 Q When we talked about this on Friday, I remember</p> <p>4 one of the last things that you said was that the dealer</p> <p>5 is not allowed to write off -- or write-down new</p> <p>6 inventory. Do you recall that testimony?</p> <p>7 A The dealer -- there are mechanisms to write</p> <p>8 down new inventory: LIFO, FIFO. There are mechanisms</p> <p>9 to do that. The manner in which we did this was not</p> <p>10 appropriate.</p> <p>11 Q Okay. So it's not the fact that he wrote down</p> <p>12 new inventory, like you testified on Friday, it's the</p> <p>13 manner in which he wrote down new inventory that you</p> <p>14 object to?</p> <p>15 A I think to further my comment, the new</p> <p>16 inventory write-down does happen. It's relatively rare</p> <p>17 and it's relatively small in terms of magnitude, in</p> <p>18 terms of the number, in terms of how it is actually</p> <p>19 done. I personally have not seen it. Has it happened</p> <p>20 before? I'm sure that it's happened before but it's</p> <p>21 rare.</p> <p>22 Q And it is lawful, isn't it?</p> <p>23 A In a lawful manner when it follows the</p> <p>24 appropriate guidelines.</p> <p>25 Q Okay. And you believe it was not done in a</p>

Attachment 10

1151	<p>1 lawful manner. Is that correct?</p> <p>2 A That's correct.</p> <p>3 Q Okay. And can you point to any specific law</p> <p>4 that was violated by the manner in which it was written</p> <p>5 down?</p> <p>6 A I can't.</p> <p>7 Q Now, as far as the used vehicle write-downs,</p> <p>8 are you alleging here that that was the result of a</p> <p>9 willful failure of dealer to comply with the provisions</p> <p>10 of any laws relating to dealership operations? In other</p> <p>11 words, do we include the used vehicle write-downs in</p> <p>12 Bullet Point No. 2?</p> <p>13 A Yes.</p> <p>14 THE WITNESS: And this may not be</p> <p>15 appropriate, Your Honor, so I don't know -- I'd like to</p> <p>16 make a comment, but I know I'm only supposed to say yes</p> <p>17 or no.</p> <p>18 JUDGE BENNETT: Well, you might have been</p> <p>19 able to go on, but since you brought it to his attention</p> <p>20 to say something, I assume he's going to object --</p> <p>21 (Laughter)</p> <p>22 JUDGE BENNETT: -- so why don't you just</p> <p>23 wait for the next question. If he wants you to expand,</p> <p>24 he'll ask you.</p> <p>25 THE WITNESS: Okay.</p>	1153	<p>1 that Bates Nissan took a cumulative \$2.7 million</p> <p>2 reduction in net profits and taxable income through the</p> <p>3 means described in this report."</p> <p>4 Is that the language that you're talking</p> <p>5 about?</p> <p>6 A Yes, sir.</p> <p>7 Q Okay. Do you know what that language means?</p> <p>8 A Other than the direct image of what's stated</p> <p>9 here, that he took a \$2.7 million reduction in profits</p> <p>10 and taxable income, that's how I take it to mean.</p> <p>11 Q A better question would have been: Do you</p> <p>12 understand Mr. Walter's theory behind this statement?</p> <p>13 A The way I read the material is that Mr. Walter</p> <p>14 said he took a reduction of 2.7 in taxable and net</p> <p>15 profits through the means described in his report. The</p> <p>16 means then outline the manner in which that -- that was</p> <p>17 actually written down.</p> <p>18 Q And what were the means described in this</p> <p>19 report that resulted in the allegedly \$2.7 million?</p> <p>20 A The reductions in new car inventory were taken</p> <p>21 on prior model year vehicles, and it appeared that the</p> <p>22 write-downs were not consistent between those models.</p> <p>23 He also indicated that the number -- I believe it was</p> <p>24 30-something -- vehicles of 217 or 200 some-odd vehicles</p> <p>25 in inventory was significant. It was -- the magnitude</p>
1152	<p>1 MR. COFFEY: Judge, I do want him to</p> <p>2 expand. Give him a fair opportunity.</p> <p>3 A On Friday, I said that it was relative to new</p> <p>4 vehicles only and, in fact, when I was reading through</p> <p>5 some material this weekend, it does apply to used</p> <p>6 vehicles as well. The consistency, the manner in which</p> <p>7 the write-downs were done, there's no standard</p> <p>8 methodology that's being applied to calculate the</p> <p>9 numbers that they have. So to answer your question</p> <p>10 directly, Mr. Coffey, it is used as well.</p> <p>11 Q (BY MR. COFFEY) All right. And what materials</p> <p>12 were you looking through this weekend which caused the</p> <p>13 change in your testimony?</p> <p>14 A I was looking through the supplemental notice</p> <p>15 of termination. It refers to a \$27 million discrepancy</p> <p>16 over time. I think it's on Page 2. And then I was</p> <p>17 referring to the material that was produced by the</p> <p>18 experts in terms of what was actually done.</p> <p>19 Q Okay. I think you meant \$2.7 million --</p> <p>20 A Yes, sir.</p> <p>21 Q -- discrepancy. Is that correct?</p> <p>22 A I believe that's correct.</p> <p>23 Q Okay. Let's go ahead and explore that</p> <p>24 statement on Page 2663. And I think it is the third</p> <p>25 full paragraph. And it says that, "Mr. Walter observed</p>	1154	<p>1 was bigger than what he had seen.</p> <p>2 And then on the used vehicles, he stated</p> <p>3 that the write-downs were not consistent and did not</p> <p>4 follow some of the industry standard methodologies with</p> <p>5 Blue Book or Black Book or some sort of mechanism to</p> <p>6 determine what the value of that inventory should be.</p> <p>7 Q Do you understand what Mr. Walter is stating</p> <p>8 when he says that Bates Nissan took a \$2.7 million</p> <p>9 reduction in net profits and taxable income? Do you</p> <p>10 understand how Mr. Walter gets to that statement, the</p> <p>11 logic behind it?</p> <p>12 A I don't know how to answer your question. The</p> <p>13 way I read this is that he accumulated these dollars</p> <p>14 over a period of time -- I think it was '9 to '13 -- he</p> <p>15 added them up, and it was \$2.7 million.</p> <p>16 Q So your understanding is that Mr. Walter simply</p> <p>17 added up all of the write-downs, both new and used, from</p> <p>18 2009 to 2013, and he arrived at \$2.7 million?</p> <p>19 A That's what this states, yes.</p> <p>20 Q Okay. And by adding up all of those</p> <p>21 write-downs, Mr. Walter is able to say that Bates Nissan</p> <p>22 avoided taxes on \$2.7 million in taxable income. Is</p> <p>23 that what you're saying?</p> <p>24 A I don't know how to answer that question.</p> <p>25 Q Quite simply, are you accusing Bates Nissan of</p>

Attachment 10

<p style="text-align: right;">1155</p> <p>1 not paying taxes on \$2.7 million in taxable income? 2 A I'm not accusing Nissan -- or Bates Nissan. 3 What has been provided to us is that it -- the fact that 4 the inventory is being written down and it's not being 5 paid taxes on, I believe the 2.7 is cumulative -- well, 6 I believe it's cumulative, because that's what it 7 states, and I don't believe that it is \$2.7 million 8 total. I think some of it rolls over into the prior 9 year, and it's accounted for in the next year. So the 10 net number, I don't know the net number. 11 Q But you are clearly alleging here, sir, in 12 writing, that Bates Nissan is avoiding tax on 13 \$2.7 million in taxable income by virtue of the 14 write-downs that it took over those four-year periods? 15 MR. JARRETT: Objection, misstates the 16 document, Your Honor. 17 JUDGE BENNETT: Sustained. 18 Q (BY MR. COFFEY) Is, in fact, that your 19 allegation -- 20 MR. JARRETT: Objection, Your Honor. That 21 was sustained. 22 MR. COFFEY: Well, I asked a different 23 question. 24 JUDGE BENNETT: He's asking if that is 25 the -- if that is, in fact, the allegation. And I'll</p>	<p style="text-align: right;">1157</p> <p>1 right now, but basically it says that dealers are to 2 file adjusted financial statements with Nissan? 3 A The statement, I believe -- and I don't have it 4 in front of me either -- states that if you make one, 5 you should send it. 6 Q Okay. 7 A But dealers are not required to make a 13-month 8 statement. 9 Q Right. But now you're saying that if they do 10 make one, they're required to file it with Nissan. Is 11 that correct? 12 A That's correct. 13 Q Okay. I would like to walk you through some 14 testimony from your second deposition, and this is to be 15 found on Pages 71 and 72 of the deposition dated 16 November the 5th, 2013. And both of those pages are on 17 one page, in the consolidated version, if you have that. 18 If not, then we can supply it. 19 MR. ALANIZ: And if the Court would like 20 to follow along, you can find this at Exhibit C-358, 21 Page 54, of the PDF. 22 JUDGE BENNETT: Okay, thank you. I'll 23 just pay attention to the questions and what's read and 24 discussed. 25 Q (BY MR. COFFEY) Let's start with Page 70,</p>
<p style="text-align: right;">1156</p> <p>1 allow the witness to answer, to the extent that he can. 2 A I agree with the allegation. The allegation is 3 that he is avoiding to pay tax. The dollar amount -- 4 Mr. Coffey, I can't tell you what the dollar amount is. 5 If that's the number you're looking for, I'd have to go 6 back and look at that. 7 Q (BY MR. COFFEY) Are you alleging that Bates 8 Nissan is permanently avoiding tax on any amount of 9 taxable income? 10 A I don't know how to answer that question. 11 Q Yes or no, if you know. 12 A I don't know how to answer that question. 13 Q Okay. Let's talk about 13-month statements. 14 And for this, we will need your prefiled direct 15 testimony. We will also need some business management 16 bulletins, specifically C-105, 106, and 107. And before 17 we go into those documents, let me just ask you 18 directly, Mr. Steiner: Are Nissan dealers required to 19 file with Nissan their 13-month statements if, in fact, 20 they create a 13-month statement? 21 A Yes. 22 Q They are required to do that? 23 A Yes. 24 Q And that is under that language contained in 25 the standard provisions -- I don't have it available</p>	<p style="text-align: right;">1158</p> <p>1 Mr. Steiner. Do you have that in front of you? 2 A Yes, sir. 3 Q Okay. At Line 15, I asked if you are familiar 4 with NNA's requirements for dealer financial statements, 5 and you asked -- 6 A I'm sorry, sir. I'm on Page 70, Line 15 -- 7 okay. I apologize. 8 Q Quite all right. 9 And then you asked me, can I be more 10 specific. Right? 11 A Are you familiar with NNA's requirements -- 12 yes, uh-huh. 13 Q Okay. And then I said, "It's our understanding 14 that NNA requires dealers to file monthly and yearly 15 financial statements with NNA, and they have to be in a 16 particular format." Do you agree with that? 17 A Yes. 18 Q And your answer was "Yes." 19 Then I went on to say: "We also 20 understand that there is something in the industry 21 called a 13-month statement. Do you know what a 22 13-month statement is?" 23 And your answer was? 24 A I'm aware of one, yes. 25 Q Okay. Then I go: "Can you go ahead and give</p>

Attachment 10

<p style="text-align: right;">1183</p> <p>1 Q Okay. Has that -- has your view of the 2 requirement been more clearly -- more clearly expressed 3 to the dealers than these three business management 4 bulletins do? 5 In other words, has it ever been clearly 6 said to the dealers that 13-month statements are 7 adjusted statements; if you prepare one, you're required 8 to file it with us? 9 A I don't know if there's other documentation in 10 here, Mr. Coffey, that would support that. From the 11 documents that you've shown me, that's the background 12 that I have with regard to what's been communicated to 13 the dealers. There may be additional communication that 14 I don't have, but I can't answer your question directly. 15 Q And do you agree with me that what we've seen 16 so far in these business management bulletins are 17 ambiguous, to say the least? 18 A The -- the documents that you have taken me 19 through state what they state. They don't state the 20 policy that's in the sales and service agreement. 21 Q And that policy, as you describe it, is the 22 language about adjusted financial statements that we 23 just went through? 24 A The policy is, as I mentioned, if you create a 25 13, you need to send a 13. A 13 is not required; but if</p>	<p style="text-align: right;">1185</p> <p>1 jackets to look at how vehicles were written down and 2 what the process was being used in the dealership. So 3 we rely on the dealership to provide true and accurate 4 information to us. 5 Q Well, that is how you would find out whether or 6 not the write-downs are proper, if you will, by going in 7 and auditing the deal jackets. Right? Or actually the 8 deal files? 9 A But your question was an audit of the financial 10 statement. I don't -- 11 Q Now, I'm asking you wouldn't you want -- if you 12 are concerned about Bates Nissan's filings being 13 inaccurate and skewing your database, if you will, 14 wouldn't you like to know whether or not you have an 15 uncorrupted database already, and wouldn't you go out 16 and audit those dealers' financial records to make sure 17 that all of them who use LCM are using it correctly? 18 A Mr. Coffey, we don't even know who uses LCM. I 19 couldn't tell you anybody that uses it. I don't know. 20 Q And you have no idea whether or not you have an 21 uncorrupted database which could possibly be prejudiced 22 by what Mr. Bates has filed with you. Wouldn't you 23 agree? 24 A We don't audit a financial statement. We rely 25 on the dealer to submit to us true and accurate</p>
<p style="text-align: right;">1184</p> <p>1 you do one, send it. 2 Q Does Nissan audit dealership financial records? 3 A Can you -- well, can you restate the question 4 for me, please? 5 Q Yes. 6 Does Nissan audit dealership financial 7 records? In other words, does it do anything to go out 8 there, look at the dealership's records and make sure 9 that the 12- and 13-month statements being filed with 10 Nissan are true, complete, and accurate? 11 A I'm not aware of a formal audit that's done. 12 Q Okay. Would you agree with me that if you want 13 to assure yourself that dealer financial records being 14 filed with Nissan are true, accurate, and complete, you 15 would go out and make sure that the dealers check their 16 financial records and make sure that what's being 17 reported to you is true, accurate, and complete? 18 A From my perspective, that's the agreement that 19 we have the dealer; that he will provide us true, 20 accurate, and complete information. 21 Q But wouldn't you at least want to know whether 22 all of your dealers who are filing this stuff with you 23 are using lower of cost to market correctly? 24 A I -- I don't know how we would tell that from 25 an audit, without going into the store and pulling deal</p>	<p style="text-align: right;">1186</p> <p>1 information regardless of -- if it's Mr. Bates or if 2 it's somebody else. 3 Q So you have no idea whether your dealers are 4 filing true, accurate, and complete financial 5 information with you and particularly in terms of 6 whether or not they are using LCM correctly? 7 A I do not know who's using LCM, whether they're 8 doing it correctly or not. 9 Q Fair enough. 10 JUDGE BENNETT: Mr. Steiner, while he's 11 getting his next questions prepared, I have a few 12 questions for you. 13 CLARIFICATION EXAMINATION 14 BY JUDGE BENNETT: 15 Q As I understood your testimony so far, the fact 16 that the 13th-month statement was not submitted to 17 Nissan skewed some of the financial data that Nissan may 18 have looked at in evaluating Bates' performance. Is 19 that correct? 20 A That's correct. 21 Q And when would that skewing have occurred? In 22 your mind, I know there's been some discussion about the 23 first few months of the next calendar year, as profits 24 might have appeared to be overstated, and so on. Is 25 that your understanding?</p>

Attachment 10

1187	<p>1 A Yes. So a couple of different metrics. The 2 capital on net worth would've been impacted because as 3 they readjust the schedule and then put those monies 4 into the monthly figures when they sell those cars, 5 they're inflated. The gross is inflated. The gross per 6 vehicle is inflated. Return on sales is inflated. Some 7 key metrics that we use to determine financial health. 8 Q And when would Nissan have looked at that 9 information or relied upon that information that you 10 believe is -- may have been skewed? 11 A It would've been used -- well, both for 12 comparison in the first quarter more so than probably 13 the second and third. But it would've been used in 14 comparison also with regard to the rest of the calendar 15 year or the fiscal year as you look at how they're 16 selling vehicles and the significant changes in the 17 gross as they go up and down, what's causing that. 18 And they may have used that information to 19 try to assist the dealer in terms of making some 20 recommendations. Certainly, on the retail process 21 appraisal that I described, they would've been looking 22 much deeper to see how that was affecting their business 23 and their operation. But primarily it should've been in 24 the first three or four months where it was more 25 pronounced.</p>	1189	<p>1 A I would certainly prefer that it was timely; 2 then you could do the analysis that needs to be done. I 3 don't really understand or know why that the end date 4 was pushed out so far. I -- I can't comment on that. I 5 don't know why. 6 Q Okay. 7 JUDGE BENNETT: That was all. 8 MR. COFFEY: Thank you, Judge. 9 CROSS-EXAMINATION (CONTINUED) 10 BY MR. COFFEY: 11 Q I have just a few more questions from the 12 statute, just some house cleaning. 13 Your testimony so far -- 14 MR. COFFEY: Yeah, if you would go ahead 15 and provide him a copy. 16 Q (BY MR. COFFEY) Your testimony so far, as I 17 understand it, is that from the performance standpoint, 18 you are only attempting to terminate Bates Nissan 19 because its RSE score during the default period failed 20 to reach 100 percent RSE on a 12-month rolling basis. 21 Is that correct? 22 A That's correct. 23 Q Okay. And then on the supplemental notice of 24 termination part, you are alleging that by taking the 25 write-downs that Bates Nissan took, it willfully and</p>
1188	<p>1 Q The difference would've been more pronounced or 2 the information would've been used by Nissan? 3 A The difference more pronounced. I mean, we use 4 this information on a monthly basis. I have a team -- 5 or had a team at that particular point in time that 6 would call on a dealer monthly and would work with them 7 to try to improve their performance. They would use 8 this as one source of information. But I'm sure you've 9 also seen there's dozens of contact reports where they 10 have made other recommendations, not just financial 11 recommendations, but advertising, promotions, process 12 enhancements that could be made, a number of different 13 things, training. 14 Q I think you have C-106 in front of you. It's 15 to the right. Maybe it can be brought up, just that one 16 portion or just C-106. But it says that 13-month 17 statements will be accepted beginning January 21st, 18 2012, through the end of the 2012 calendar year. I 19 mean, it appears to give a dealer all the way through 20 the end of that next year to file that 13th-month 21 statement. If that's the case, then doesn't it seem 22 that it wouldn't be very useful to Nissan in terms of 23 that month to month or throughout the 2012 year if the 24 dealers actually have all the way to the end of that 25 next year to file it?</p>	1190	<p>1 intentionally violated laws relating to dealership 2 operations? 3 A My -- my position with regard to the 4 supplemental termination is they -- they willfully and 5 knowingly submitted information that was false; that 6 they submitted similar information to the government 7 that was false; and that as a result of that, we had 8 inaccurate, untrue financial statements of which to 9 evaluate the dealership with. 10 Q But are you or are you not alleging willful and 11 intentional violation of the law? 12 A The -- the law -- the government or another 13 entity will determine if they violated the law. What I 14 saw was what they were doing was not appropriate, and 15 they were doing that willingly, and it was for the 16 purposes of lowering their taxable income. That's what 17 I saw. 18 Q I know. But the problem with that answer is 19 that the notice of termination specifically says in 20 bullet point -- well, let's find the notice of 21 termination so we're accurate here. 22 The notice of termination -- this is the 23 supplemental one, it's C-34. In Bullet Point 2, if you 24 have that in front of you, that's Page 2. 25 A Yes.</p>

Attachment 10

1199	1201
<p>1 it's Page 15 of the testimony, but it's Paragraph 46, to 2 be more specific. Are you there, sir? 3 A I'm on Page 15. 4 Q Okay. And I direct your attention to Paragraph 5 46. Do you see that? 6 A I see that, yes. 7 Q Now, I'd like to direct your further attention 8 down to the bottom four lines up, the word beginning, 9 "however." Are you with me? 10 A Yes, I see it. 11 Q Now, let's read that across. "However, NNA has 12 not asserted the failure to file the 13th-month 13 financial statements as a ground for termination." That 14 was your testimony then? 15 A That's correct. 16 Q Do you stand by that testimony today? 17 A I do. 18 Q So it's -- if it's not the fact that they 19 failed to file, what is the general problem Nissan has 20 with respect to these 13th-month financials? 21 A The -- well, as with the 12-month financials, 22 they're inaccurate; they're false; they're misleading. 23 They don't have the correct information in them, both 24 the 12th and 13th month statement. 25 Q Before this case, did Nissan even know that</p>	<p>1 A I do. 2 MR. JARRETT: Now let's turn to the next 3 page, 107. Let me find where it states -- I think it's 4 back one page. I'm sorry. Oh, I'm sorry. Let's -- I'm 5 sorry. Go forward. 6 Q (BY MR. JARRETT) I turn your attention, 7 Mr. Steiner, to that last paragraph. It's not indented, 8 but the sentence begins "used vehicle." Are you there? 9 A I am there, yes. 10 Q Now, according to Nissan's manual, I'll read. 11 "Used vehicles should be reappraised at month end and 12 written down to current wholesale value." Did I read 13 that correctly? 14 A That's correct. 15 Q Okay. And is that the standard policy for 16 Nissan relative to what should be accounted for on 17 Page 5 at Line 41? 18 A Yes, it is. 19 Q Now, as this document states, it's based on 20 current wholesale value. Do you understand current -- 21 does Nissan, I should say, understand current wholesale 22 to be loan value of a used vehicle? 23 A No. 24 Q Does the manual state loan value? 25 A No.</p>
1200	1202
<p>1 Bates Nissan had created 13th-month financials? 2 A I was not aware of a 13th-month financial. 3 MR. JARRETT: If we could go to Exhibit 4 C-173. 5 Q (BY MR. JARRETT) And while Mr. Dyer is 6 bringing that up, there's been a lot of discussion 7 throughout the earlier portion of this trial relative to 8 the Nissan accounting manual. On Line 173, Page 5 at 9 Line 41, if you would. I direct your attention on 10 Line 41. What is that general line entry for, sir, if 11 you know? 12 A It's an adjustment for used vehicle inventory. 13 Q So it's not Nissan's position that it's 14 improper for a dealer to adjust used vehicle inventory, 15 is it? 16 A Oh, no. No, no. 17 Q Now, let's, then, now turn to the financial 18 accounting manual. If you would go to C-101, please. 19 And this is the first page of the manual. 20 MR. JARRETT: I'd like for you, Mr. Dyer, 21 if you would to go to Page 106 of the manual. I believe 22 it's PDF107. 23 Q (BY MR. JARRETT) Now, do you see at the top 24 where this section of the manual pertains to used 25 vehicle inventory?</p>	<p>1 Q Does Nissan understand in its ordinary and 2 normal business operation that wholesale constitutes 3 some range of value between wholesale and loan? 4 A Can you restate that for me, please? 5 Q Yeah. 6 By having stated wholesale value, does 7 Nissan understand that wholesale, current wholesale to 8 constitute some range of dollar between wholesale and 9 loan? 10 A Wholesale value to me is the way it's 11 described. That's wholesale value. Loan value is 12 something completely different. 13 Q And is loan value, in your understanding, less 14 than wholesale? 15 A I don't -- frankly, in this discussion, I don't 16 know what loan value is. Loan value to the consumer, 17 loan value to the dealer, loan value to -- I don't know 18 what loan value is. 19 Q All right. Do you know whether this manual was 20 in effect from at least 2009 through '13? 21 A I believe the date that we went over with 22 Mr. Coffey was from -- the last revision was '88. So I 23 believe it to be true. 24 Q Okay. Thank you. 25 Relative to the supplemental notice of</p>

Attachment 10

1207	<p>1 A Yes, sir.</p> <p>2 Q Now, generally speaking, using this as just</p> <p>3 your frame of reference, how credible in the eyes of</p> <p>4 Nissan are these financial statements that Bates Nissan</p> <p>5 had submitted?</p> <p>6 A I don't believe, as I testified before, either</p> <p>7 the 12th- or 13th-month statements are accurate based on</p> <p>8 the finding from the experts that we want through and</p> <p>9 reviewed these statements.</p> <p>10 Q Now, just to assist the Court, if you would,</p> <p>11 I'd like to call out on the right-hand column, the</p> <p>12 middle of the page where you see the large paragraph</p> <p>13 where the --</p> <p>14 MR. JARRETT: There you go, Ricky.</p> <p>15 Q (BY MR. JARRETT) Is it in -- is it Nissan's</p> <p>16 view that what Bates Nissan, did throughout the course</p> <p>17 of 2010 through '13 at least, that it's recapturing of</p> <p>18 the reductions that are shown on its month 13's, do</p> <p>19 those recaptured amounts affect the amounts that are</p> <p>20 shown here in this paragraph of total -- under total</p> <p>21 liabilities, the net working capital, net cash position,</p> <p>22 and effective net worth?</p> <p>23 A They do.</p> <p>24 MR. JARRETT: And if you would expand out</p> <p>25 of that, please, just on the first page, down to the</p>	1209	<p>1 Capital and Financing. Are you there?</p> <p>2 A I am there.</p> <p>3 Q Now, what I would like to do, knowing that this</p> <p>4 relates to capital and financing, I would like to now</p> <p>5 turn the page, if you would. So starting at the first</p> <p>6 full sentence at the top of that section, it says,</p> <p>7 "Dealer shall at all times maintain and employ such</p> <p>8 amount and allocation of net working capital and net</p> <p>9 worth as are substantially in accordance with seller's</p> <p>10 guides therefor and which will enable dealer to fulfill</p> <p>11 all of its responsibilities under this agreement."</p> <p>12 Having read that, sir, my questions to</p> <p>13 you -- does Nissan maintain guides that -- that the</p> <p>14 dealer is to follow relative to his financial reporting</p> <p>15 to the company?</p> <p>16 A Yes.</p> <p>17 Q Are those guides known to Bates Nissan?</p> <p>18 A Yes.</p> <p>19 Q Are they known to all of your dealers?</p> <p>20 A Yes.</p> <p>21 Q Generally speaking, how are those guides known</p> <p>22 to your dealers, including Bates Nissan?</p> <p>23 A They are reviewed and communicated on a regular</p> <p>24 basis and are part of the dealer contact -- part of the</p> <p>25 my team's dealer contact. And if guides aren't met,</p>
1208	<p>1 lower column where it calls out each individual month.</p> <p>2 Q (BY MR. JARRETT) And looking at the months of</p> <p>3 January through December, is it Nissan's position that</p> <p>4 based upon its review of the records that Bates produced</p> <p>5 that its recapturing of the amounts of reductions taken</p> <p>6 on both new and used affect the profit dollars reported</p> <p>7 to Nissan in the months of January through December?</p> <p>8 A Yes.</p> <p>9 Q And is that true for each and every year for</p> <p>10 which Bates had submitted such financials based on the</p> <p>11 reductions taken?</p> <p>12 A Yes.</p> <p>13 MR. JARRETT: Let's call up Exhibit C-17,</p> <p>14 please.</p> <p>15 Q (BY MR. JARRETT) As a point of reference, sir,</p> <p>16 this is the Nissan Standard Provisions. Correct?</p> <p>17 A Yes, sir.</p> <p>18 Q And I believe there had been testimony</p> <p>19 generally referring to this as the dealer agreement.</p> <p>20 But technically speaking, these standard provisions, you</p> <p>21 understand, are incorporated by reference into the</p> <p>22 dealer agreement. Is that correct?</p> <p>23 A That's correct.</p> <p>24 Q Now, if we would, let's turn to Page 12 of the</p> <p>25 standard provisions. And focusing on E, which is</p>	1210	<p>1 those conversations are had, and it's the dealer's</p> <p>2 obligations to fulfill those requirements.</p> <p>3 Q Is Bates supposed to follow those guidelines?</p> <p>4 A Yes.</p> <p>5 Q Now, generally speaking, why does Nissan even</p> <p>6 have financial guidelines?</p> <p>7 A I mean, this is critical to the business. If</p> <p>8 you don't have the appropriate capital, you don't have</p> <p>9 the net worth and the cash to manage your business with,</p> <p>10 then you can't properly manage your business; it'll</p> <p>11 choke.</p> <p>12 Q And in your review of the Bates Nissan</p> <p>13 financial statements, can you know if Bates satisfied</p> <p>14 the guides?</p> <p>15 A As I stated several times, I don't believe</p> <p>16 either the 12th- or 13-month statements are correct. It</p> <p>17 may show him being within the guide; but because they're</p> <p>18 overinflated, there's no relevance. There's no accuracy</p> <p>19 with it.</p> <p>20 Q Let's be clear just for the record. Does</p> <p>21 Nissan put any credible value into the financial</p> <p>22 statements that your dealer Bates Nissan submitted at</p> <p>23 least between 2009 through '13?</p> <p>24 A There -- they're critical. They're just a huge</p> <p>25 part of understanding how the business is being run and</p>

Attachment 10

1211	<p>1 trying to support and help the dealer as well as know</p> <p>2 the health of the dealership.</p> <p>3 Q But to my question, does the company hold those</p> <p>4 with any credible value? Does it find them to be</p> <p>5 truthful? Does it find them to be accurate?</p> <p>6 A Yes.</p> <p>7 Q In what respects would Bates' dealer financial</p> <p>8 statements be truthful and accurate?</p> <p>9 A They're not.</p> <p>10 Q Okay. Yeah, I think I need to clarify that,</p> <p>11 because my question initially was essentially does the</p> <p>12 company find that Bates -- or in its opinion, is Bates</p> <p>13 Nissan's financial statements credible and accurate and</p> <p>14 follow and adhere to the guidelines?</p> <p>15 A No.</p> <p>16 Q Okay. Off the subject of where we have been</p> <p>17 thus far this morning, I'd like to go back to issues</p> <p>18 that were covered yesterday on cross.</p> <p>19 Can you just briefly explain what an</p> <p>20 unrepresented territory is, sir?</p> <p>21 A It's an area, a geographic area where we do not</p> <p>22 have a dealership or a defined area within a dealership.</p> <p>23 Q And under RSE, does Nissan measure the</p> <p>24 unrepresented territory?</p> <p>25 A Yes.</p>	1213	<p>1 summary of that is accurate, and my math as to the total</p> <p>2 is accurate with the math being 1,216 units, assuming</p> <p>3 all of that to be truthful and accurate, has that amount</p> <p>4 of loss harmed Nissan?</p> <p>5 A Absolutely.</p> <p>6 Q And how so, sir?</p> <p>7 A Well, obviously in the lost sales. It's also</p> <p>8 harmed the dealer in terms of his lost opportunity.</p> <p>9 It's harmed the customer in terms of our representation</p> <p>10 in the marketplace. The customer is not aware of our</p> <p>11 products; they're not aware of what's available, our</p> <p>12 competitiveness; and as a result of that, we've lost</p> <p>13 opportunity to capture that market.</p> <p>14 Q Now, I believe yesterday -- or Friday,</p> <p>15 Mr. Coffey had questioned you about a hypothetical</p> <p>16 involving a customer in Montana, and, I believe he said</p> <p>17 it was East Tree Stump, Montana. Do you remember that?</p> <p>18 A Yes, I do.</p> <p>19 Q Now, if I recall his question accurately, you</p> <p>20 were asked whether Bates Nissan was actively and</p> <p>21 effectively promoting sales within its primary market</p> <p>22 area if a customer from East Tree Stump, Montana, is</p> <p>23 sold a car by Bates. Do you recall that?</p> <p>24 A I do.</p> <p>25 Q Let's stop right there.</p>
1212	<p>1 Q And did it do so throughout the entire time</p> <p>2 frame within the central region for which Bates</p> <p>3 Nissan --</p> <p>4 A Yes.</p> <p>5 Q -- was -- was calculated under the RSE metric?</p> <p>6 A Yes.</p> <p>7 Q How many states generally have made up the</p> <p>8 central region during your tenure?</p> <p>9 A When I was in the region, it was 14 states.</p> <p>10 MR. JARRETT: Ricky, do you have the chart</p> <p>11 that I created over the weekend? It's the summary. And</p> <p>12 I'll explain it to -- can you project that, please.</p> <p>13 Q (BY MR. JARRETT) Mr. Steiner, on your screen</p> <p>14 there is a chart that I created over the weekend for</p> <p>15 demonstrative purposes. And I'll represent that the</p> <p>16 calendar years are the years that are shown and taken</p> <p>17 right out of Exhibits C-35 and C-33, which are the</p> <p>18 two -- well, one is the notice of default, the other is</p> <p>19 the notice of termination. And within those two</p> <p>20 documents, C-35 and C-33 corresponding to each of those</p> <p>21 calendar years, as well as through September -- January</p> <p>22 through September of '13, 35 and 33 call out what are</p> <p>23 the total loss in Nissan sales had Bates been a hundred</p> <p>24 percent retail sales effective.</p> <p>25 So assuming my call outs of that, my</p>	1214	<p>1 Can Bates Nissan from its dealership go</p> <p>2 into Montana, seek out a Montana customer, and sell to</p> <p>3 that customer in Montana?</p> <p>4 A No.</p> <p>5 Q And why can it not do that in the eyes of</p> <p>6 Nissan?</p> <p>7 A Well, first of all, they're not licensed in</p> <p>8 Montana. They can only sell from the one point that we</p> <p>9 have an agreement with.</p> <p>10 Q And so as you would understand the hypothetical</p> <p>11 that Mr. Coffey gave you, the Montanan had to go to</p> <p>12 Bates Nissan to purchase the vehicle. Is that --</p> <p>13 A That's correct.</p> <p>14 Q -- your understanding?</p> <p>15 A Yes.</p> <p>16 Q And in the eyes of Nissan, is that a vehicle</p> <p>17 that Bobby Bates and his dealership sold in its PMA?</p> <p>18 A He sold it at his dealership in his PMA.</p> <p>19 Q Now, second, let's assume that the customer</p> <p>20 who's from Montana purchases from Bates but then</p> <p>21 registers its vehicle in Montana. Can that happen?</p> <p>22 A Sure.</p> <p>23 Q And do customers routinely buy from a local</p> <p>24 dealer and have their vehicle registered elsewhere?</p> <p>25 A Yes.</p>

Attachment 10

1231	<p>1 The point being that any sales that are</p> <p>2 registered outside the PMA are over and above the</p> <p>3 contractual obligation of penetrating your PMA at</p> <p>4 100 percent RSE?</p> <p>5 MR. JARRETT: Objection, calls for a legal</p> <p>6 conclusion, and I think this has been asked and</p> <p>7 answered. It's been -- yesterday's -- or Friday's</p> <p>8 testimony for an hour but --</p> <p>9 JUDGE BENNETT: If he can answer, answer</p> <p>10 it if you can, if you understand it. So I'm going to</p> <p>11 overrule the objection.</p> <p>12 But we may have an issue here, but go</p> <p>13 ahead, if you can answer it.</p> <p>14 A The -- as I understand the question, he needs</p> <p>15 to be 100 percent on RSE on a 12-month rolling basis.</p> <p>16 That calculation is defined based on his PMA, but he's</p> <p>17 not required to only sell within the PMA.</p> <p>18 Q (BY MR. COFFEY) But, sir, it was more than</p> <p>19 that, because you testified that the dealer has no</p> <p>20 obligation to register a sale outside of his PMA. Isn't</p> <p>21 that right?</p> <p>22 A That's correct.</p> <p>23 Q So if, in fact, a dealer does that and</p> <p>24 registers a sale outside of his PMA, then he has</p> <p>25 exceeded his contractual obligation?</p>	1233	<p>1 write-down price and the sale price? You understand</p> <p>2 that?</p> <p>3 A I understand that. I think we went through</p> <p>4 this, too, in prior testimony, in that I understand that</p> <p>5 that needs to be done from a GAP and a procedural</p> <p>6 perspective, but I don't agree with the initial</p> <p>7 write-down to begin with.</p> <p>8 Q That's what I'm going to get at, but before I</p> <p>9 get there, you also believe -- and I believe you stated</p> <p>10 it right in here in your supplemental notice of</p> <p>11 termination -- let's go to BN 2665 of C-34, C-34 being</p> <p>12 the supplemental notice of termination. And we're going</p> <p>13 to be about five pages in, it looks like.</p> <p>14 And I want to direct your attention to the</p> <p>15 first full paragraph, second sentence, where it says,</p> <p>16 "It appears to Nissan that Bates Nissan has carried</p> <p>17 forward 2009 reduced taxable income into 2010, and then</p> <p>18 the sum of 2009 and 2010 into 2011." Do you see that</p> <p>19 language?</p> <p>20 A I do.</p> <p>21 Q Okay. Is that still your testimony?</p> <p>22 A Yes.</p> <p>23 Q Can you tell me, sir, how recaptured income can</p> <p>24 be carried forward cumulatively?</p> <p>25 A The amount that was initially carried forward</p>
1232	<p>1 MR. JARRETT: Objection. Same thing,</p> <p>2 Judge, legal conclusion. We're now beyond the scope of</p> <p>3 my -- certainly my cross, but go ahead, I guess.</p> <p>4 JUDGE BENNETT: I'll allow it, but do you</p> <p>5 understand the question?</p> <p>6 THE WITNESS: No. I think I've answered</p> <p>7 it a couple of times.</p> <p>8 JUDGE BENNETT: Okay. I think there's</p> <p>9 some confusion here as to the nature of the question,</p> <p>10 and the witness indicated he doesn't understand it. So</p> <p>11 you can try to rephrase it differently.</p> <p>12 MR. COFFEY: If it's okay with the court,</p> <p>13 I'll come back to it later. Give the witness time to</p> <p>14 think about it.</p> <p>15 Q (BY MR. COFFEY) Okay. Mr. Steiner, I believe</p> <p>16 your testimony on the supplemental notice of termination</p> <p>17 is that Bates Nissan recaptured its write-downs. Is</p> <p>18 that correct?</p> <p>19 A To the best of my knowledge, yes, they entered</p> <p>20 them into the financial statement when they sold them</p> <p>21 the next year.</p> <p>22 Q And do you understand that the IRS requires a</p> <p>23 dealer who writes down a vehicle to recapture the</p> <p>24 write-down amount in terms of gross profit as calculated</p> <p>25 by the write-down price -- the differential between the</p>	1234	<p>1 was never reduced, so it continued to add upon itself.</p> <p>2 Q Are you talking about the recaptured gross</p> <p>3 profit now or the write-downs themselves?</p> <p>4 A The write-downs.</p> <p>5 Q So it's your position, then, that even though</p> <p>6 Bates Nissan recaptured the write-downs, the fact that</p> <p>7 it continued to use additional write-downs caused that</p> <p>8 income never to be recaptured? Is that the idea?</p> <p>9 A My -- my position is, one, the write-downs were</p> <p>10 not done based on any methodology. They were written</p> <p>11 down for the sole purpose of trying to avoid tax.</p> <p>12 With regard to the carry-forward, the</p> <p>13 number kept going up annually to maintain a particular</p> <p>14 amount of tax that wanted to be -- that the dealership</p> <p>15 wanted to pay.</p> <p>16 Q So are you saying the fact that the write-downs</p> <p>17 were, in your opinion, improper, that that essentially</p> <p>18 resulted in that recaptured gross profit not being</p> <p>19 covered by future write-downs or further write-downs?</p> <p>20 A Can you restate that for me, please?</p> <p>21 Q Yeah. I'm just trying to capture the logic of</p> <p>22 your position. And so I'm asking you: If we have</p> <p>23 recapture of gross profit and yet, in your opinion, we</p> <p>24 have the continuous accumulation of income over the</p> <p>25 years, year after year, what is causing recaptured</p>

Attachment 10

1235	<p>1 income to cumulatively move into the future</p> <p>2 cumulatively?</p> <p>3 MR. JARRETT: Your Honor, I need to</p> <p>4 object. It's, one, compound and vague. I am lost by</p> <p>5 the question, honestly.</p> <p>6 MR. COFFEY: Let me start over, if I may,</p> <p>7 Judge.</p> <p>8 JUDGE BENNETT: That's fine.</p> <p>9 MR. COFFEY: Okay.</p> <p>10 Q (BY MR. COFFEY) It's your opinion that you can</p> <p>11 have recaptured gross profit and the cumulation of</p> <p>12 taxable income over the years that is not -- that tax is</p> <p>13 not being -- being paid on. Is that what you're saying?</p> <p>14 A Yes, that's what I'm saying.</p> <p>15 Q Okay. Now, given that the write-downs</p> <p>16 occurred, can you point to anything in Bates Nissan's</p> <p>17 accounting that was improper?</p> <p>18 A I believe I already had testified to this, but</p> <p>19 you're -- from my perspective, you're mixing accounting</p> <p>20 principles with the fact that once you take it out, you</p> <p>21 have to put it back in somewhere. And that's what they</p> <p>22 did.</p> <p>23 The issue is why they were doing what they</p> <p>24 were doing and how they were doing what they were doing.</p> <p>25 So the fact that the money went out and then went back</p>	1237	<p>1 A Yes.</p> <p>2 Q Okay. But now, if your experts on deposition</p> <p>3 said, "We're not lawyers. We're not qualified to make a</p> <p>4 determination of what laws were violated," then who</p> <p>5 would you rely upon?</p> <p>6 A From my perspective, again, from a breach of</p> <p>7 contract, I'm not relying on an outside entity, a</p> <p>8 governmental agency, to say they broke the law. They</p> <p>9 breached our contract, and that's what we're terminating</p> <p>10 for.</p> <p>11 Q So you're not alleging, then, that Bates Nissan</p> <p>12 has violated any laws; you're alleging that the contract</p> <p>13 was breached because the write-downs were taken?</p> <p>14 MR. JARRETT: Objection, misstates prior</p> <p>15 testimony, Judge.</p> <p>16 JUDGE BENNETT: I think he's trying to</p> <p>17 clarify, and it's a fair question. The witness can</p> <p>18 answer.</p> <p>19 A So I'm sorry. Please --</p> <p>20 Q (BY MR. COFFEY) Sure. Let me repeat it.</p> <p>21 You're not pointing to any particular laws</p> <p>22 that have been violated by Bates. What you're saying is</p> <p>23 that you have breached our contract by taking the</p> <p>24 write-downs that you took?</p> <p>25 A I am saying that you breached our contract by</p>
1236	<p>1 in, I understand that you're trying to pin that down to</p> <p>2 the fact that that didn't -- that did happen, and it</p> <p>3 did; but the method in which all this occurred is not</p> <p>4 based on any factual or business operating premise to</p> <p>5 derive those numbers.</p> <p>6 So, yes, it went out, it came back in.</p> <p>7 The financial statements are incorrect. The capital</p> <p>8 information is not correct. That all happened.</p> <p>9 Q But all -- from what I'm hearing from you in</p> <p>10 your testimony now, all of that, in your opinion,</p> <p>11 happened because the write-downs were improper to begin</p> <p>12 with?</p> <p>13 A Absolutely.</p> <p>14 Q All right. Now, when you were discussing -- or</p> <p>15 rather not discussing what laws might have been violated</p> <p>16 by Bates, I believe you referred to your experts as the</p> <p>17 witnesses which will make the point of which tax laws</p> <p>18 were violated by Bates. Is that correct?</p> <p>19 A I don't know if they will address the actual</p> <p>20 law. I would have to defer -- I don't know the answer</p> <p>21 to that question.</p> <p>22 Q Okay. But you're -- any allegations that</p> <p>23 you're making of willful violation of the law, you're</p> <p>24 going to rely upon your experts to make them rather than</p> <p>25 you making them. Is that correct?</p>	1238	<p>1 using the methods and the approach that was taken.</p> <p>2 Correct. If that was your statement, that's correct.</p> <p>3 Q And you're not pointing to any particular laws</p> <p>4 that were violated by Bates?</p> <p>5 A That's correct.</p> <p>6 Q Curing the default. If, in fact -- let me give</p> <p>7 you a hypothetical. If, in fact, a dealer two months</p> <p>8 prior to the notice of termination begins to cure -- and</p> <p>9 by that I mean he starts to achieve on a monthly basis</p> <p>10 100-plus RSE, and he maintains that progress for the ten</p> <p>11 months following the notice of termination, in other</p> <p>12 words, an unbroken stream of monthly 100 percents --</p> <p>13 which starts inside the default period. Right?</p> <p>14 A I understand.</p> <p>15 Q The three and a half years that Bates had to</p> <p>16 cure, he starts at the -- in the last two months,</p> <p>17 continues on for 12 months without missing a 100 percent</p> <p>18 month yet, does that cure?</p> <p>19 A No.</p> <p>20 Q Okay. How about six months inside the default</p> <p>21 period and six months outside the default period? Does</p> <p>22 that cure?</p> <p>23 A No.</p> <p>24 Q So what you're saying, then, is that that</p> <p>25 100 percent RSE on 12-month rolling basis has to start</p>

Attachment 10

1239	1241
<p>1 at least 12 months into the -- or towards the end of the</p> <p>2 default period and be completed prior to the date that</p> <p>3 the notice of termination issues?</p> <p>4 A No, that's not what I'm saying.</p> <p>5 Q Well, what are you saying?</p> <p>6 A If a dealer were to show performance during the</p> <p>7 NOD period -- there is no cure to an NOT. If a dealer</p> <p>8 were showing performance improvement in the NOD period,</p> <p>9 like we did in this situation, we would likely extend or</p> <p>10 we would consider an extension. The situation that you</p> <p>11 gave me and you outlined in your question is, what</p> <p>12 happens after termination? The company's position is</p> <p>13 that when you issue termination, we're done. We're at</p> <p>14 the end of the line. There is no cure period for</p> <p>15 termination.</p> <p>16 So the time to cure is when you have the</p> <p>17 opportunity when you're in default. Once the decision</p> <p>18 is made, like we went through testimony, you have 90</p> <p>19 days and then it's ended.</p> <p>20 Q So the bottom line is, the full 12 months, the</p> <p>21 full rolling 12 months of 100 percent RSF, all of that</p> <p>22 has to occur during the default period, and none of it</p> <p>23 can leak out to after the notice of termination?</p> <p>24 A After the notice of termination has been</p> <p>25 communicated, that -- that's the end point. That's the</p>	<p>1 dealer a letter, a warning letter saying, "You need to</p> <p>2 get your capitalization up." Is that right?</p> <p>3 A That's correct.</p> <p>4 Q Okay. But what you're saying is, we were not</p> <p>5 getting good numbers -- not -- that's not it. You're</p> <p>6 saying that because of the write-downs, that was having</p> <p>7 an affect upon the capitalization numbers which were not</p> <p>8 explicit in Bates' financial statements?</p> <p>9 A They were explicit. They were listed. They</p> <p>10 weren't accurate.</p> <p>11 Q Because of the write-downs?</p> <p>12 A That's correct.</p> <p>13 Q The write-downs had a tendency to skew the</p> <p>14 capitalization numbers because it had a tendency to skew</p> <p>15 the profitability picture of the dealership?</p> <p>16 A Yes, sir.</p> <p>17 Q So it was nothing that Bates did intentionally</p> <p>18 about letting its capitalization fall below guide; it</p> <p>19 was because the write-downs were taken the way they</p> <p>20 were?</p> <p>21 MR. JARRETT: Objection, argumentative.</p> <p>22 JUDGE BENNETT: Overruled. I'll allow</p> <p>23 that.</p> <p>24 A The -- and I apologize, I got caught up. Can</p> <p>25 you restate it for me, please?</p>
1240	1242
<p>1 stop point.</p> <p>2 Q You were asked questions about Bates'</p> <p>3 capitalization. And we talked about that earlier in the</p> <p>4 day, and I believe your testimony was that Bates is not</p> <p>5 being terminated for capitalization issues. Is that</p> <p>6 still your testimony?</p> <p>7 MR. JARRETT: Objection, misstates prior</p> <p>8 testimony.</p> <p>9 MR. COFFEY: Well, then, let me just ask</p> <p>10 you directly.</p> <p>11 Q (BY MR. COFFEY) Are you attempting to</p> <p>12 terminate Bates Nissan for capitalization reasons?</p> <p>13 A 12 A.8., I believe it was, was outlined in the</p> <p>14 supplemental notice of termination in terms of it was a</p> <p>15 breach. The breach was, in fact, that the information</p> <p>16 that was provided with regard to capitalization was not</p> <p>17 accurate. It was misleading. And that was the reason</p> <p>18 for the breach.</p> <p>19 Whether -- I don't have accurate</p> <p>20 capitalization numbers to be able to tell you if it was</p> <p>21 above or below guide. I have bad information on the 12-</p> <p>22 and 13-month statement, and frankly, I don't know what</p> <p>23 their capital is for that period of time.</p> <p>24 Q Because if, in fact, Nissan sees a dealer's</p> <p>25 capitalization falling below guide, it will send the</p>	<p>1 Q (BY MR. COFFEY) Yes, sir. It's not because</p> <p>2 Bates was reporting false capitalization information to</p> <p>3 Nissan; it's because it took the write-downs that it</p> <p>4 took, and in Nissan's opinion, that changed the</p> <p>5 profitability picture of the dealership which, in turn,</p> <p>6 changed the capitalization picture as shown on the</p> <p>7 financial statements?</p> <p>8 A So one did the other. The write-downs or the</p> <p>9 changes, all of that affected the capital.</p> <p>10 Q That's what I'm asking you. Is that what</p> <p>11 you're saying?</p> <p>12 A That's what I'm saying.</p> <p>13 Q Okay. When you were talking about the loss to</p> <p>14 Nissan and you were talk -- you were giving testimony to</p> <p>15 the effect that because Bates was not sales effective</p> <p>16 for a period of time, that therefore you lost money. Do</p> <p>17 you recall that testimony?</p> <p>18 A Yes.</p> <p>19 Q Can you point to any particular figure of lost</p> <p>20 money that Bates was responsible for?</p> <p>21 A I can use the 1200 units that was used as the</p> <p>22 example, and it's a significant amount of money.</p> <p>23 Q Okay. And let's see how we got to that 1200</p> <p>24 units. Basically, you calculated the differential</p> <p>25 between Bates' RSE scores that it actually achieved and</p>

Attachment 10

1247	1249
<p>1 A Yes, they do.</p> <p>2 Q And during the tenure -- your tenure as</p> <p>3 regional vice president for the central region, how long</p> <p>4 was that, sir?</p> <p>5 A Just short of four years.</p> <p>6 Q And how many notices of termination issued in</p> <p>7 your four years?</p> <p>8 A There were two, maybe three.</p> <p>9 Q And that's for a 14-state region?</p> <p>10 A Fourteen states, almost four years.</p> <p>11 Q Thank you.</p> <p>12 MR. JARRETT: Pass the witness.</p> <p>13 MR. COFFEY: One last question, Judge.</p> <p>14 FURTHER RE-CROSS-EXAMINATION</p> <p>15 BY MR. COFFEY:</p> <p>16 Q Mr. Steiner, do you have any evidence of Bates</p> <p>17 Nissan's intent to misrepresent its financial status to</p> <p>18 Nissan, other than the fact that write-downs were taken</p> <p>19 by Bates Nissan and reported on the financial statement?</p> <p>20 A I can't speak to their intent. I don't know</p> <p>21 what their intent was.</p> <p>22 Q Okay. Well, that's fine, but do you have any</p> <p>23 evidence which would suggest an intent, other than that</p> <p>24 the write-downs were taken and reported on the financial</p> <p>25 statements?</p>	<p>1 call its next witness.</p> <p>2 MR. DONLEY: Call Bryne Liner, Your Honor.</p> <p>3 JUDGE BENNETT: Mr. Liner, if you'd raise</p> <p>4 your right hand.</p> <p>5 (Witness sworn)</p> <p>6 JUDGE BENNETT: Okay. And if you would,</p> <p>7 state and spell your name for the record.</p> <p>8 THE WITNESS: It's Bryne Liner. That's</p> <p>9 B-R-Y-N-E, last name, L-I-N-E-R.</p> <p>10 JUDGE BENNETT: You submitted prefiled</p> <p>11 testimony in this case, didn't you?</p> <p>12 MR. DONLEY: Exhibits 364 and Exhibits</p> <p>13 365, his reports, Your Honor.</p> <p>14 JUDGE BENNETT: Oh, that's right, because</p> <p>15 he's an expert. Sorry.</p> <p>16 MR. DONLEY: Correct.</p> <p>17 JUDGE BENNETT: And then at this point in</p> <p>18 time, do you recall preparing the expert reports, two</p> <p>19 expert reports in this case?</p> <p>20 THE WITNESS: Yes, sir.</p> <p>21 JUDGE BENNETT: Okay. And do you adopt</p> <p>22 all of the information that you prepared in your reports</p> <p>23 and the opinions reflected in your reports --</p> <p>24 THE WITNESS: Yes.</p> <p>25 JUDGE BENNETT: -- at this time under</p>
1248	1250
<p>1 A I believe the write-downs were taken and that</p> <p>2 they were taken to lower the taxable income from the</p> <p>3 store.</p> <p>4 Q And that's the only evidence of malintent that</p> <p>5 you have against Bates Nissan?</p> <p>6 A Well, we have the expert evidence that was</p> <p>7 provided with the deal jackets, the dollar amounts,</p> <p>8 trying to understand the methodology of what occurred</p> <p>9 and why it occurred. But other than the expert</p> <p>10 testimony -- or evidence, I don't have any other</p> <p>11 evidence other than that.</p> <p>12 Q Okay.</p> <p>13 MR. COFFEY: That's all, Judge.</p> <p>14 JUDGE BENNETT: Okay. Anything further?</p> <p>15 MR. JARRETT: Nothing further.</p> <p>16 JUDGE BENNETT: Okay. Thank you very</p> <p>17 much, Mr. Steiner. You're free to step down.</p> <p>18 MR. DONLEY: Your Honor, can we have just</p> <p>19 a moment to switch chairs?</p> <p>20 JUDGE BENNETT: That's fine.</p> <p>21 Let's go off the record.</p> <p>22 (Discussion off the record)</p> <p>23 JUDGE BENNETT: Let's go ahead and go back</p> <p>24 on the record.</p> <p>25 And at this time Nissan North America may</p>	<p>1 oath?</p> <p>2 THE WITNESS: Yes, sir.</p> <p>3 JUDGE BENNETT: Okay. You may proceed.</p> <p>4 MR. DONLEY: Thank you, Your Honor. It</p> <p>5 would be up to the other side to --</p> <p>6 JUDGE BENNETT: Do what? Are you</p> <p>7 tendering him for cross-examination?</p> <p>8 MR. DONLEY: Yeah, we're tendering him for</p> <p>9 cross, Your Honor.</p> <p>10 JUDGE BENNETT: Thank you.</p> <p>11 You may proceed when you're ready.</p> <p>12 MR. COFFEY: Thank you, sir.</p> <p>13 BRYNE LINER,</p> <p>14 having been first duly sworn, testified as follows:</p> <p>15 CROSS-EXAMINATION</p> <p>16 BY MR. COFFEY:</p> <p>17 Q Let's see. Mr. Liner, you are a certified</p> <p>18 fraud examiner. Is that correct?</p> <p>19 A Yes, sir.</p> <p>20 Q And as I understand it, a certified fraud</p> <p>21 examiner is an accountant who belongs to an association</p> <p>22 that's located here in Austin which gives a test</p> <p>23 periodically on the issue of fraud. Am I right so far?</p> <p>24 A No, sir.</p> <p>25 Q No?</p>

Attachment 10

1259	<p>1 MR. COFFEY: All right.</p> <p>2 Q (BY MR. COFFEY) So having the 75,000-dollar</p> <p>3 income goal, that was not improper. Correct?</p> <p>4 A Having the 75,000-dollar goal for any business</p> <p>5 is acceptable.</p> <p>6 Q Okay. But the manner of the write-downs you</p> <p>7 find unacceptable?</p> <p>8 A The way in which Bates wrote down its new and</p> <p>9 used inventory to achieve a predetermined taxable income</p> <p>10 goal without proper documentation, violating lower of</p> <p>11 cost or market, is improper.</p> <p>12 Q See, what keeps throwing me is you keep going</p> <p>13 back to that 75,000-dollar income goal. First, you say</p> <p>14 it's not improper, then you say it is improper to have</p> <p>15 that in your mind when you're writing down inventory.</p> <p>16 Is that what you're saying?</p> <p>17 A No, sir.</p> <p>18 Q Okay. Well, let's go back to the write-downs,</p> <p>19 then. The write-downs, you believe, are improper</p> <p>20 because they had a 75,000-dollar taxable income goal in</p> <p>21 mind when they made them. Correct?</p> <p>22 A That was Mr. Bates' goal, yes.</p> <p>23 Q Was that or was that not one of the improper</p> <p>24 things that you had found, writing down under LCM with a</p> <p>25 specific 75,000-dollar taxable income goal in mind?</p>	1261	<p>1 Is there anything more that they did, that</p> <p>2 Bates did, other than taking the write-downs with 75,000</p> <p>3 income in mind and not providing any documentation for</p> <p>4 those write-downs? Anything more that you consider</p> <p>5 improper?</p> <p>6 MR. DONLEY: Objection, Your Honor, asked</p> <p>7 and answered. It's getting on the verge of badgering.</p> <p>8 We've been around this question time and time and time</p> <p>9 again.</p> <p>10 JUDGE BENNETT: I'll allow him to answer</p> <p>11 this one last time, I think.</p> <p>12 A I'm going to tell you I've got a pretty good</p> <p>13 memory, but I am getting older. I would defer to my two</p> <p>14 reports that at least have 20 opinions. To the extent</p> <p>15 that those opinions address concerns or whatever's</p> <p>16 contained in my report would be my opinion, as I sit</p> <p>17 here right now.</p> <p>18 I don't remember all specific 20 bullet</p> <p>19 points. Some of them are duplicate, because we were</p> <p>20 asked to do a rebuttal report of Mr. Davis, as you are</p> <p>21 aware. But I would defer back to my reports and other</p> <p>22 than that, I can't think of anything else that we have</p> <p>23 not covered.</p> <p>24 Q (BY MR. COFFEY) But as you're sitting here</p> <p>25 right now, the only two things that you point to as</p>
1260	<p>1 A I would agree with that statement, yes.</p> <p>2 Q Okay. And then the other things that you found</p> <p>3 improper was, number one, no documentation for the</p> <p>4 write-downs. Correct?</p> <p>5 A That is correct.</p> <p>6 Q Was there anything else that you found to be</p> <p>7 improper?</p> <p>8 A Obviously, you've got financial statements</p> <p>9 being submitted to Nissan that are inaccurate,</p> <p>10 unreliable, and misleading. So that's a different</p> <p>11 factor, but I think it's a little different than the tax</p> <p>12 issue we were talking about.</p> <p>13 Q Well, right now, let's stick to what was</p> <p>14 improper about the write-downs. Let's get a full list</p> <p>15 of those, then we can go on to the statements filed with</p> <p>16 Nissan. Okay?</p> <p>17 Is there anything more that you think was</p> <p>18 improper in those write-downs?</p> <p>19 A Again, the write-downs do affect Nissan's</p> <p>20 financial data.</p> <p>21 Q Sir, we'll get -- believe me, you'll have</p> <p>22 plenty of opportunity to talk about the financial</p> <p>23 statements. Let's go ahead and make sure we've got a</p> <p>24 full list of everything that you think was improper as</p> <p>25 far as the write-downs were concerned.</p>	1262	<p>1 being improper was the 75,000-dollar goal and no</p> <p>2 documentation for the write-downs?</p> <p>3 MR. DONLEY: Objection, Your Honor,</p> <p>4 misstates his testimony and asked and answered and asked</p> <p>5 and answered.</p> <p>6 JUDGE BENNETT: Sustained. I think the</p> <p>7 witness referred to his report as the best indicator of</p> <p>8 his opinions, and I'm going to allow him to do that.</p> <p>9 Q (BY MR. COFFEY) And then I believe the next</p> <p>10 thing that you recall that concerned you was the fact</p> <p>11 that by reporting these write-downs to Nissan and</p> <p>12 recapturing the write-downs in terms of gross profit,</p> <p>13 that constituted submission of false information to</p> <p>14 Nissan?</p> <p>15 A I think that's a kind way of saying it, yes.</p> <p>16 Q Okay. Well, let's use false and fraudulent,</p> <p>17 then, which I believe is what you used in your report.</p> <p>18 Is that correct?</p> <p>19 A Again, I don't remember the specific language</p> <p>20 of my report, but I have used some terms as misleading,</p> <p>21 false, improper, not reliable. Those are some of the</p> <p>22 adjectives that come to mind. If I used "fraudulent," I</p> <p>23 may have said that. Again, I don't remember the exact</p> <p>24 language.</p> <p>25 Q And I think a fair amount of your report was</p>

Attachment 10

1263	<p>1 devoted to the issue of whether or not a dealer could</p> <p>2 depreciate his inventory as opposed to write it down.</p> <p>3 Do you recall that?</p> <p>4 A I recall my report, yes.</p> <p>5 Q Then you recall that you spent a fair amount of</p> <p>6 time telling the court that a dealer cannot depreciate</p> <p>7 inventory; he can only write it down. Is that correct?</p> <p>8 A At the time of my first report, part of my</p> <p>9 report dealt with the subject matter of depreciation.</p> <p>10 The angle was, is that Bates Nissan claims they could</p> <p>11 depreciate inventory. Well, in an accounting world, you</p> <p>12 can't depreciate inventory. You can depreciate items</p> <p>13 used in your business, like furniture and fixtures, or</p> <p>14 cars used in your business placed in service.</p> <p>15 So we did spend part of our report</p> <p>16 addressing the fact that the, quote/unquote,</p> <p>17 depreciation would be improper with respect to</p> <p>18 inventory.</p> <p>19 I believe after I submitted my report, the</p> <p>20 attorneys for Bates Nissan modified their pleading</p> <p>21 saying, "Oops, we meant to say 'write-downs,'" which I</p> <p>22 understand that term and has a whole different</p> <p>23 perspective from an accounting perspective.</p> <p>24 But in addition to depreciation, our</p> <p>25 report, at least the first report addressed a number of</p>	1265	<p>1 throughout my report, and I reference my report in my</p> <p>2 deposition, we talked about tax evasion and possibly tax</p> <p>3 fraud. And as a CFE, again, I can't draw a legal</p> <p>4 conclusion with respect to fraud, but I can inform the</p> <p>5 court about badges of fraud, irregularities, red flags</p> <p>6 that cause me concern as a certified fraud examiner,</p> <p>7 which I hope we covered in my deposition with you.</p> <p>8 But clearly, I did say, "This is not a</p> <p>9 fraud case," because I don't expect this judge or the</p> <p>10 court to say, "We find fraud," and someone's going to go</p> <p>11 and get three meals and a cot. I don't expect that to</p> <p>12 be on the menu.</p> <p>13 Q Well, let me go ahead and read from your</p> <p>14 deposition exactly what you did say.</p> <p>15 MR. DONLEY: Can you give me just a</p> <p>16 minute, Mr. Coffey?</p> <p>17 MR. COFFEY: Sure.</p> <p>18 MR. DONLEY: Where are you, please?</p> <p>19 MR. COFFEY: I'm on Page 28 of his</p> <p>20 deposition.</p> <p>21 MR. DONLEY: Give me just a moment.</p> <p>22 MR. COFFEY: If we could, let's put that</p> <p>23 in front of him.</p> <p>24 THE WITNESS: Thank you.</p> <p>25 Q (BY MR. COFFEY) Are you there, sir, Page 28?</p>
1264	<p>1 lower of cost or market valuation issues, the financial</p> <p>2 statements to Nissan, so depreciation was just one</p> <p>3 component of that first report that I issued.</p> <p>4 Q If, in fact, you found all of these fraud red</p> <p>5 flags, why did you tell me on your deposition that this</p> <p>6 is not a fraud case?</p> <p>7 A When I was deposed, you asked me if this was a</p> <p>8 fraud case, and I said from my perspective, from what I</p> <p>9 understand Nissan is alleging, this is a termination</p> <p>10 case. We're in this courtroom, and my understanding is</p> <p>11 this is not a criminal court matter. So from that</p> <p>12 perspective, it's not a fraud case from a legal finding.</p> <p>13 However, in my report, I did talk about tax evasion,</p> <p>14 possibly tax fraud if proven in a court.</p> <p>15 So those are some of the adjectives that I</p> <p>16 know I put in my first report, so clearly the subject</p> <p>17 matter of fraud or tax evasion were discussed in my</p> <p>18 report and probably in my deposition.</p> <p>19 Q We're going to go to your deposition in a</p> <p>20 minute, but I want to get your recollection of what you</p> <p>21 testified to. My notes say that you said this is not a</p> <p>22 fraud case, so you did not look at the elements of</p> <p>23 fraud?</p> <p>24 A It's not a fraud case from a legal court</p> <p>25 perspective of this is a fraud finding. However,</p>	1266	<p>1 A I am, yes.</p> <p>2 Q Okay. At Line 4, you said: I mean, this is</p> <p>3 not a fraud case, so I did not look at the elements of</p> <p>4 fraud.</p> <p>5 Was that your testimony then?</p> <p>6 A Yes.</p> <p>7 Q Is that your still your testimony now?</p> <p>8 A With respect to elements of fraud, at the time</p> <p>9 I did not address that. But during the deposition at</p> <p>10 this time, we talked about lower of cost or market</p> <p>11 violations. We talked about tax evasion. We also</p> <p>12 talked about fraud. For me, elements of fraud is if you</p> <p>13 go to the CFE manual, there's a whole section on the</p> <p>14 elements of fraud, and I didn't go to the manual at that</p> <p>15 time and pull up here are the elements of fraud.</p> <p>16 Q At this time when I was asking you about fraud,</p> <p>17 why didn't you tell me about all these red badges of</p> <p>18 fraud that you're now claiming you saw?</p> <p>19 A We talked about tax evasion and tax fraud if</p> <p>20 proven in a court of law, I believe, in my deposition.</p> <p>21 Q That's right. I believe one of your</p> <p>22 conclusions of law -- let's see if we can find it --</p> <p>23 Conclusion of Law 8. And I believe it was in your</p> <p>24 second report -- here it is. If you could turn to Page</p> <p>25 7 of your June 12, 2015 report.</p>

Attachment 10

1319	1321
<p>1 on new and used motor vehicles.</p> <p>2 MR. DONLEY: Your Honor, may I go to the</p> <p>3 board, please?</p> <p>4 JUDGE BENNETT: You may.</p> <p>5 Q (BY MR. DONLEY) Were you here, Mr. Liner, when</p> <p>6 I prepared, along with Mr. Davis' assistance, R-490?</p> <p>7 A Yes, I was.</p> <p>8 Q Now, can you tell us based generally on R-490,</p> <p>9 what were the effects of the write-downs that Bates</p> <p>10 Nissan took on the new and used motor vehicles at issue</p> <p>11 in this case?</p> <p>12 A The impact is that the write-downs accumulate</p> <p>13 over time. They go from one year and then carry over</p> <p>14 into the next year.</p> <p>15 Q Based on what you see on 490, can you explain</p> <p>16 to the judge what you mean by they accumulate and carry</p> <p>17 over based on these numbers? Would you use the specific</p> <p>18 numbers?</p> <p>19 A Sure. In Year 1, if you start out with</p> <p>20 \$75,000 -- 475 profit, and you want to achieve a taxable</p> <p>21 income of 75,000, that means you've got to write down</p> <p>22 \$400,000 and pay taxes on 75. That 75 -- 400 has got to</p> <p>23 go somewhere, so it flips over into Year 2.</p> <p>24 So in Year 2, let's assume in this example</p> <p>25 you have 475 of profits. Again, you have to account for</p>	<p>1 A I believe so, yes.</p> <p>2 Q Does that appear that that's what Bates Nissan</p> <p>3 was doing in addition to the other things that you've</p> <p>4 testified to?</p> <p>5 A Yes.</p> <p>6 JUDGE BENNETT: Well, just to be clear,</p> <p>7 using the example that you're using, you're assuming</p> <p>8 that they have consistent current profits of \$475,000</p> <p>9 each year, new profits, basically --</p> <p>10 THE WITNESS: That is correct, yes.</p> <p>11 JUDGE BENNETT: -- separate and apart from</p> <p>12 any recapture?</p> <p>13 THE WITNESS: That's correct.</p> <p>14 Q (BY MR. DONLEY) I want to focus on one of the</p> <p>15 opinions that you set forth in your report. I think I</p> <p>16 want to go over to Exhibit 365. That's your rebuttal</p> <p>17 report, is it not?</p> <p>18 MR. DONLEY: If you'd bring that up,</p> <p>19 please.</p> <p>20 Q (BY MR. DONLEY) That's your rebuttal report,</p> <p>21 sir?</p> <p>22 A It is, yes.</p> <p>23 Q I want to focus on Opinion No. 9, if we could,</p> <p>24 which is on Page 8 of the document, I believe.</p> <p>25 MR. DONLEY: There you go. Blow up that</p>
1320	1322
<p>1 the 400,000 that was carried over or accumulated from</p> <p>2 the prior year. So your total profit is \$875,000. If</p> <p>3 you were to report taxable income of 75, you've got to</p> <p>4 account for \$800,000 of write-offs. That carries over</p> <p>5 into Year 3.</p> <p>6 All of a sudden we're at a million 275.</p> <p>7 And to hit taxable goal of 75,000, that means we have to</p> <p>8 do write-offs of \$1.2 million.</p> <p>9 So over time, the write-downs increase if</p> <p>10 we're going to stay at a predetermined taxable income</p> <p>11 level at \$75,000.</p> <p>12 Q Question for you, Mr. Liner: The \$400,000 of</p> <p>13 recovered profits in Year 2, do you see that, sir?</p> <p>14 A I do.</p> <p>15 Q Now, since \$800,000 in this example had to be</p> <p>16 written down in Year 2 to get to the 75,000-dollar</p> <p>17 taxable income, is there any tax law, regulation,</p> <p>18 publication, or any accounting principles that would</p> <p>19 allow Bates Nissan to use write-downs for new and used</p> <p>20 motor vehicles in Year 2 to recapture yet, once again,</p> <p>21 part of the write-down that was brought over from Year 1</p> <p>22 into Year 2 which is that \$400,000?</p> <p>23 A Not that I'm aware of, no.</p> <p>24 Q Would that be a violation of 1.471-4, I believe</p> <p>25 that we looked at to do that?</p>	<p>1 opinion for me.</p> <p>2 Thank you.</p> <p>3 Q (BY MR. DONLEY) That opinion says, "It appears</p> <p>4 that both Mr. Davis and Mr. Woodward have failed to</p> <p>5 address the specific testimony, facts, and circumstances</p> <p>6 relating to this matter in their reports." Right?</p> <p>7 A Yes.</p> <p>8 Q What are you talking about here? If you would,</p> <p>9 please tell the judge what you're talking about that you</p> <p>10 believe Mr. Davis and Mr. Woodward both failed to</p> <p>11 address?</p> <p>12 A In their reports and in Mr. Davis' testimony,</p> <p>13 they sort of use a whole lot of words to talk about LIFO</p> <p>14 and GAP violations, but the elephant in the room is</p> <p>15 improper inventory write-downs, reductions. That's the</p> <p>16 64-dollar question.</p> <p>17 And they failed, in my opinion, to say,</p> <p>18 "Bates did it properly." They sort of skirt around the</p> <p>19 issue and try to justify new cars with -- or Mr. Davis</p> <p>20 did. Mr. Davis tried to justify new car write-downs by</p> <p>21 looking at a used car book -- Blue Book, Black Book --</p> <p>22 but you can't make that distinction.</p> <p>23 So the real issue here is inventory</p> <p>24 write-downs that were done improperly with respect to</p> <p>25 the lower of cost or market. No documentation, no</p>

Attachment 10

1323	<p>1 support. And the goal was to hit a predetermined</p> <p>2 taxable income level.</p> <p>3 My opposing two experts have failed to</p> <p>4 address the central issue that I believe brings us here.</p> <p>5 And it doesn't do me any good to talk about LIFO or</p> <p>6 finance stuff, because those are irrelevant issues as I</p> <p>7 appreciate this hearing and our time.</p> <p>8 MR. DONLEY: Your Honor, I should have</p> <p>9 done it while I was over there. May I go back to the</p> <p>10 chart just for a moment?</p> <p>11 JUDGE BENNETT: You may.</p> <p>12 Q (BY MR. DONLEY) There is an example that</p> <p>13 Mr. Coffey gave you. I'm going to make sure we look at</p> <p>14 that more specifically.</p> <p>15 Oh, and by the way, before I forget, based</p> <p>16 on what you saw in all the documents and testimony that</p> <p>17 you've heard, did Bates Nissan misrepresent information</p> <p>18 on their financial returns to Nissan?</p> <p>19 A Absolutely. Yes.</p> <p>20 Q For what years?</p> <p>21 A Anytime they submitted a financial statement,</p> <p>22 it was improper as long as there was an inventory</p> <p>23 write-down that was improper.</p> <p>24 Q Would that have been from at least 2010 to</p> <p>25 2013?</p>	1325	<p>1 report that on financial statements to a manufacturer?</p> <p>2 A It would be improper. It would still be wrong,</p> <p>3 because when you report sales of a vehicle, and the</p> <p>4 profits you realized on that sale, even if you sold it</p> <p>5 in the same month, the financial would be improper. So</p> <p>6 what I said earlier, where there would be impact, there</p> <p>7 would be an impact on the Nissan financial statement.</p> <p>8 Q And the impact would be the \$5,000?</p> <p>9 A Which would be improper, yes.</p> <p>10 Q And then finally, Mr. Linc, I asked</p> <p>11 Mr. Davis -- this was my last question to him, and I'll</p> <p>12 make it my last question to you.</p> <p>13 Have you seen any documents or evidence</p> <p>14 that suggest that Bates Nissan did anything other than</p> <p>15 make up the used and new motor vehicle write-down in its</p> <p>16 head, put them down on a piece of paper, and send them</p> <p>17 to Mr. Gautier to be included on a tax return?</p> <p>18 A As Mr. Davis said, and I agree, I've seen no</p> <p>19 documentation other than it was made up and put on a</p> <p>20 piece of paper.</p> <p>21 MR. DONLEY: I'll pass the witness, Your</p> <p>22 Honor.</p> <p>23 JUDGE BENNETT: You may proceed.</p> <p>24 MR. COFFEY: Yes, sir.</p> <p>25</p>
1324	<p>1 A Yes.</p> <p>2 Q The example that I think Mr. Coffey spoke to</p> <p>3 you about was if there was a vehicle -- assume Bates</p> <p>4 vehicle bought a vehicle in November for \$20,000, writes</p> <p>5 it down in November. So it's a November write-down.</p> <p>6 Put that lower arrow there for the write-down of</p> <p>7 \$15,000. Do you remember this example?</p> <p>8 A I do.</p> <p>9 Q All right. And then sells the vehicle at</p> <p>10 retail. So in November it sold for 15,000. Sold for</p> <p>11 20,000, I think was his example. I apologize. Sells it</p> <p>12 for 20,000. I believe you testified the adjusted basis</p> <p>13 for that vehicle would be 15,000. Correct?</p> <p>14 A Yes.</p> <p>15 Q All right. So what was the actual gross profit</p> <p>16 without the adjusted basis?</p> <p>17 A The gross profit without the adjusted basis</p> <p>18 would be zero.</p> <p>19 Q All right. Gross profit, zero. And what about</p> <p>20 with a dealer recapture on its financial statement to</p> <p>21 Nissan in this one?</p> <p>22 A The angle there, just to clarify this, is that</p> <p>23 a recapture would be a \$5,000 profit.</p> <p>24 Q And so that would be on that month's financial</p> <p>25 statement. Is that an accurate and correct way to</p>	1326	<p>1 RE-CROSS-EXAMINATION</p> <p>2 BY MR. COFFEY:</p> <p>3 Q After five days of testimony in this case, are</p> <p>4 you testifying to this Court that it's your</p> <p>5 understanding that Bates Nissan is taking the position</p> <p>6 that it made these write-downs properly?</p> <p>7 A I believe Bates Nissan has acknowledged that</p> <p>8 the write-downs were done improperly.</p> <p>9 Q Okay. So it's not your testimony that Bates</p> <p>10 Nissan has ever maintained in these proceedings that it</p> <p>11 did these write-downs properly or in accordance with all</p> <p>12 of the tax regulations and rules. Correct?</p> <p>13 A I believe I -- Mr. Schneider's letter, the law</p> <p>14 firm that basically comes to the IRS and says, you know,</p> <p>15 we've been doing this wrong, and Mr. Davis testified,</p> <p>16 you know, we got to use invoice for new cars. I believe</p> <p>17 Bates Nissan has acknowledged that they've been doing</p> <p>18 inventory lower of cost to market improperly for many,</p> <p>19 many years, at least the time period that I looked at.</p> <p>20 Q Okay. And the time period that you looked at</p> <p>21 would be 2009 through 2013. Correct?</p> <p>22 A That is correct.</p> <p>23 Q With the exception of 2010 where no new vehicle</p> <p>24 write-downs were taken -- actually, no vehicle</p> <p>25 write-downs were taken at all in 2010. Correct?</p>

Attachment 10

1331	1333
<p>1 Q Sir, sir, my question was, can you point to 2 anywhere in the literature where it says when you're 3 writing down, you cannot have a predetermined taxable 4 income level in mind? 5 A I cannot. 6 Q Now, you have seen the supplemental notice of 7 termination in this case. In fact, you just reviewed it 8 with counsel. Correct? 9 A I'm sure I've seen it. 10 Q Okay. I'm going to pull it up for you here. 11 MR. COFFEY: Let's go ahead and pull up 12 C-34. 13 Q (BY MR. COFFEY) Let's go ahead and look at 14 BN002663. Let's look at the third full paragraph down 15 where it says, "Nissan retained the expert services of 16 Mr. Herb Walter. During Mr. Walter's analysis of the 17 matter, and in his report, Mr. Walter observed that 18 Bates Nissan took a cumulative \$2.7 million reduction in 19 net profits and taxable income through the means 20 described in his report." 21 You've seen that language before, have you 22 not? 23 A I have. 24 Q And you have analyzed the truth of that 25 statement, have you not?</p>	<p>1 know, that's the -- he provided the information that he 2 had received from Bates Nissan on the issues that we've 3 reviewed. Correct? 4 A That would be my assumption, yes. 5 Q And then one last question, Mr. Liner. Is 6 there a difference between having a taxable income in 7 mind and hoping to hit it and saying I want to pay taxes 8 on 75,000 and that I'm going to shape my deductions to 9 ensure I do -- in other words, is there a difference 10 between saying I simply want to pay \$75,000 in taxes on 11 taxable income and hope I get there versus shaping 12 deductions that are inappropriate and unlawful to get to 13 \$75,000 in taxable income? 14 A On one end, it's great to have a goal. On the 15 other end, it's tax fraud if proven in a court of law. 16 MR. DONLEY: Your Honor, I'll pass the 17 witness. 18 JUDGE BENNETT: Anything further? 19 MR. COFFEY: I don't think so, Judge. 20 JUDGE BENNETT: Thank you very much. 21 You're free to step down. 22 THE WITNESS: Thank you. 23 JUDGE BENNETT: Do you want to call your 24 next witness? 25 MR. DONLEY: Can I have just two seconds,</p>
1332	1334
<p>1 A I've read the report of Mr. Walters. I have 2 read this document. I have not tested his numbers in 3 any way, shape, or form. That was not in my scope of 4 work to do. But I'm sure he'll testify in a couple of 5 days. 6 Q Can you or can you not testify as to whether or 7 not the allegation or the observation that Bates took a 8 cumulative \$2.7 million reduction is true and accurate? 9 A I believe it is true and accurate. 10 Q And how do you justify -- or how do you swear 11 that with Mr. Schneider's \$726,583 recapture? 12 A My understanding is the Delta is the financial 13 impact or the financial numbers that were received by 14 Nissan versus the IRS. So I'm sure Mr. Walters will be 15 able to explain that when you depose him -- or when he 16 testifies. But that's my understanding generically. 17 It's not something I proved or ticked and tied. 18 Q Okay. 19 MR. COFFEY: Pass the witness, Judge. 20 MR. DONLEY: Couple of questions, Your 21 Honor, if I may. 22 FURTHER REDIRECT EXAMINATION 23 BY MR. DONLEY: 24 Q Just to clarify, Mr. Liner, the information 25 that Mr. Schneider provided to the IRS as far as we</p>	<p>1 Your Honor? 2 JUDGE BENNETT: That's fine. We'll go off 3 the record. 4 (Brief recess) 5 JUDGE BENNETT: Let's go ahead and go back 6 on the record. You may call your next witness for the 7 record. 8 MR. DONLEY: Your Honor, Nissan will call 9 Mr. Herb Walter. 10 (Witness Walter sworn) 11 JUDGE BENNETT: If you would, state and 12 spell your name for the record, please. 13 THE WITNESS: Herbert Walter, W-A-L-T-E-R. 14 JUDGE BENNETT: And you have prepared 15 expert reports. Just one or two? 16 MR. DONLEY: It's three, Your Honor. 17 JUDGE BENNETT: I'm sorry. 18 MR. DONLEY: Exhibit 366, Exhibit 367, and 19 Exhibit 368. Those will all be R exhibits, R-366, 20 R-367, and R-368. 21 JUDGE BENNETT: So, Mr. Walter, you're 22 familiar with the three reports you've prepared in this 23 case that were just identified? 24 THE WITNESS: Yes, I am, Your Honor. 25 JUDGE BENNETT: Do you offer all of the</p>

Attachment 10

1335	<p>1 same opinions as contained in those reports at this time</p> <p>2 under oath.</p> <p>3 MR. DONLEY: Your Honor, may I interrupt?</p> <p>4 There is one thing. And you'll understand why I'm doing</p> <p>5 that. We found out over the weekend there's, I believe</p> <p>6 four or five of Mr. Walter's charts where he had data</p> <p>7 processing errors. He grabbed the wrong numbers, made</p> <p>8 some wrong calculations. And I didn't want him to swear</p> <p>9 to them before we did, so I apologize. I almost missed</p> <p>10 that.</p> <p>11 What we would do. Your Honor, is now offer</p> <p>12 those corrected pages in place of those in his report,</p> <p>13 which were in Exhibit R-368. To be clear, Your Honor,</p> <p>14 over the weekend, we did prepare those. we fixed the</p> <p>15 numbers, we sent those to opposing counsel, pointed out</p> <p>16 the numbers that the issues were, explained they were</p> <p>17 just data processing errors, nothing else, no new</p> <p>18 opinions, just simply some issues with the data</p> <p>19 processing itself. I'm not sure we had reached an</p> <p>20 agreement yet on getting those in, but we certainly want</p> <p>21 those in as replacement pages in Mr. Walter's second</p> <p>22 rebuttal report, which is R-368 before he swears to it.</p> <p>23 MR. COFFEY: We have no objection, Your</p> <p>24 Honor.</p> <p>25 JUDGE BENNETT: Okay.</p>	1337	<p>1 JUDGE BENNETT: That's correct.</p> <p>2 THE WITNESS: It would change some numbers</p> <p>3 in the narrative, I would expect.</p> <p>4 JUDGE BENNETT: Those will need to be</p> <p>5 corrected then. I'm not going to have him adopt his</p> <p>6 reports at this time. You'll need to get those</p> <p>7 corrected. And then the amended ones can be adopted</p> <p>8 under oath once they've been fully revised.</p> <p>9 I'm going to allow him to be tendered for</p> <p>10 cross-examination with the understanding that his</p> <p>11 reports -- he can be questioned on them, you know,</p> <p>12 ultimately, certainly examined. But the reports</p> <p>13 themselves will not be adopted under oath until such</p> <p>14 time as they're properly revised and corrected.</p> <p>15 MR. DONLEY: All right. And if I may</p> <p>16 offer, Your Honor, I will tell opposing counsel, please</p> <p>17 exam away. I know if Mr. Walter needs to change a</p> <p>18 number in his second rebuttal report that we haven't</p> <p>19 changed yet, he would be able to do that so that all</p> <p>20 questions can be asked and we can move forward.</p> <p>21 THE WITNESS: If I might speak to that for</p> <p>22 a second, Your Honor. If we could take just a few</p> <p>23 minutes, I can call back to my office and have somebody</p> <p>24 working on that while we're still going on the</p> <p>25 examination over the afternoon.</p>
1336	<p>1 MR. DONLEY: Your Honor, if I may further</p> <p>2 then, what we would be doing then in R-368 is replacing</p> <p>3 Attachment 5 with Attachment 5R, with the R being</p> <p>4 replacement. We would be replacing Attachment 6 with</p> <p>5 Attachment 6R. Replacing Attachment 7 with Attachment</p> <p>6 7R. Replacing Attachment 8 with Attachment 8R.</p> <p>7 Replacing Attachment 9 with Attachment 9R. And</p> <p>8 replacing Attachment 10 now with Attachment 10R. And</p> <p>9 then that would correct Mr. Walter's second rebuttal</p> <p>10 report in that regard.</p> <p>11 JUDGE BENNETT: And does that require any</p> <p>12 changes in the actual substance of his report itself in</p> <p>13 terms of his --</p> <p>14 MR. DONLEY: Correct me if I'm wrong, but</p> <p>15 I believe the answer is absolutely no. It's just data</p> <p>16 entry things. And although it changed some numbers, it</p> <p>17 doesn't change the outcomes or the opinions reached from</p> <p>18 them.</p> <p>19 JUDGE BENNETT: Does it change, though,</p> <p>20 the numbers contained in a discussion in his report such</p> <p>21 that those would have to be corrected?</p> <p>22 MR. DONLEY: I don't believe so. It does?</p> <p>23 THE WITNESS: It probably does. In the</p> <p>24 narrative, you're saying, Your Honor? In the narrative</p> <p>25 portion of the report?</p>	1338	<p>1 JUDGE BENNETT: That's fine. Let's go off</p> <p>2 the record to allow that.</p> <p>3 MR. DONLEY: Thank you, Your Honor.</p> <p>4 (Recess: 3:45 p.m. to 3:50 p.m.)</p> <p>5 JUDGE BENNETT: Let's go ahead and go back</p> <p>6 on the record at this time. And as I indicated before</p> <p>7 we went off the record, the witness is going to be</p> <p>8 making some corrections to one or more of his reports</p> <p>9 that were prepared in this case to reflect the changes</p> <p>10 in the tables that were replaced, and -- but that's not</p> <p>11 going to stop us from proceeding with his testimony.</p> <p>12 So is there anything else before he is</p> <p>13 turned over for cross-examination?</p> <p>14 MR. DONLEY: I believe that's it, Your</p> <p>15 Honor. Thank you very much.</p> <p>16 JUDGE BENNETT: Then, you may proceed.</p> <p>17 MR. COFFEY: Thank you, Judge.</p> <p>18 HERBERT WALTER,</p> <p>19 having been previously duly sworn, testified as follows:</p> <p>20 CROSS-EXAMINATION</p> <p>21 BY MR. COFFEY:</p> <p>22 Q Can you see me okay, Mr. Walter, from there?</p> <p>23 A I can. But I can barely hear you.</p> <p>24 Q Here we go with this microphone again. Let me</p> <p>25 try a little closer. Can you hear me better now?</p>

Attachment 10

1351	<p>1 relationships doesn't mean slow. Building relationships 2 is just part of selling. 3 Q So your thesis is that you can build just as 4 many and as quality relationships by selling faster to 5 the customer than by selling slower to the customer? 6 A I wouldn't summarize it that way. I've side 7 what I've said. It's a process for dealers that they 8 have to balance the -- the decisions they make with 9 respect to staffing, training, handling of customers, 10 moving the customer through the sales process, following 11 up with those customers. You put it all together, and 12 that's how dealers run dealerships. And we're talking 13 in this case specifically about the new process. But it 14 would ripple over into used and service and parts also. 15 Q So you're saying now that it's a balancing act 16 between building the relationships and selling fast 17 enough to compete with those that you're competing with 18 for allocation? 19 A It's beyond that. It's a balancing act of all 20 the management decisions because everything they do, 21 whether the floor is swept, whether the bathroom's 22 clean, anything in terms of building those relationships 23 is relevant at some level to the customer relationships 24 and your ultimate sales process. 25 Q Do you agree that it is important for the</p>	1353	<p>1 to which that CSI score indicates that the dealer is 2 developing good relations with his customers? 3 A It's a metric that -- with different titles. 4 Some call is CSI; some use some other initials. But 5 both of the metrics are metrics to help measure the 6 satisfaction of their customers across their dealer 7 body. And so it's certainly a measure. I would agree 8 with you there. 9 Q And SSI, as you indicated, is sales 10 satisfaction index. Correct? 11 A I think that's typically what the three 12 initials stand for, yeah. 13 Q And that index attempts to determine the degree 14 to which the customer is satisfied with the sales 15 process at the dealership? 16 A It's a broad general statement. I would agree 17 with that. 18 Q Which is, again, an indicator of the degree to 19 which the dealer is developing good relationships with 20 the customer? 21 A I think both these metrics are measuring more 22 than just relationships. It's typically based on some 23 questionnaires. You may go into -- I don't know what it 24 is, 10, 20, 30 questions, whatever they all are. And so 25 it's broader than just relationships. It's the whole</p>
1352	<p>1 prosperity of both the Nissan brand and its dealerships 2 that dealers be given an opportunity to build 3 relationships with their customers? 4 A I would expect that's true for both, sure. 5 Q Okay. And, in fact, Nissan attempts to measure 6 the degree to which a dealer develops good relationships 7 with customers with metrics such as CSI and SSI. 8 Correct? 9 A Nissan does and the other manufacturers I'm 10 familiar with do also, sure. 11 Q Sure. And for the Court's benefit, CSI is 12 defined as what? 13 A You've got customer service index and sales 14 index. You're measuring both the service and parts 15 effectiveness as well as the new sales process 16 effectiveness. 17 Q Right. And CSI is, as you said, customer 18 service index? 19 A Right. 20 Q And it produces an actual score. Right? 21 A Correct. 22 Q And Nissan compares that with the scores of 23 other dealers. Correct? 24 A Yes. 25 Q And comes to some conclusions as to the degree</p>	1354	<p>1 package of the customer experience with respect to what 2 they found or what they experienced at the dealership. 3 Q Okay. Let's go on to the next conclusion that 4 you came to, and I believe that's on Page 4 under 5 conclusion 11.c. "Bates' financial statements reflect 6 year-end adjustments and accounts that call into 7 question the statement's accuracy and reliability." And 8 we're going to get to that, believe me, in detail. 9 So let's skip past that one for a moment. 10 And let's look at 11.d., "Bates substantially 11 underperformed the geographic comparison dealerships and 12 the size-based comparison dealerships based on its 13 return on sales and return on assets." 14 What -- other than just being 15 self-explanatory, tell me what return on sales is and 16 what return on assets is. 17 A Well, I have to give you two answers to this. 18 Let me explain -- 19 Q Sure. 20 A -- a bit, if I could. 21 The return on sales is simply 22 profitability over sales. What percentage of your top 23 line dropped to your bottom line, if you will. So if 24 you sold a hundred dollars, did you make a dollar. 25 That's a 1 percent return on sales. If I'm making 1</p>

Attachment 10

1355	<p>1 percent and you're making 1.5 percent on a relative 2 basis, you're more profitable than I am. 3 Return on assets is the same thing. 4 You've got a balance sheet. You've got a million 5 dollars in total assets. And so did you make -- how did 6 you deploy those assets to earn profitability. And so 7 return on assets is a similar kind of metric. 8 The reason I said I'd have to give you two 9 answers is that in my first report, the one we're 10 looking at, 366, that's when I first raised the flag 11 that there was something wrong with Bates' financial 12 statements. And so while I looked at some of the 13 metrics that we'll talk about, presuming you ask me 14 about them, it also was very preliminary in the sense 15 that at that time, I didn't have the Schneider letter, I 16 didn't have the deal jackets, I didn't have the detail 17 of the write-downs that we spent all last week in 18 hearing testimony about. And so whether those financial 19 statements and the metrics are even usable or reliable, 20 now that it's not October of '14, it's September of '15, 21 are certainly called into question. 22 Q So this analysis that you did which resulted in 23 I.I.d., you're not going to stand by that analysis -- 24 wait -- at this point in time because you believe that 25 Bates' financial statements are so inaccurate that you</p>	1357	<p>1 combine those two of the write-downs in the management 2 of the 75,000 approximately for taxable income. Those 3 two together. But it is way beyond your question of is 4 it just LCM. The answer is absolutely not. 5 Q Are you finished? 6 A I am. 7 Q We can use your language, then. 8 In your opinion, Bates Nissan misused LCM 9 in order to achieve a predetermined taxable income of 10 \$75,000 a year. Fair? 11 A Yes. 12 Q Okay. Then, as I recall, the second reason 13 that you thought Bates' financial statements were 14 inaccurate is because he didn't use all of the 15 write-downs he could have used under LCM. Is that 16 correct? 17 A Well, from that -- I think it was a broader 18 discussion than that. But from an accounting 19 standpoint, consistency and completeness are important. 20 And so it's not about did he or didn't he use them all. 21 It's about did he use them properly, did he use them 22 consistently, and did he use them against the breadth of 23 the inventory. 24 Q Okay. So in your opinion, he did not use the 25 write-downs consistently because he did not take down</p>
1356	<p>1 don't know if they support this analysis or not? 2 A Well, they don't support the analysis that I 3 did in October of '14. I did update some of these and 4 analyses in July of '15 report. And so I can't -- now, 5 that I know more than I knew then, I stand by what I 6 knew then. But what I knew then was raising a flag that 7 I saw some issues, problems, and so forth which now have 8 been further developed over the course of the 9 intervening year. 10 Q And let's go ahead and list all of the reasons 11 why you believe that Bates' financial statements are 12 inaccurate. And my recollection from your deposition 13 testimony is that, No. 1, Bates used the 14 lower-of-cost-to-market methodology to achieve a 15 predetermined taxable income of \$75,000. Is that 16 correct? 17 A No. 18 Q No? Okay. 19 A I would say Bates misused what it claimed was a 20 lower of cost to market. We heard testimony for four or 21 five days now with respect to no documentation, no 22 support, no paperwork to document the write-downs on 23 both new and used. So I wouldn't agree that they used 24 the LCM to achieve the write-downs. I would agree they 25 used the write-downs to achieve the 75,000, and I would</p>	1358	<p>1 all the write-downs that he could have taken? 2 A Well, it's beyond that. 3 Q Well, what I'm trying to do is, I'm trying to 4 identify all three of the reasons why you believe his 5 write-downs are inaccurate. We talked about the first 6 one. He misused LCM to achieve a predetermined taxable 7 income. Right? 8 A Misused, I would agree, yes. 9 Q Yes. Okay. And now No. 2 is that methodology 10 of misuse, he did not apply to all of his inventory; 11 therefore, he failed to consistently apply the misuse of 12 LCM to all of his inventory. Is that correct? 13 A I think that's right. I think you've got a 14 double negative in there. But I think that's right. He 15 did not apply the misuse to all of his inventory each 16 year. 17 Q Okay. So you think it would've been more 18 accurate financial statements had he applied the misuse 19 of LCM to all of the inventory instead of just part of 20 the inventory? 21 A No. Misuse is misuse. He applied to part, he 22 applied to all. It's still misuse. The financial 23 statements are inaccurate and unreliable. 24 Q And part of the misuse is that he didn't apply 25 the misuse to all of his inventory?</p>

Attachment 10

1359	1361
<p>1 A Part of the misuse is he did not apply it to 2 all of his inventory. 3 Q And then the other reason, as I recall from 4 your testimony, is that he did not follow the Treasury 5 regs when implementing the lower of cost to market? 6 A I'd put that with No. 1, the misuse. You've 7 got to follow an accounting methodology in terms of how 8 you're writing down and what you're writing down. I 9 don't know if that's No. 1 and 3 or if they're really 10 both No. 1. But that's the misuse. 11 Q Have we covered all three of the reasons now 12 that you believe that the financial statements are 13 inaccurate? 14 A As a broad three topics, I would agree with 15 that. 16 Q Okay. Now, did the fact that Bates Nissan 17 recovered the write-downs in terms of gross profit, does 18 that add to the inaccuracy of the financial statements? 19 A It does. And I was turning around looking for 20 490 that was up on the board a few minutes ago. It's 21 been flipped over. But in the recovery and combined 22 with the management of the income at 75,000, the 23 recovery doesn't really recover; it's just added to in 24 the next round or the next year of write-downs. 25 Q The recovery doesn't really recover. The</p>	<p>1 A No. 2 Q How should Bates Nissan have reported gross 3 profits differently? 4 A It should not have taken the write-downs as it 5 took them. And therefore each and every one of the 6 write-downs is impacting the gross profits, because 7 they're unsupported. 8 Q So anytime we find a criticism of what Bates 9 Nissan did, whether it is reporting to the IRS or 10 whether it's reporting to Nissan, it all goes back to 11 not doing the write-downs properly. Fair statement? 12 A In my analysis, that's right. Both new and 13 used are not written down properly. And once you don't 14 write them down properly, with the proviso that you are 15 also managing to that 75,000 each year, you're forcing 16 another set of write-downs as was shown up, I think, it 17 was 490 that was on the board a few minutes ago. 18 Q So because the write-downs were not done 19 properly, as long as you continue writing down more than 20 you recover in gross profits, under your thesis, the 21 gross profits are not being reported to the IRS? 22 A It's not based on more than you wrote down. 23 It's based on managing to the 75,000. So it's -- it's 24 writing down at levels that permit you or have you 25 accomplish that predetermined goal so that they're not</p>
1360	1362
<p>1 recovery is reported on the tax returns. Correct? 2 A No. The 75,000 is reported on the tax returns 3 because you're managing the inventory -- excuse me, 4 you're managing the income to the 75,000. 5 Q Well, sir, this is where I think we need a 6 lesson in logic. And the reason I say that is, it seems 7 to me that your opinion is that because the write-downs 8 were done improperly, they were not done consistently, 9 and they were not done pursuant to the Treasury regs; 10 that therefore they did not have the effect -- pardon 11 me -- that therefore the gross profit recovery did not 12 have the effect of covering those write-downs. 13 A The gross profit recovery had the effect of 14 misstating the financial statements each and every month 15 in which there was recovery. And I'll go back to the 16 same answer Mr. Liner gave that goes back to the Judge's 17 example the other day. Once you shoot somebody, yeah, 18 you take them to the hospital, however that exact 19 example went. But at the end of the day, it's not the 20 recovery; it's the write-down. And then when it 21 recovers, it doesn't really recover because you're still 22 managing to the \$75,000 in income. 23 Q Did, in fact, Bates Nissan report gross profits 24 the way the IRS requires Bates Nissan to report gross 25 profits?</p>	<p>1 real write-downs, so you're not really recovering. 2 Q So what happens when Bates Nissan runs out of 3 inventory to write-down against the recaptured gross 4 profit? What happens? 5 A Well, as Mr. Gautier said, eventually it 6 catches up to you. And as we've seen -- or I've seen in 7 the financial statements, the write-offs get larger and 8 larger. And we've seen examples where -- I think 9 Mr. Bates testified to it -- in 2014, he needed more 10 write-down, so over a few days he took a write-down -- 11 again, I'll make an example up -- of a thousand dollars 12 on a particular vehicle and then a few days later 13 increased that to 1,500, just again, for sake of a 14 hypothetical. So if you're running out of inventory, 15 then the only other part of the formula that you can 16 affect is taking a bigger write-down. 17 Q So do you agree that even under your thesis, 18 the most that Bates Nissan was gaining by these 19 so-called improper write-downs is the deferral of 20 income, the deferral of the recaptured income for 21 another year? 22 A For tax purposes, that would be, I think, 23 correct. For the reporting to Nissan, that would not be 24 correct. 25 Q Let's stick with tax for a while, then we can</p>

Attachment 10

1363	<p>1 go back to reporting with Nissan, because they're two</p> <p>2 separate but interrelated issues. Right?</p> <p>3 A It's hard to separate them in my mind.</p> <p>4 Q Okay. Let me separate them in my mind and ask</p> <p>5 you questions along those lines.</p> <p>6 So what you're saying is that even under</p> <p>7 your thesis, sooner or later, the write-down trap is</p> <p>8 going to catch you, and you're going to run out of</p> <p>9 sufficient inventory to cover, to cover the recaptured</p> <p>10 gross profit and still maintain your taxable income at</p> <p>11 \$75,000. Correct?</p> <p>12 A You're going to run out of inventory, or you're</p> <p>13 going to run out of the size of the write-down on each</p> <p>14 of those inventory units. That's the catch up -- as I</p> <p>15 would interpret Mr. Gautier's statement. He didn't say</p> <p>16 that, but that's how I interpret it.</p> <p>17 Q And in Bates Nissan's case, the inventory trap</p> <p>18 closed when Nissan decided to make an issue of the, in</p> <p>19 your opinion, improper write-downs. Correct?</p> <p>20 A Certainly, at some point in late '14 or early</p> <p>21 '15, the Schneider letter comes out to the IRS. And so</p> <p>22 in that sense, that is the end of the line with respect</p> <p>23 to that write-down process that was improper.</p> <p>24 Q Right. And Mr. Schneider -- I think we covered</p> <p>25 this with Mr. Liner to some degree. Mr. Schneider told</p>	1365	<p>1 on the new car side and the used car side for at least</p> <p>2 the years 2009 through 2013. Correct?</p> <p>3 A Well, no, they're actually all from 2013 as it</p> <p>4 relates to rolling them forward one year at a time. And</p> <p>5 so you've got different layers of that 726. But the 726</p> <p>6 as an actual write-down was at the end of '13 catching</p> <p>7 up for all of the earlier write-downs.</p> <p>8 Q That's it. Catching up for all of the earlier</p> <p>9 write-downs. In other words, cumulatively over all</p> <p>10 those years, all of the write-downs that needed to be</p> <p>11 declared as taxable income ended up in 2013?</p> <p>12 A At the end of 2013, early '14. I would agree</p> <p>13 with that.</p> <p>14 Q And then they were reversed by Mr. Schneider,</p> <p>15 and he said, hey, we can't support these write-downs, so</p> <p>16 we're going to go ahead and pay tax on the taxable</p> <p>17 income represented by these write-downs. Agreed?</p> <p>18 A In substance. It's my understanding of his</p> <p>19 letter, yes.</p> <p>20 Q Okay. Now, let's go ahead to a -- a statement</p> <p>21 that has been attributed to you, Mr. Walter. And we can</p> <p>22 see it at BN2663 in C-34.</p> <p>23 MR. COFFEY: And I would ask Mr. Dyer to</p> <p>24 bring that page up on the monitor. It's 2663, a couple</p> <p>25 of pages in.</p>
1364	<p>1 the IRS, we cannot support what we did in the past; we</p> <p>2 don't have any documentation to do that with. And it</p> <p>3 was probably improper to begin with. So he went ahead</p> <p>4 and recaptured all of the write-downs for as long as he</p> <p>5 had records and declared an additional 726,583 in</p> <p>6 taxable income to the IRS and said, we will pay the tax</p> <p>7 on this over four years. Correct?</p> <p>8 A Close.</p> <p>9 Q Okay. Add what you think needs to be added to</p> <p>10 make that a perfectly accurate statement.</p> <p>11 A That was the write-down that Bates Nissan took</p> <p>12 with respect to the end of '13, end of '14 and that</p> <p>13 726,000 -- and I thought it was 531, you said 580 or</p> <p>14 something. But whatever the number is.</p> <p>15 Q It was 83. We can check that real quickly.</p> <p>16 A At that point in time --</p> <p>17 Q You were right, 531.</p> <p>18 A It's the -- actually, I think it's 532 rounded,</p> <p>19 but we'll leave that alone. Sorry.</p> <p>20 The -- at that point in time, you're</p> <p>21 recapturing the write-downs that occurred at the end of</p> <p>22 2013 that are the cumulative effect of forcing each year</p> <p>23 to be roughly \$75,000.</p> <p>24 Q The cumulative effect in terms of taxable</p> <p>25 income for all of the write-downs that Bates took both</p>	1366	<p>1 Q (BY MR. COFFEY) And it's that paragraph that</p> <p>2 begins, "Nissan retained the expert services of Mr. Herb</p> <p>3 Walter for this case." Do you see that paragraph?</p> <p>4 A I do.</p> <p>5 Q Okay. And further in that paragraph it says,</p> <p>6 "Mr. Walter observed that Bates Nissan took a cumulative</p> <p>7 \$2.7 million reduction in net profits and taxable income</p> <p>8 through the means described in his report."</p> <p>9 Are you standing by the testimony that we</p> <p>10 laymen read that to mean, and that is that Bates evaded</p> <p>11 or avoided taxes on \$2.7 million in income?</p> <p>12 A You've compounded the numbers of issues, and I</p> <p>13 would not agree with your statement.</p> <p>14 Q Okay. Did, in fact, Bates Nissan avoid taxes</p> <p>15 on \$2.7 million of taxable income?</p> <p>16 A From an IRS standpoint, no.</p> <p>17 Q Are you saying that Nissan gets to tax Bates</p> <p>18 Nissan on \$2.7 million?</p> <p>19 A No. But there's a line item on the financial</p> <p>20 statement that's taxable income, net income before taxes</p> <p>21 that's listed on what's reported to Nissan. So I'm</p> <p>22 drawing a line between what is reported on a tax return</p> <p>23 as taxable income and what's reported to Nissan as a</p> <p>24 taxable income. And we can refer to my report, 366,</p> <p>25 where that number comes from if you would like. But</p>

Attachment 10

1367	<p>1 that's the distinction I'm drawing.</p> <p>2 Q So at least for taxable income purposes, the</p> <p>3 way we recognize taxable income, i.e., that which we</p> <p>4 have to pay taxes to the IRS on, you're not maintaining</p> <p>5 that Bates avoided tax on \$2.7 million in income?</p> <p>6 A That's correct. I'm not. That would be the</p> <p>7 726 that we've talked about that some months after this</p> <p>8 report Mr. Schneider came up with and said that Bates</p> <p>9 Nissan was doing wrong breakdowns for new and used and</p> <p>10 recaptured the 726,000.</p> <p>11 Q Thank you.</p> <p>12 Let's then go to 2665.</p> <p>13 A 2665.</p> <p>14 Q Are you there, sir?</p> <p>15 A It's up on the board. Is this a continuing</p> <p>16 page from that letter?</p> <p>17 Q It is. It's a continuing page. It's, like,</p> <p>18 two pages further in from the language that we talked</p> <p>19 about just a moment ago.</p> <p>20 A Okay.</p> <p>21 Q And I'm directing your attention to the first</p> <p>22 full paragraph, and specifically the sentence that says,</p> <p>23 "It appears to Nissan that Bates Nissan --"</p> <p>24 A Hold on. Let me find that sentence.</p> <p>25 Q Yes, sir. It's the second sentence.</p>	1369	<p>1 forward 2009 reduced taxable income, you said taxable</p> <p>2 income, into 2010 and then the sum of 2009 and 2010</p> <p>3 taxable income into 2011?</p> <p>4 A Again, you're -- I can't answer as asked. If</p> <p>5 you want me to explain, I'll try.</p> <p>6 Q Well, let me ask one question before you</p> <p>7 explain all this.</p> <p>8 A Sure.</p> <p>9 Q Did you intend to say -- after you told Nissan</p> <p>10 that Bates had carried forward 2009 reduced taxable</p> <p>11 income into 2010, did you then intend to tell Nissan</p> <p>12 that they carried forward the sum of 2009 and 2010</p> <p>13 taxable income into 2011?</p> <p>14 A From Nissan's financial statements, the answer</p> <p>15 is yes. That's exactly what they did, as laid out on</p> <p>16 490 a few minutes ago.</p> <p>17 Q Sir, you said taxable income. Now, that to all</p> <p>18 of us laymen means that which we have to pay taxes on to</p> <p>19 the IRS. So when you used the term "taxable income,"</p> <p>20 are you saying, I don't mean taxable income that we have</p> <p>21 to pay taxes on to the IRS; I mean the so-called taxable</p> <p>22 income that's reported to Nissan? Is that what you're</p> <p>23 saying?</p> <p>24 A Yeah. That's what's on their financial</p> <p>25 statement.</p>
1368	<p>1 A Oh, there it is. I got it.</p> <p>2 Q "It appears to Nissan that Bates Nissan has</p> <p>3 carried forward 2009 reduced taxable income into 2010</p> <p>4 and then the sum of 2009 and 2010 into 2011."</p> <p>5 Now, there, you used the specific term of</p> <p>6 "reduced taxable income."</p> <p>7 A I didn't draft this letter. I think this is</p> <p>8 from the lawyers. But I see the reduced in quotes that</p> <p>9 you're talking about.</p> <p>10 Q Yes. So you did not report to Nissan the</p> <p>11 analysis that resulted in this language getting into the</p> <p>12 notice of termination?</p> <p>13 A That's not what I said.</p> <p>14 Q You didn't do that?</p> <p>15 A That's not what I said.</p> <p>16 Q Did you, in fact, tell Nissan that Bates has</p> <p>17 carried forward 2009 reduced taxable income into 2010</p> <p>18 and then the sum of 2009 and 2010 into 2011? Did you</p> <p>19 tell Nissan that or not?</p> <p>20 A In substance, yes.</p> <p>21 Q In substance, yes?</p> <p>22 A I mean, I might not have used exactly those</p> <p>23 words in describing it. But, yes, in substance that's</p> <p>24 exactly what I've described.</p> <p>25 Q And is it true that Bates Nissan carried</p>	1370	<p>1 Q So you're saying that because Nissan has a line</p> <p>2 on its financial statement for taxable income, that you</p> <p>3 can make a statement like this to Nissan which you know</p> <p>4 is going to be repeated in a termination notice from</p> <p>5 Nissan to Bates Nissan?</p> <p>6 A From Nissan's financial statement reporting</p> <p>7 standpoint, that's exactly what has happened to those</p> <p>8 financial statements. I don't know what other way to</p> <p>9 describe it. Again, I didn't write this particular</p> <p>10 sentence. But I would concur with that description.</p> <p>11 That's how the Nissan statements, starting at least in</p> <p>12 2010 through '13 and probably earlier years, are</p> <p>13 misstated.</p> <p>14 Q So you concur with Nissan in the statement</p> <p>15 to -- or in a statement to the effect that Bates Nissan</p> <p>16 avoided taxes on 2009 and 2010 taxable income?</p> <p>17 A Again, you're mingling the difference between</p> <p>18 what's reported to Nissan. And so from a Nissan</p> <p>19 standpoint, if you add that to your question, the answer</p> <p>20 is absolutely. If you're talking about tax payment to</p> <p>21 the U.S. Treasury that you write based on your 1120,</p> <p>22 your corporate tax return, then the answer is no,</p> <p>23 because that would be based on the 726.</p> <p>24 Q So let's go on to the next sentence that</p> <p>25 follows the one we just ended up discussing.</p>

Attachment 10

1371	<p>1 "This appears to have been done</p> <p>2 cumulatively each year up to at least 2013, which is the</p> <p>3 last year of available tax returns produced to Nissan in</p> <p>4 this case."</p> <p>5 Now, isn't that telling the Judge, the</p> <p>6 agency, and Nissan that taxable income for IRS purposes</p> <p>7 is being moved forward cumulatively and taxes avoided on</p> <p>8 it; because otherwise, why would you refer to available</p> <p>9 tax returns when referencing this taxable income?</p> <p>10 A Again, I didn't write it, but I agree with that</p> <p>11 statement. That's when the tax returns were produced.</p> <p>12 And you need the tax returns and the related financial</p> <p>13 statements to help unwind what some of the misreporting</p> <p>14 is, inaccurate reporting on Bates' financial statements.</p> <p>15 So they go hand in hand from an analysis standpoint. I</p> <p>16 don't necessarily read that as saying, and I didn't see</p> <p>17 or hear you read the word that says Bates Nissan owes</p> <p>18 the U.S. Government or the U.S. Treasury the tax with</p> <p>19 respect to over \$2 million. That's not what you just</p> <p>20 read.</p> <p>21 Q Well, let's see what Nissan did with your</p> <p>22 statement here on Page 2665. Further on -- farther down</p> <p>23 on that same page, Nissan starts to quote from the tax</p> <p>24 fraud section of the Internal Revenue Service Manual.</p> <p>25 Do you see that language?</p>	1373	<p>1 2.7 million or whatever it is?</p> <p>2 A If you look at Paragraphs 29 and 30 of my</p> <p>3 report.</p> <p>4 Q Okay. Let's go to that. Which report are we</p> <p>5 talking about now?</p> <p>6 A 366.</p> <p>7 Q 366, Paragraphs 29 and 30.</p> <p>8 A 30 and 31.</p> <p>9 Q 29 and 30 and 31?</p> <p>10 A I'm on Page 8.</p> <p>11 Q Yeah, I'm there too.</p> <p>12 Are you saying with this analysis on</p> <p>13 Page 8 that Bates Nissan avoided taxes on \$2.7 million</p> <p>14 worth of income?</p> <p>15 A No. And if by taxes, you mean writing a check</p> <p>16 to the U.S. Treasury for the IRS, the answer is no.</p> <p>17 Q So how did you arrive at this 2.7 million,</p> <p>18 which I understand ended up somewhere on Bates'</p> <p>19 financial statement provided to Nissan? Is that what</p> <p>20 you're saying?</p> <p>21 A Look at Footnotes 15 and 16. You add the</p> <p>22 numbers together, and they add up to, on a rounded</p> <p>23 basis, what's on 29 and 30 and 31.</p> <p>24 Q And those numbers in that footnote, those are</p> <p>25 the write-downs that were taken over the years depicted?</p>
1372	<p>1 A I do. The second-to-the-last paragraph?</p> <p>2 Q Yes. It goes into a long explanation of how</p> <p>3 the IRS defines tax fraud. And it's hard to escape the</p> <p>4 conclusion that when Nissan starts trotting out this tax</p> <p>5 fraud language, they're not referring to what you told</p> <p>6 them up here at the first full paragraph. Do you see</p> <p>7 that?</p> <p>8 A I see you're linking it. But the 726 is</p> <p>9 absolutely applicable to what they're reading with</p> <p>10 respect to the IRS. I'm looking on the prior paragraph</p> <p>11 with respect to Nissan. You're mingling the two topics.</p> <p>12 Q So you're saying that Nissan should not have</p> <p>13 mingled the two topics, i.e., what you're reporting to</p> <p>14 them in terms of cumulative taxable income and then</p> <p>15 their reference to the tax fraud section of the IRS</p> <p>16 manual?</p> <p>17 A Well, you're trying to parse the words.</p> <p>18 They're inexplicably tied, because the same write-downs</p> <p>19 are the origin for both of the problems. One problem</p> <p>20 goes the path of the IRS; one problem goes the path of</p> <p>21 niche. The actual implications are different. That's</p> <p>22 why we're talking about the 726 when we talk about IRS</p> <p>23 and over 2 million for the financial statements with</p> <p>24 respect to reporting to Nissan.</p> <p>25 Q And how exactly did you arrive at that</p>	1374	<p>1 A No. That's the results of the write-downs,</p> <p>2 because that's based on the financial statement</p> <p>3 reporting to Nissan between the final -- excuse me, the</p> <p>4 12th-period and 13th-period statements. And then 31</p> <p>5 breaks it down a little bit into a different component.</p> <p>6 Q What do you mean by the results of the</p> <p>7 write-down?</p> <p>8 A Based on the write-downs -- and, again, I'll</p> <p>9 refer to 490; and if you want, I can flip the page over</p> <p>10 and talk about it.</p> <p>11 Q I'd like for you just to answer my question, if</p> <p>12 you can.</p> <p>13 A I can. With respect to rolling the write-downs</p> <p>14 over year by year, again, 490 is a great tool to explain</p> <p>15 that. But when you put that rolling year by year by</p> <p>16 year, you get each year misreported, as was laid out on</p> <p>17 490 by -- I think it was Mr. Davis and Mr. Donley.</p> <p>18 Q Okay. Let's go back to 490, and let's talk</p> <p>19 about that.</p> <p>20 A Okay. I've got it.</p> <p>21 Q So tell me how we get to \$2.7 million in</p> <p>22 misreported taxable income to Nissan.</p> <p>23 A Well, if you remember, the hypothetical here</p> <p>24 was a current year -- I'll call it actual income of</p> <p>25 475 -- that was reported to Nissan in year one of this</p>

Attachment 10

1375	1377
<p>1 hypothetical. 2 Q Okay. This is hypothetical numbers that you're 3 using there? 4 A Right. Right. Exactly. 5 Q Can't you use real numbers which help us get to 6 this 2.7 million so that we actually know what you're 7 talking about? 8 A Well, this hypothetical is basically the same 9 concept with respect to that. We can go to 5R and 6R in 10 my new report, in my July report where I've updated the 11 analysis. Because, again, this was the first set of red 12 flags. 13 Q Did you update your analysis with real numbers 14 or with hypothetical numbers? 15 A Real numbers. 16 Q Okay. Let's go to those analyses. You say 5, 17 6, and -- 18 A Five and six. 19 Q Five and six. So that's Attachment 5 and 6R? 20 A It is. And I don't have a copy of those at the 21 desk. 22 MR. DONLEY: May I approach, Your Honor? 23 JUDGE BENNETT: You may. 24 We're spending a great deal of time on 25 this. And honestly, I feel like I understand it very</p>	<p>1 accounting issues fairly well. I think I understand 2 this. 3 I understand the difference semantics of 4 how each side is trying to paint the issues also. But 5 we're spending a great deal of time on a basic factual 6 thing that I think really factually is not disputed; 7 it's the painting of it that is being disputed. Now, 8 it's the semantics of how each side is trying to portray 9 it. 10 MR. COFFEY: Your Honor, I do think you 11 understand it very well, so I don't think you need any 12 further education on it. With that -- 13 JUDGE BENNETT: I understand you want to 14 clarify things for the record. 15 MR. COFFEY: I did, but I think it's now 16 clarified. So with that, we will pass the witness. 17 JUDGE BENNETT: I would've interrupted 18 more often if I'd known -- 19 (Laughter) 20 MR. DONLEY: All right. May I proceed, 21 Your Honor? 22 JUDGE BENNETT: You may. 23 MR. DONLEY: Thank you. 24 25</p>
1376	1378
<p>1 well. I mean, essentially isn't what happened in terms 2 of the numbers that you reached is that you took the 3 12-month financial statements reported to Nissan and 4 what the net profits were shown for Bates on that over 5 the 2010, '11, '12, '13 time period, added up each of 6 them for each of the four years to come up with number 7 and then ultimately looked at the reported tax returns 8 financial data, which were -- they tried to get to 9 roughly 75 each year and then took the difference? Is 10 that essentially what you did? 11 THE WITNESS: Essentially, Your Honor. 12 And the difference is bigger each year because of the 13 rollover effect that was outlined on 490 where in the 14 first year -- 15 JUDGE BENNETT: Well, and to be clear, 16 though -- I'm going to interrupt you just for a minute. 17 Yes, I understand what you're saying except for the 18 fourth year, because they actually -- their profits were 19 not as high in the fourth year, which is why you go 20 from an 813 down to a 726. 21 THE WITNESS: That's correct, Your Honor. 22 JUDGE BENNETT: I understand this issue. 23 I know you all have tried to clarify things. My 24 undergraduate degree is in finance, and I spent a year 25 in accounting with IBM as an intern. I understand</p>	<p>1 REDIRECT EXAMINATION 2 BY MR. DONLEY: 3 Q Mr. Walter, let me give you a moment to get 4 those documents out of the way if you need to. 5 A Sure. Thank you. 6 Q Yes, sir. 7 A I'm ready. 8 Q And by the way, does 5R actually show that the 9 actual numbers where 490 actually shows a hypothetical? 10 A Right. That's correct. 5R and 6R show the 11 actual numbers where 490 is just a hypothetical. 12 Q All right. Before we go into the substance any 13 further, let's talk a little bit about your background. 14 A Sure. 15 Q You're a CPA? 16 A I am. 17 Q How long have you been a CPA? 18 A Since '79, I think. 19 Q And you grew up where as a CPA? 20 A In Cincinnati, Ohio. 21 Q You worked for a CPA for whom? 22 A I worked for 32 years with PriceWaterhouse and 23 then later with PriceWaterhouseCoopers after the merger. 24 Q Were you a partner there? 25 A I was for the last 20 years of my career.</p>

Attachment 10

1407

SOAH DOCKET NO. 608-14-3211.LIC

MVD DOCKET NOS. 14-0010.LIC and 15-0013.LIC

BATES NISSAN, INC.,	)	STATE OFFICE OF
Complainant,)	
)	
v.)	
)	
NISSAN NORTH AMERICA, INC.,	)	ADMINISTRATIVE HEARINGS
Respondent.)	

HEARING ON THE MERITS

Tuesday, September 22, 2015

BE IT REMEMBERED THAT at 8:31 a.m., on Tuesday, the 2nd day of September 2015, the above-entitled matter came on for hearing at the State Office of Administrative Hearings, William P. Clements, Jr., Building, 300 West 15th Street, Room 404, Austin, Texas, before CRAIG BENNETT, Administrative Law Judge, and the following proceedings were reported by Kim Pence and Steven Stogel, Certified Shorthand Reporters.

Volume 6

Pages 1407 - 1646

Attachment 10

1408	1410
<p>1 PROCEEDINGS</p> <p>2 TUESDAY, SEPTEMBER 22, 2015</p> <p>3 (8:31 a.m.)</p> <p>4 JUDGE BENNETT: Let's go ahead and go back</p> <p>5 on the record, and we left off with the redirect I</p> <p>6 believe we were on.</p> <p>7 MR. DONLEY: We did, Your Honor. And I</p> <p>8 have one thing to report on the record. Last evening we</p> <p>9 were able to correct the two pages from R-368,</p> <p>10 Mr. Walter's second rebuttal report, to take care of the</p> <p>11 changes that were made on Attachments 5R through 10.</p> <p>12 We've now made those in the body of the report itself.</p> <p>13 And those -- there's two replacement pages. That would</p> <p>14 be 11R and 12R, and I've tendered those to opposing</p> <p>15 counsel this morning, and I believe they're okay with</p> <p>16 them.</p> <p>17 MR. ALANIZ: We have no objection.</p> <p>18 JUDGE BENNETT: And in terms of the record</p> <p>19 copy, those changes have been added already to the</p> <p>20 record copy or are you in the process --</p> <p>21 MR. DONLEY: They have been. They've been</p> <p>22 added, Your Honor.</p> <p>23 JUDGE BENNETT: Okay. Then with that, I</p> <p>24 don't think I fully asked the question because we</p> <p>25 stopped midstream, but with those changes, do you fully</p>	<p>1 What does that show us?</p> <p>2 A It's showing as reported on the year-end</p> <p>3 financial statements for Bates Nissan, as well as</p> <p>4 District 13 and the central region dealers of a certain</p> <p>5 size range that was based on the report analysis I did,</p> <p>6 the gross profit per new unit sold. So the average</p> <p>7 gross profit for the year for all the Nissans sold by</p> <p>8 all three of these comparisons.</p> <p>9 Q Why did you use District 13?</p> <p>10 A That's the district that Bates is in. It's a</p> <p>11 smaller group of dealers, and then the regional group</p> <p>12 that I used is based on a little larger group of</p> <p>13 dealers.</p> <p>14 Q Now, I believe there was some testimony earlier</p> <p>15 in the case that Bates Nissan at one point was making</p> <p>16 \$1,200 gross profit per new retail unit. Do you recall</p> <p>17 that testimony?</p> <p>18 A I do.</p> <p>19 Q Is that reflected in Attachment 19?</p> <p>20 A It is in one way. The -- each year is</p> <p>21 listed, '10, '11, '12 and then through nine months</p> <p>22 of '13. And nine months of '13 is a little bit higher</p> <p>23 than \$1,200, yes, sir.</p> <p>24 Q Now, that \$1,200 that was testified to,</p> <p>25 Mr. Walter, is there any way to determine whether or not</p>
1409	1411
<p>1 adopt your expert reports under oath?</p> <p>2 THE WITNESS: Yes, I do, Your Honor.</p> <p>3 JUDGE BENNETT: Okay. Then they are</p> <p>4 admitted also as exhibits and also as sworn testimony</p> <p>5 adopted under oath.</p> <p>6 MR. DONLEY: Thank you, Your Honor. May</p> <p>7 we proceed?</p> <p>8 JUDGE BENNETT: You may.</p> <p>9 MR. DONLEY: May I have Mr. Walter come</p> <p>10 back to the screen over here, Your Honor?</p> <p>11 JUDGE BENNETT: Yes.</p> <p>12 MR. DONLEY: Thank you. And I would ask</p> <p>13 that -- for Exhibit R-366, Attachment 19, be brought up,</p> <p>14 please.</p> <p>15 PRESENTATION ON BEHALF OF RESPONDENT (CONTINUED)</p> <p>16 HERBERT WALTER,</p> <p>17 having been previously duly sworn, continued to testify</p> <p>18 as follows:</p> <p>19 REDIRECT EXAMINATION (CONTINUED)</p> <p>20 BY MR. DONLEY:</p> <p>21 Q All right. Mr. Walter, up on the screen,</p> <p>22 continuing from where we were yesterday, we now have</p> <p>23 Attachment 19 to your report, which is R-366. Correct?</p> <p>24 A Yes, sir.</p> <p>25 Q All right. What is -- what is Attachment 19?</p>	<p>1 that number is accurate based on the financial</p> <p>2 statements provided to Nissan by Bates Nissan for</p> <p>3 2010, '11, '12 or '13?</p> <p>4 A Yeah, there is.</p> <p>5 Q How -- how can you tell if it's accurate?</p> <p>6 A It's not. I can tell it's not because of all</p> <p>7 the write-downs that have been discussed for the last</p> <p>8 two weeks.</p> <p>9 Q Is there any way to know what the gross profit</p> <p>10 per new retail unit for Bates Nissan for 2010 to 2013 is</p> <p>11 based on those financial statements?</p> <p>12 A No easy way. I guess if you reconstructed</p> <p>13 their books and records and went way back and tried, you</p> <p>14 could do that. But just off the top, no, there's not</p> <p>15 really an easy way to do that.</p> <p>16 Q Can you do it based on the financial statements</p> <p>17 themselves provided to Nissan?</p> <p>18 A No, I think you'd have to go behind those</p> <p>19 financial statements to the subsidiary ledgers and other</p> <p>20 records.</p> <p>21 Q Let's go to R -- or Attachment R28 in R-366.</p> <p>22 What is Attachment 28, Mr. Walter?</p> <p>23 A Attachment 28, as the title indicates, is the</p> <p>24 dealerships variable net advertising per retail unit</p> <p>25 sold. I'll explain briefly, Your Honor.</p>

Attachment 10

1412	<p>1 Advertising is a variable expense as at</p> <p>2 the top of the P&L. There's also a reimbursement that</p> <p>3 occurs that comes back off of the 1 percent that I think</p> <p>4 you've heard some testimony on. So that 1 percent goes</p> <p>5 out and parts of it come back in terms of the</p> <p>6 reimbursement. So this is the net of those numbers as</p> <p>7 it relates to advertising.</p> <p>8 And what I'm looking at there on a</p> <p>9 comparative basis is looking how much did the dealership</p> <p>10 spend in total on its advertising for new, used, service</p> <p>11 and parts across the board based on a per-new-unit</p> <p>12 comparison to get it on a size-adjusted standard basis.</p> <p>13 Q Again, the red bars, that's Bates Nissan?</p> <p>14 A The red bar is Bates Nissan. The blue again is</p> <p>15 the District 13 average, and the green bar is the</p> <p>16 central region.</p> <p>17 And, Your Honor, I didn't mention, but</p> <p>18 central region there's a parenthetical that says 650 to</p> <p>19 1050, that's a subset of the region that I picked to get</p> <p>20 size adjusted. So that's roughly the range, a little</p> <p>21 above, a little below, where Bates Nissan was typically</p> <p>22 selling. So it's those dealers I wanted on a</p> <p>23 similar-size basis as a second comparison in addition to</p> <p>24 the region.</p> <p>25 Q From 2010 --</p>	1414	<p>1 little lower on the P&L called Institutional</p> <p>2 Advertising. For most dealers it's a relatively small</p> <p>3 number, 20 or \$30,000 a year on average. In Bates</p> <p>4 Nissan's case, they're booking more advertising in</p> <p>5 institution -- the institutional advertising than I've</p> <p>6 seen in some of the other comparisons. It's up as high</p> <p>7 as over a hundred thousand dollars.</p> <p>8 So to be fair I wanted to look at it both</p> <p>9 ways, with and without this institutional advertising.</p> <p>10 And what's normally in there, auto shows and other</p> <p>11 things as opposed to just the ads in newspapers and on</p> <p>12 TV is -- is what's supposed to be the difference. I</p> <p>13 haven't got the records to go behind exactly how Bates</p> <p>14 has booked it, but just to be complete in showing it</p> <p>15 with and without the institutional advertising, I've</p> <p>16 added it in on this Chart 30.</p> <p>17 Q Same question again on Attachment 30. Does it</p> <p>18 show a doubling of advertising from 2010 to 2013 for</p> <p>19 Bates Nissan?</p> <p>20 A No. No. On a relative basis, it goes up a</p> <p>21 little bit in '13 from where it was in '10, '11 and '12,</p> <p>22 but there's nowhere near doubling or redoubling.</p> <p>23 Q Overall between these two charts we've looked</p> <p>24 at on new vehicle -- or looked at advertising on a new</p> <p>25 retail unit sold, the movement is relatively small in</p>
1413	<p>1 A Excuse me, in addition to the district. I</p> <p>2 misspoke.</p> <p>3 Q I apologize.</p> <p>4 From 2010 to 2013, how did Bates Nissan's</p> <p>5 advertising per new retail unit sold compare to the</p> <p>6 district and the central region?</p> <p>7 A On a -- on a per-new-unit basis, which is</p> <p>8 reflected on Attachment 28, it stayed relatively flat in</p> <p>9 '10 and '11. It actually dropped per unit in '12. It</p> <p>10 recovered part of the way in '13 through September, but</p> <p>11 not all the way where it had been in '10 and '11.</p> <p>12 Q Were you here when Mr. Bates testified he</p> <p>13 doubled and redoubled his advertising expense?</p> <p>14 A Yes, I was.</p> <p>15 Q What does Attachment 28 tell us with regard to</p> <p>16 whether or not Bates Nissan actually doubled and</p> <p>17 redoubled -- well, let me just start there. Did it</p> <p>18 double?</p> <p>19 A No, it did not.</p> <p>20 Q Did it redouble?</p> <p>21 A Not on a relative basis, not at all.</p> <p>22 Q Let's go to Attachment 30, please. That looks</p> <p>23 like it. What is Attachment 30, Mr. Walter?</p> <p>24 A Attachment 30 is similar to 28, but there's</p> <p>25 a -- another category of advertising that's down a</p>	1415	<p>1 advertising dollars, is it not?</p> <p>2 A Relatively small and consistently below the</p> <p>3 Nissan dealers -- other Nissan dealers.</p> <p>4 Q All right. Mr. Walter, I want to now go to</p> <p>5 your second rebuttal report, which is R-368, and we're</p> <p>6 going to bring up 5R, Attachment 5R. What is</p> <p>7 Attachment 5R to R-368?</p> <p>8 A Attachment 5R is simply the comparison as</p> <p>9 reported of the 12th month and the 13th month by Bates</p> <p>10 Nissan. And so on the top line of 5R, I'm showing the</p> <p>11 net profit, and you can see parenthetically 12th month.</p> <p>12 I'm showing the amount of the write-downs for new and</p> <p>13 used, and I'm showing the other 13th period adjustments.</p> <p>14 There could be some depreciation, there could be some</p> <p>15 bonuses paid. There could be some other 13th period</p> <p>16 line items that I'm taking no issue with. The whole</p> <p>17 discussion here throughout the last two weeks has been</p> <p>18 over the inventory write-downs. So just as a pool, I'm</p> <p>19 saying that the rest of the 13th period adjustments that</p> <p>20 are not inventory related is shown on the noninventory</p> <p>21 13th period adjustment line.</p> <p>22 And then the bottom line is the total of</p> <p>23 the 13th period adjustments. And the last line is the</p> <p>24 net profit as it was reported on the 13th-month</p> <p>25 statement.</p>

Attachment 10

1416	1418
<p>1 Q And so when you look at net profit before bonus 2 and income tax 12th month, which is the top line from 3 2010 to 2013, what does that top line show us? 4 A Well, it shows us what Nissan was told the 5 profitability of Bates was. So as you read across that 6 line, according to the -- the Nissan financial 7 statements that Bates Nissan actually submitted to 8 Nissan, in '09 it was 96,000. It jumped to 323,000, 9 then jumped to 532 in '12, and '13 it was 990 -- 992,000 10 and 979,000. So from Nissan's perspective, that's how 11 profitable Bates was, over \$3 million. 12 Q And then if you look at the bottom line, net 13 profit before taxes -- or before bonuses and income tax 14 13th month, what does that line show us all the way 15 across from 2009 to 2013? 16 A That's the 13th period adjustment -- adjusted 17 statement, which would be equivalent to what Bates 18 Nissan told the IRS. So you're seeing just across there 19 the roughly \$75,000 per year, but for '13 where it's a 20 little bit higher than 75,000. 21 Q The delta between the top and the bottom line 22 is sometimes as much as \$800,000 or more? 23 A Yes, in '13, in terms of the write-downs, 24 that's correct. 25 Q And what do you conclude by Attachment 5R</p>	<p>1 February -- February year-to-date, on and on and on. So 2 each of the individual 12 months as well as what's 3 referred to as the 12th month statement, which is really 4 just the December statement. 5 Q Starting at least in '09 and going all the way 6 through 2013? 7 A Yes, sir. 8 Q Let's go to 8R, please, Attachment 8R. Now, 9 we've heard a little bit I think on return on sales in 10 this case, but what is Attachment 8R? 11 A 8R is return on sales, simple math, what's the 12 profit in the numerator, what's the sales in the 13 denominator. And you've got on the Y axis on the left 14 the percentages. And then the red -- red bar -- you now 15 have two red bars. Red and I'll call it pink or a 16 little bit lighter color, maybe it's orange, I don't 17 know. But the red bar is based on the 12th month 18 statement. The lighter color, the pink or so bar, is 19 based on the adjusted 12th month statement. And what I 20 mean by adjusted is I've backed out the year-by-year 21 inventory write-offs along the lines of the Schneider 22 letter, which says take out the whole 726. I took that 23 whole 726 out of 2013. 24 And the blue bar is still District 13 as a 25 comparator. What it's showing is that what Bates Nissan</p>
1417	1419
<p>1 regarding the financial statements that were provided to 2 Nissan over this period? 3 A Well, I guess that's at the core of what 4 started my whole analysis when I saw the magnitude of 5 those adjustments, when I saw what they were, that's 6 where I started digging deeper and deeper. We talked 7 about that -- or I talked about that a little bit 8 yesterday with Mr. Coffey. That's where the red flags 9 started to go up and I started looking behind the 10 adjustments, and ultimately we received the -- the 11 records with respect to the inventory adjustments that I 12 think the testimony is pretty clear were unsupported. 13 Q What does Attachment 5R tell us about the 14 accuracy and reliability of the financial statements 15 reported to Nissan? 16 A Reported to Nissan they're totally inaccurate, 17 unreliable. They're just -- those numbers don't reflect 18 the operation of Bates Nissan. 19 Q And in looking at 5R, what financial statements 20 would have been inaccurate and unreliable that were 21 provided to Nissan? 22 A The month by month by month, because this is a 23 summary at year end 12/31. But the January numbers 24 would be also inaccurate; the year-to-date January, 25 which of course is the same number, would be inaccurate.</p>	<p>1 told Nissan was that its returns were roughly at or, in 2 some years, above the district performance. But when 3 you back out those adjustments that have been subject to 4 so much testimony, Bates Nissan's returns on that 5 adjusted basis are substantially less than the -- the 6 average dealer in the -- in the district. 7 Q And what -- what do you then conclude based on 8 8R? 9 A Well, if I remember testimony of Mr. Steiner 10 and some others about how Nissan counsels the dealer and 11 so forth, go back to the gross profit chart we looked at 12 a few minutes ago, go to the return charts, the 13 information they had from which they were then making 14 their DOM visits that I think there was testimony were 15 basically monthly, that information was inaccurate and 16 unreliable when they made the visits. I can only assume 17 then that based on inaccurate information they didn't 18 have the ability to provide the kind of counseling they 19 might otherwise have provided. 20 Q All right. Let's go to Attachment 9R, please. 21 What is Attachment 9R, Mr. Walter? 22 A 9R is net working capital. The balance sheet 23 assets -- excuse me, balance sheet metric. A little 24 tougher to adjust because I can back out the 25 adjustments, but there's a lot going on in the balance</p>

Attachment 10

1420	<p>1 sheet between the 12th and the 13th month. So this is</p> <p>2 more of an estimate of if you get rid of the adjustments</p> <p>3 what might working capital really have looked like</p> <p>4 instead of the year-to-year inflated based on this</p> <p>5 carryforward. It's harder to do. It's more of an</p> <p>6 estimate or approximation of the net working capital.</p> <p>7 But what it's showing very clearly is if all you do is</p> <p>8 just back out the 12th-month adjustments, the actual</p> <p>9 working capital that Bates Nissan was working with, was</p> <p>10 substantially less than what was reported on its</p> <p>11 year-end financials.</p> <p>12 Q Is net working capital an important metric for</p> <p>13 Nissan?</p> <p>14 A It is.</p> <p>15 Q Then let's go to Attachment 10R. What is</p> <p>16 Attachment 10R, please?</p> <p>17 A The same thing, now with respect to net worth.</p> <p>18 And the reason this works this way, Your</p> <p>19 Honor, is when you're making the write-off, you're going</p> <p>20 to be crediting inventory to reduce it. You're going to</p> <p>21 be debiting cost of goods sold to increase your expenses</p> <p>22 so that you decrease your profitability. And that's the</p> <p>23 link between the P&L, the income statement and the</p> <p>24 balance sheet. So I'm trying to just give an</p> <p>25 approximation of if you take that out what might happen.</p>	1422	<p>1 incorrectly, the -- the OEMs are going to have no way of</p> <p>2 knowing what capital the entrepreneurs who run their</p> <p>3 dealership body are putting into the business.</p> <p>4 Q Continuing on with this same exhibit, let's go</p> <p>5 to Attachment 21, please. There you go.</p> <p>6 Attachment 21 we're switching gears here a</p> <p>7 little bit, are we not, Mr. Walter?</p> <p>8 A Yes, we are.</p> <p>9 Q What are we talking about now with</p> <p>10 Attachment 21?</p> <p>11 A There's been a lot of discussion of was the</p> <p>12 write-down to loan, was the write-down between loan and</p> <p>13 wholesale, was it made up to some other number? And so</p> <p>14 I took a few of the -- of the used vehicles to look at</p> <p>15 what that write-down was. I actually went to the NADA</p> <p>16 Guide. I've been a subscriber to the NADA guide for</p> <p>17 over 20 years, so I knew exactly what they were all</p> <p>18 talking about.</p> <p>19 And so I looked at a trim based on the</p> <p>20 model year and model of the NADA guide. I actually used</p> <p>21 the lowest loan value I could find, rather than fully</p> <p>22 trimming out the vehicle, adding in a nav system, adding</p> <p>23 in a sun roof, adding in a fancy stereo, other things</p> <p>24 that might be the true configuration of the car. I took</p> <p>25 basically the loan value on the baseline trim of the</p>
1421	<p>1 And again, I admit these are an estimate because it's</p> <p>2 harder to do because the two statements are involved</p> <p>3 rather than the income statement where it's more</p> <p>4 straightforward.</p> <p>5 Q Does Attachment 9R and 10R show what was told</p> <p>6 to Nissan versus what the truth might be based on your</p> <p>7 best estimates?</p> <p>8 A It's an estimate of what directionally the</p> <p>9 truth would be. I can't really get to the bottom of it</p> <p>10 without really going behind the balance sheet portion of</p> <p>11 the financial statement more -- in more detail. So</p> <p>12 it's -- again, I've used the word "approximation." It</p> <p>13 directionally is showing exactly that.</p> <p>14 Q Net worth an important metric for Nissan?</p> <p>15 A It is, for the reasons I mentioned a few</p> <p>16 minutes ago.</p> <p>17 Q What would happen if all dealers misreported</p> <p>18 working capital and net worth like Bates did to Nissan?</p> <p>19 A Well, I think there was some testimony earlier</p> <p>20 that those are metrics that manufacturers look at, and</p> <p>21 I'm familiar with them from many different</p> <p>22 manufacturers. They basically all show that on their</p> <p>23 financial statement. It's a measure of how much capital</p> <p>24 the manufacturers, the OEMs, expect given the size of</p> <p>25 the dealership. And if everybody is reporting</p>	1423	<p>1 model. For example, a 2012 Ultima or a 2012 Rogue, and</p> <p>2 compared that to what Bates wrote it down to. And so</p> <p>3 using the lowest loan available, that's the blue line or</p> <p>4 blue bar; the red is what Bates actually wrote the</p> <p>5 vehicle down. So I'm showing a gap that it's below</p> <p>6 loan. If I had fully trimmed out these cars, I'd show a</p> <p>7 bigger gap. It would be further below loan.</p> <p>8 Q So did you use the most conservative approach</p> <p>9 in using the NADA Blue Book loan value?</p> <p>10 A I did.</p> <p>11 Q And what do you conclude based on Attachment 21</p> <p>12 with regard to what Bates Nissan has claimed in this</p> <p>13 case that it used to write-down used motor vehicles?</p> <p>14 A Well, I did this as a test. The Schneider</p> <p>15 letter said that Bates used loan. I said, fine, let me</p> <p>16 go see if I can find the loans they used. I didn't find</p> <p>17 them.</p> <p>18 So this is showing that the information</p> <p>19 that the Schneider letter told the IRS on this test</p> <p>20 basis certainly is not the loan value of these vehicles.</p> <p>21 Q How about what Mr. Bates told the</p> <p>22 Administrative Law Judge in this case?</p> <p>23 A In terms of being between loan and wholesale,</p> <p>24 no, that wouldn't be true, Your Honor, because wholesale</p> <p>25 would be higher than the blue bar, because wholesale is</p>

Attachment 10

1424	<p>1 above loan. So if it were wholesale and loan, the red</p> <p>2 bar should be somewhere above blue and it's not. It's</p> <p>3 below blue. It's below the line.</p> <p>4 Q Now, did you just go in and pick nine used cars</p> <p>5 that came out this way for purposes of your chart?</p> <p>6 A No, I picked nine cars to take a look at them,</p> <p>7 and all nine of them turned out that way and I decided</p> <p>8 not to test any more. All I was looking for was to</p> <p>9 confirm or see if what the Schneider letter had said was</p> <p>10 correct. It was not.</p> <p>11 Q Did any of them come out differently that you</p> <p>12 evaluated and you just failed to put them on your chart?</p> <p>13 A No. I picked the nine vehicles. I said, "Let</p> <p>14 me see the deal jackets." I looked them up in NADA and</p> <p>15 this is what it is.</p> <p>16 Q Let's go to Attachment 27, please. And we're</p> <p>17 sticking with gross -- we're sticking with the -- now</p> <p>18 we're on new cars, are we not?</p> <p>19 A We're on new car gross profit.</p> <p>20 Q Tell me what the Attachment 27 tells us?</p> <p>21 A Your Honor, this and the next chart are</p> <p>22 probably the two most important charts I'm going to be</p> <p>23 talking to you about. This is on the left-hand side by</p> <p>24 month. So now we're in the 45-month period from the</p> <p>25 beginning -- actually we're beyond the 45-month period.</p>	1426	<p>1 Q What does Attachment 27 tell us with regard to</p> <p>2 the accuracy and the reliability of the financial</p> <p>3 statements that were submitted to Nissan?</p> <p>4 A Earlier I said month by month you've got</p> <p>5 problems with them -- or I have problems with them, and</p> <p>6 this is certainly confirmatory of that. To the extent</p> <p>7 those write-downs that aren't supported in one year are</p> <p>8 then reversed in the second year, and I admit they're</p> <p>9 reversed, but that reversal is what is the distortion in</p> <p>10 these financial statements.</p> <p>11 Q Then let's look at Attachment 28. I believe</p> <p>12 it's for used motor vehicles at issue in this case, is</p> <p>13 it not?</p> <p>14 A Same chart, Your Honor, with respect to used.</p> <p>15 You see the same basic triangle, high in January and</p> <p>16 February, the early months, sloping down from the upper</p> <p>17 left to the lower right in 2010, '11, '12, '13 and '14.</p> <p>18 And used has more -- more slope, more years because some</p> <p>19 of the testimony is in the early years Bates wrote down</p> <p>20 fewer of the new but consistently wrote down used and</p> <p>21 expanded the used write-downs in the later years.</p> <p>22 So when you put these two together, you're</p> <p>23 seeing this consistent pattern of the monthly</p> <p>24 write-downs affected -- or, excuse me -- the annual</p> <p>25 write-downs affecting the monthly statements going from</p>
1425	<p>1 We're into '14.</p> <p>2 From the beginning of '10 through the end</p> <p>3 of '14 on the X axis, the Y axis are dollars, and now</p> <p>4 month by month by month I'm comparing the gross profit</p> <p>5 for the total new vehicles for the average dealer in the</p> <p>6 district versus Bates Nissan. You've heard a lot of</p> <p>7 testimony from a lot of witnesses about the reversal in</p> <p>8 the early months of the year. This is one of the</p> <p>9 charts -- an earlier version of it -- in my October</p> <p>10 report that set red flags off for me and now I've</p> <p>11 revised it in my latest chart -- or latest report</p> <p>12 Exhibit 368.</p> <p>13 What it's showing, Your Honor, is when the</p> <p>14 write-downs in '11 reversed in '12, notice how steep the</p> <p>15 gross profit is in those first few months of 2012. And</p> <p>16 when you reverse in '12 to '13, you've got the Bates</p> <p>17 gross profit, the red bar, is very steep, and then they</p> <p>18 continue to -- to be slide -- to be higher than the</p> <p>19 region on an average gross profit basis because that</p> <p>20 return isn't all recovered in January and February or</p> <p>21 March. A few of those units don't sell until April or</p> <p>22 May or June and so forth. And so it's this pattern of</p> <p>23 the triangle, if you will, of the reversal of the</p> <p>24 write-downs from year end that sets all kinds of red</p> <p>25 flags off in my mind.</p>	1427	<p>1 year to year in an adverse way when I compare it</p> <p>2 heads-up against what the average district dealers are.</p> <p>3 Q And the average district dealers, that's what</p> <p>4 we see on the blue bars on these two charts?</p> <p>5 A Yes, sir.</p> <p>6 Q And what does exhibit -- Attachment 28 tell us</p> <p>7 with regard to the accuracy and the reliability of the</p> <p>8 financial statements submitted to Nissan?</p> <p>9 A Same thing. As they're submitted to Nissan,</p> <p>10 because of that pattern, I don't find them accurate or</p> <p>11 reliable.</p> <p>12 Q Let's go over to Attachment 30, please. What</p> <p>13 does Attachment 30 show us?</p> <p>14 A Attachment 30, the title is Cumulative Net</p> <p>15 Profit and Income Tax as a Percentage of Annual Profit.</p> <p>16 What I'm looking at here, Your Honor, is adding the</p> <p>17 bottom lines together to see how Bates' profits month by</p> <p>18 month by month -- this is a 2013 chart -- how does it</p> <p>19 profit per month versus how does an average dealer, the</p> <p>20 blue line, profit per month? So when I add together</p> <p>21 those spikes that were early in the year, Bates Nissan</p> <p>22 on the Y axis -- this is a percentage of their total</p> <p>23 profitability for the year -- Bates Nissan dramatically</p> <p>24 accelerates their profitability into the first half of</p> <p>25 the year through June or so compared to the average</p>

Attachment 10

<p style="text-align: right;">1428</p> <p>1 dealer that is give or take roughly linear somewhat of a 2 45-degree angle going up. And that's indicative of this 3 unreliability of the early month income statements 4 because of the write-down recovery. 5 Q And what does Attachment 30 tell us about the 6 accuracy and reliability of the financial statements? 7 A They're not accurate and reliable on a 8 month-by-month basis. 9 Q Let's go to Attachment 31, please. What is 10 Attachment 31, Mr. Walter? 11 A Attachment 31 we're still talking about the 12 write-downs. This is simply a count of the write-downs, 13 the number of units written down, the yellow being new, 14 the gray being used. What's evident here is consistent 15 with some of the testimony that we've heard earlier that 16 the number of write-downs increased over the years to 17 get from a couple hundred thousand write-down to up to 18 \$813,000 write-down. And you can see that just in the 19 number of units written down, it's growing from about 60 20 units up to north of 160 units. So over the years, not 21 only is the write-down compounding, but the need for 22 more and more units to be written down is similarly 23 growing. 24 Q And finally let's look at Attachment 33. 25 What does Attachment 33 show us,</p>	<p style="text-align: right;">1430</p> <p>1 MR. DONLEY: Your Honor, may Mr. Walter 2 and I head over here to these charts for a moment? 3 JUDGE BENNETT: That's fine. 4 MR. DONLEY: One last thing we'd like to 5 do. 6 If I could have just one moment, Your 7 Honor, to switch this around. 8 Q (BY MR. DONLEY) Mr. Walter, have you taken 9 what's on Exhibit 490 and actually translated that into 10 the actual numbers on the financial statements that were 11 provided to Nissan? 12 A Yes, I have. 13 Q Let's flip these pages back. Would you flip 14 that other one back for me? 15 A (Complied) 16 Q Is that now what you have written on the board 17 on these two pages that are being displayed? 18 A Yes, it is. 19 Q Can you walk us through this and tell us what 20 these two pages actually show us with regard to the 21 actual financial statements 2010 to 2013 that were 22 provided to Nissan by Bates Nissan? 23 A I can. 24 Madam reporter, can you hear me okay? 25 THE REPORTER: Yes.</p>
<p style="text-align: right;">1429</p> <p>1 Mr. Walter? 2 A It's a simple example of the 2013 reductions 3 that were taken in early '14. There was a little bit of 4 testimony on this that the initial write-downs occurred 5 in February 5th of '14, and then for the same stock 6 number, the same vehicle, five days later the write-down 7 was kicked up. 8 This is just a complete list of them, Your 9 Honor. I think there's 26 or 27 of them on the page, 10 and it's just showing that over a five-day period these 11 27 units -- 26, 27 units that were written down somehow 12 or another were kicked up an extra five hundred to a 13 couple thousand dollars in greater write-downs in order 14 to accomplish the \$75,000 profitability goal. 15 Q Have you seen or heard any evidence, 16 Mr. Walter, for the initial write-downs, anything that 17 would support those, or for the additional write-downs 18 that were taken five days later? 19 A No. 20 Q What do you conclude based on Attachment 33? 21 A It just goes as part of the overall story that 22 we've heard over and over again, and that is that the 23 write-downs were unsupported and that they were done for 24 a purpose, and that purpose was to manage the taxable 25 income.</p>	<p style="text-align: right;">1431</p> <p>1 A What I'm showing is very similar to your 2 Attachment R90 -- excuse me, Exhibit R90 -- 490 is you 3 start with the profitability in the 12th-month period. 4 And Your Honor asked a question and I think you made a 5 statement yesterday about what the actual numbers are 6 instead of the hypothetical on 490, and so that's what 7 this is laying out. 8 The original profitability reported in '10 9 to Nissan was 323,000. That's comprised of two 10 components, the current-year profit plus the carryover 11 2009 write-downs that are reversed in 2010. If we then 12 look at the goal of taxable income of just approximately 13 75,000, in this case 74,988, you come to the 13th-month 14 write-downs for how much was written down. But the 15 bottom half of this page I break that write-down into 16 two components. One is the next year write-downs, which 17 is the 277, and the other is the noninventory 18 adjustments, which I'm not taking criticism of. They 19 are whatever they are based on depreciation or bonuses 20 or something for the total 248. But this 277 write-down 21 then rolls up into the next year, 2011, and you go 22 through the same process again. 23 So the numbers I showed you on the chart a 24 few minutes ago on the screen were what was the 12th 25 period, what was the 13th period and how do they</p>

Attachment 10

1432	<p>1 actually roll together as you look at the write-downs. 2 And so what this exhibit is up on the charts is showing 3 you that the 277 in '10 rolls up as a component of the 4 2011 profits. The 2011 write-down rolls up as a 5 component of the 2012 profits. The number that's been 6 mentioned a number of times, you'll recognize the 7 813,448 rolls up from 2012 to '13. So I'm showing how 8 the cumulative effect of the write-downs is rolling from 9 year to year to year in this chart. That's the first 10 thing I'm showing. 11 The second thing is I'm totaling it across 12 the page, Your Honor, to show what the total impact is. 13 And so if you just look at the third line, Nissan was 14 told in these years there was \$2.8 million in profit. 15 The IRS was told it was about \$320,000 in profit. And 16 if you look at that difference, it's \$2.5 million. That 17 \$2.5 million is broken into two components, 2,259,672, 18 which is the cumulative effect of the write-downs, plus 19 the noninventory adjustments, which I'm not taking 20 criticism of, gives you the 2.5. And so basically what 21 I'm showing is that the -- the updated version, if you 22 will, of the \$2.7 million that I testified about 23 yesterday, which I learned about or showed in my 24 October of '14 report. In my July of '15 report on 25 Attachments 5R and 6R, I've updated that based on an</p>	1434	<p>1 reported to Nissan on the 2010 through 2013 financial 2 statements, was that information material? 3 A Absolutely. 4 Q Why do you say that? 5 A Well, because again we've heard other testimony 6 from the Nissan witnesses and, frankly, Your Honor, from 7 my experience with a variety of manufacturers, the OEMs 8 rely upon those financial statements for their monthly 9 meetings with the -- what Nissan calls their DOMs. 10 There's other terms for other manufacturers. But those 11 financial statements go into the evaluation in those 12 meetings in terms of counseling the dealer and trying to 13 improve the overall performance of this dealer body, 14 Bates Nissan and all the rest of the Nissan dealers. 15 Q One more thing if I could, Mr. Walter. I want 16 to focus your attention on 2011 and what you call the 17 recovered profit of 277,447. Do you see that? 18 A I do. 19 Q And when you add the current year profit, you 20 had a total profit for that year of 532,000. Correct? 21 A Correct. 22 Q Now, there was a write-down in 2011 on the 23 financial statements of 463,763. Correct? 24 A That's the total including both the inventory 25 and the noninventory write-downs.</p>
1433	<p>1 updated income in 2010 from a financial statement. It's 2 based on not taking criticism of the normal year-end 3 adjustments that are not inventory related. And so I 4 would say that the new version, if you will, of the 5 2.7 million is roughly 2.25 million, two and a quarter 6 million. 7 Q (BY MR. DONLEY) Mr. Walter, are you aware of 8 any basis at all, any lawful basis, accounting basis, 9 any kind of basis at all that would support telling 10 Nissan \$2.8 million in profit versus telling the IRS 11 \$320,000? 12 A Not based on the testimony that I've heard here 13 and records I've reviewed. 14 Q And that was based on the total. How about how 15 that same thing occurred in 2010, '11, '12 and '13? 16 A Same thing for each year. 17 Q Based on these two charts, which I'll mark in a 18 moment with the next number and ask for admission, what 19 do you conclude regarding the accuracy and reliability 20 of the financial statements that were provided to 21 Nissan? 22 A They're not accurate or reliable either 23 annually or, as I testified a few minutes ago, month by 24 month by month during the course of this time period. 25 Q Was the information that was inaccurately</p>	1435	<p>1 Q Now, if -- if 277 and 254 are added together 2 and you're driving to around \$75,000 in taxable income, 3 how much of the 277 -- at a minimum, how much of the 277 4 had to be further wrote down in 2011 to get there? 5 A Certainly at least the difference between 6 270 -- excuse me -- 442,245, which is the inventory 7 write-down, and the other profits that were earned 8 during the year. So somehow -- and these are fungible 9 dollars. So somehow the write-down is accumulated as 10 part of the 277 or it's accumulated as part of the 254. 11 I frankly don't care which is which, but in total the 12 write-down covers the substantial part of both of those 13 numbers. 14 Q And do we see that reoccurring in 2012 and 15 2013? 16 A We do. 17 Q Is there anything you know of that would 18 support doing that? 19 A No. 20 MR. DONLEY: What is the next R number, 21 please? 22 MS. GOEHRS: It would be 493. 23 (Discussion off the record) 24 JUDGE BENNETT: Okay. Yeah. Back on the 25 record now.</p>

Attachment 10

1504	1506
<p>1 A When I testified at deposition, I wasn't sure, 2 but I know I have at least four right now. 3 Q Would you advise using lower-of-cost-or-market 4 on new vehicles? 5 A No, sir. My first choice, as I've done for 6 over 30 years, Your Honor, is to have dealers elect the 7 LIFO method of valuing inventory. It is my first choice 8 by far. It has more benefits and more permanency for 9 deduction than lower-of-cost-or-market. 10 Q What benefits are there for LIFO versus 11 lower-of-cost-or-market? 12 A LIFO, Your Honor, you're allowed, without 13 making it too detailed, is -- if I have one vehicle in 14 stock at the end of '13 for 20,000, sell it in '14, and 15 replace it with a 22,000 vehicle, same vehicle, the 16 price went up, I can make believe I sold the \$22,000 17 vehicle, which cost 2,000 more, and reduce my taxable 18 income and -- at that time. 19 That \$2,000 difference will come back into 20 taxable income at some time into the future. It's a 21 deferral. That's all it is. Lower-of-cost-or-market is 22 a deferral of sorts, but LIFO is much more beneficial 23 over time. 24 Q Now, Mr. Woodward, you were here this morning 25 when Mr. Walter testified about the direction of the</p>	<p>1 A Okay. 2 Q And this is a chart that you prepared comparing 3 how Bates would have performed under LIFO. Is that 4 correct? 5 A Yes, sir. 6 Q And can you explain to the Court what this 7 chart illustrates? 8 A Your Honor -- 9 JUDGE BENNETT: Can we get this chart 10 pulled up? Can you identify it so we can get it pulled 11 up? Okay. Thank you. 12 A Your Honor, there's a lot of numbers on here. 13 What I tried to do is put in the left-hand side, which 14 is Column F and to the left, the -- what LIFO would have 15 been if Bates had adopted it and his tax advisor knew 16 how to do it and did it, that over time, just on new 17 LIFO, Your Honor, Mr. Bates' dealership -- if you look 18 at Column D, Line 32 -- would have over \$1 million 19 reserve for LIFO. 20 And what does that mean in English? That 21 he's not paid tax, Your Honor, on \$1 million. Now, he 22 will ultimately pay tax on all of that. It's a -- 23 basically an interest-free loan from the dealership -- 24 to the dealership from the IRS, and I would say 25 80 percent or more of dealers do it. So there's nothing</p>
1505	1507
<p>1 effective net worth and work -- and working capital for 2 Bates Nissan. Were you? 3 A Yes, sir. 4 Q Okay. And I want to be extremely clear. Is it 5 your professional opinion that but for the write-downs, 6 Bates' networking capital and net worth would be lower? 7 A It depends on where the monthly cycle -- the 8 real net worth was continuing to go up and the real 9 working capital was continuing to go up. It was just 10 not apparent looking at the financial statement 11 depending on which month you looked at. 12 Q And do you have an issue with a C corporation 13 having a \$75,000 taxable income goal? 14 A Not at all. That's a goal I have for the 15 C corps I have. I only have a handful of them. They 16 are still C corps because of other reasons. I would not 17 have a dealership be a C corp, like Mr. Bates is. That 18 shows problems with the tax advisor, just like I would 19 have LIFO instead of LCM on new vehicles. 20 Q And the C corps of which you've dealt with, 21 have you found their yearly taxable income to be in the 22 \$75,000 tax range? 23 A I do my best to get it in that range. 24 Q Now in your supplemental report, let's go to 25 C-6, on the last page.</p>	<p>1 really aggressive or -- about this. Most dealers do it. 2 So I'd be saving taxes on \$1 million. 3 What I did on the right-hand side of the 4 page, G -- and to the letter G, Column G, is just show 5 the write-down amounts on LCM for what I believe Bates 6 had done, and where it gets reversed out the following 7 year. And then the subsequent year, you might have 8 another LCM adjustment or not, because there's a couple 9 of years there that they didn't, and it shows the 10 benefits to using LCM, which are much, much less than 11 LIFO, for whatever it's worth. 12 Q (BY MR. ALANIZ) So you agree had -- had Bates 13 Nissan used this LIFO method as compared to the LCM 14 method they used that they would have paid less in 15 federal income taxes over this time period? 16 A Yes, sir. 17 Q What percentage of your dealers filed 13-month 18 statements? 19 A Not that many anymore that actually file -- you 20 mean -- by "file," send them with the manufacturers? 21 Q Sorry. Create. Create 13-month statements. 22 A Oh, 50 to 70 percent. 23 Q And of that 50 to 70 percent, what percentage 24 of those do you know file -- have to file them with the 25 manufacturer or do file them with the manufacturer?</p>

**SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NO. 14-0010 LIC**

**BATES NISSAN, INC.,
Complainant,**

v.

**NISSAN NORTH AMERICA, INC.,
Respondent.**

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BEFORE THE STATE OFFICE

OF

ADMINISTRATIVE HEARINGS

COMPLAINANT BATES NISSAN, INC.'S REPLY TO RESPONDENT NISSAN NORTH AMERICA, INC.'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

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TABLE OF CONTENTS

TABLE OF CONTENTS ii

I. INTRODUCTION..... 1

A. No Grounds for Reversal Under Tex. Gov’t Code § 2001.058(e)(1) 2

B. Nissan’s Disregard for the Truth..... 3

C. Bates Nissan’s Operations 3

 1. Chasing the Money 3

 2. RSE 3

 3. Bates’ Delay in Adopting Volume Selling..... 4

 4. Transforming to a Volume Seller 4

II. APPLICABLE LAW 5

A. California Law Does Not Apply 5

III. ARGUMENT..... 7

A. RSE Is Not a Useful Tool for Evaluating Bates’ Sales Performance Under Its Dealer Agreement..... 7

 1. Bates’ Contractual Sales Performance Obligation 7

 2. Why RSE is Not a Reasonable Criteria or Useful Tool..... 8

B. The PFD Construes the Dealer Agreement as a Whole..... 10

C. RSE Does Not Measure Bates’ Sales Performance Obligations in the Dealer Agreement..... 11

 1. Bates’ Sales Performance Obligations 11

 2. NNA’s Desire for Market Penetration 13

D. Courts and Agencies in the United States Have Not All Come to the Same Conclusions on the Reasonableness of Sales Effectiveness and RSE for Evaluating a Dealer’s Sales Performance 14

 1. *Santa Cruz Nissan - California* 14

 2. *Beck Chevrolet – New York*..... 16

 3. *Elliott Chevrolet - Texas*..... 20

 4. *Tejas Toyota - Texas*..... 20

E. The PFD Properly Construed Bates’ Obligations Under the Dealer Agreement 21

 1. Sales vs. Registrations 21

 2. Half of the RSE Expectation is Driven by Sales Outside the PMA..... 22

F. The Two Methods that the PFD Uses to Measure Bates’ Performance Demonstrate that there is No Good Cause for Termination..... 23

 1. The PFD’s First Method – Sales Registered Within Its PMA 24

 2. The PFD’s Second Method – Sales Registered as a Percentage of Expected Sales

Within Its PMA 24

3. Even Under NNA’s “Sales from the PMA” Standard, Bates Performs Well 26

G. The PFD Properly Interpreted “Sales in Relation to Sales in the Market” in TOC § 2301.455(a)(1) 27

H. Injury or Benefit to the Public Weighs in Favor of Bates Nissan..... 28

I. All Existing Circumstances Includes Bates’ Existing Post-NOT Performance. 28

J. Supplemental Notice of Termination – Tax Related, Capitalization, and Financial Statements Allegations..... 29

1. Specious Tax Fraud Allegations..... 29

2. Nissan Did Not Catch Bates..... 29

3. The False Filing Gambit..... 31

4. Lower of Cost or Market (LCM) 31

5. 13-Month Statements 32

6. Nissan’s Rules Contributed to Its Complaints..... 32

7. Bates is Demonstrably Innocent..... 33

8. The Management/Ownership Issue 33

IV. CONCLUSION 34

INDEX TO APPENDIX 37

**SOAH DOCKET NO. 608-14-3211.LIC
MVD DOCKET NO. 14-0010 LIC**

BATES NISSAN, INC., Complainant,	§ § § § § § § § §	BEFORE THE STATE OFFICE
v.		OF
NISSAN NORTH AMERICA, INC., Respondent.		ADMINISTRATIVE HEARINGS

COMPLAINANT BATES NISSAN, INC.’S REPLY TO RESPONDENT NISSAN NORTH AMERICA, INC.’S EXCEPTIONS TO THE PROPOSAL FOR DECISION

COMES NOW, Complainant, Bates Nissan, Inc., (“Bates”) and files this Reply to Respondent Nissan North America, Inc.’s (“Nissan” or “NNA”) Exceptions to the SOAH Proposal for Decision, and in support thereof would show the SOAH ALJ and TxDMV Board as follows:

I. INTRODUCTION

Judge Craig Bennett, the SOAH Administrative Law Judge (“ALJ”) assigned to the case, carefully considered all of Nissan’s specious allegations against Bates Nissan. The process took approximately 2 years and thousands of man-hours to prepare the very thorough record on which SOAH acted. The ALJ presided over eight days of hearing testimony, which included over 800 exhibits from the parties, testimony from over 20 witnesses, and closing statements by the parties. The ALJ not only had the opportunity to gauge the credibility of the witnesses, but also had the opportunity to compare each party’s briefing to its evidentiary record citation, legal citation, and to assess the accuracy and supportability of counsel’s arguments.

The Proposal for Decision (“PFD”) sets forth the arguments of both parties before reaching its conclusion. The PFD in this case provides a well-reasoned and concise analysis. The necessary Findings of Fact (“F/F”) and Conclusions of Law (“C/L”) are set forth in the PFD. The ALJ properly applied Texas Occupations Code (“TOC”) §§ 2301.453 and 2301.455 and corrected concluded that NNA does not have good cause for termination. The fact is that the subject PFD is well supported by the record in this case.

Nissan's Exceptions are a study in misstatement, misdirection and spurious innuendo. They should be rejected and Judge Bennett's Proposal for Decision adopted without alteration.

A. No Grounds for Reversal Under Tex. Gov't Code § 2001.058(e)(1)

The Texas Administrative Procedure Act ("APA") Tex. Gov't Code § 2001.058(e) provides the three ways that an agency may change an ALJ's finding of fact or conclusion of law, or may modify or vacate an ALJ's order. None of those circumstances are presented in this case. As a result, the Board should enter a final order adopting the PFD in all respects.

Nissan's first misstatement at page one of its Exceptions is that "because the PFD reached the wrong conclusions as a matter of law, the Texas Department of Motor Vehicles Board has the authority under Texas Government Code § 2001.058(e)(1) to modify the PFD and find good cause for termination." This statement is so demonstrably wrong as to be specious.

APA § 2001.058(e)(1) provides as follows: (e) a state agency may change a finding of fact or conclusion of law made by the administrative law judge, or may vacate or modify an order issued by the administrative judge, only if the agency determines: (1) that the administrative law judge did not properly apply or interpret applicable law, agency rules, written policies provided under section (c), or prior administrative decisions;..."

Nowhere in the statute does it say that reaching the wrong conclusion "as a matter of law" empowers the board to modify or vacate. Nor does NNA explain how Judge Bennett misapplied or misinterpreted applicable law, agency rules or prior administrative decisions in his PFD. NNA simply jumps into attacking Judge Bennett's Findings of Fact as if it had already established a right to request a modification or vacate of the SOAH proposed decision. It has not established any such right and the Board's review of Nissan's exceptions need go no further.

Finally, if the agency modifies a SOAH judge's proposal for decision, the agency must set forth in writing the reason and legal basis for the change in its final order.¹ NNA has not established any legal basis for any change to the PFD.

¹ Tex. Gov't Code § 2001.058(e).

B. Nissan's Disregard for the Truth

Nissan plays as fast and loose with the facts as it does with the law. Nissan has been slandering Bates Nissan since the beginning of this case. When Nissan calls Bates an incompetent dealer, it misstates the facts and the law. (*See* Section III.A-G herein.) But when Nissan accuses Bates of tax fraud, it lies.² (*See* Section III.H herein.) Nissan's own tax experts, Mr. Walter and Mr. Liner refused to accuse Bates of tax fraud. They testified that they were not accusing Bates of tax fraud.³ Only Nissan's attorneys were doing that. Judge Bennett saw through Nissan's web of deceit and rendered a just decision which should not be disturbed.

C. Bates Nissan's Operations

Bates Nissan is a 40 year Datsun/Nissan dealership located in Killeen Texas. It is family owned and operated by Bobby Bates, its Executive Manager and his father, Jimmy Bates as Dealer Principal. Bates serves Ft. Hood and the communities which have grown up around it, called the Killeen market.

1. Chasing the Money

In recent years, Nissan embarked upon a marketing plan to increase its market penetration to 10% of the US market.⁴ To accomplish this task NNA is terminating those dealers who are not producing the volume of new car sales that Nissan demands. Bates was one of those dealerships. Nissan's game plan for increasing market share is to pressure all of its dealers to sell more product faster. Selling more product faster increases market penetration and thus market share. It also increases Nissan's profits. In order to sell more, faster, however, the dealers must rely upon incentive monies provided by Nissan. In essence, dealers must sacrifice gross profit per unit to achieve the maximum volume possible for their dealerships and then rely upon backend incentive monies to make their new car departments profitable.

2. RSE

Regional Sales Effectiveness ("RSE") is a region-based hybrid sales effectiveness

² NNA's Exceptions, pp. 32-36.

³ Tr. at 1366-1376 (Walter); Tr. at 1368-1371 (Walter); Ex. C-356, pp. 28, 29, 75 (Liner Depo).

⁴ Tr. at 1021:9-15 (Corrao); C-354, p. 93:9-18 (Steiner).

measure.⁵ The formula attempts to measure a dealer's sales performance relative to the average sales performance of all other Nissan dealers in a given geography.⁶ This formula is explained in detail at PFD F/F 45-54.

3. Bates' Delay in Adopting Volume Selling

Bates Nissan, due to its reliance upon Ft. Hood for its clientele, had experienced past catastrophic slowdowns in business due to Ft. Hood troops being deployed en masse to foreign wars. The business slow down during Desert Storm, for example, was particularly intense and could have resulted in the demise of the dealership had it not adopted a conservative business philosophy. That philosophy was to keep expenses under tight control and attempt to make a gross profit on every car sale.

When Nissan began implementing its volume selling marketing plan, called "chasing the money,"⁷ Bates Nissan was slow to adapt to it partly because of its conservative mindset and partly because of the disruptions to the dealership which occurred as a result of Bates transforming itself from a conservative dealership, focused on profit per unit, to a volume seller focused on volume selling regardless of profit per unit. One of these disruptions is discussed at PFD F/F 33. There were many others, all of which were ultimately overcome by Bates but it took time to do so.

4. Transforming to a Volume Seller

Nevertheless, when Bates was threatened with termination for low RSE scores it did, in fact, begin transforming the dealership into a volume seller by hiring Kevin Adams as sales manager. Mr. Adams was experienced in volume selling for various Austin dealerships. Mr. Adams ultimately cured Bates' RSE deficiencies within the cure period provided by the franchise agreement. By the close of the record in this case, Bates was at 125% RSE. (*See* PFD F/F 59-73.)

⁵ Ex. C-1, p. 4 (Stockton Report). RSE is similar, but somewhat different from a classical sales effectiveness measure. *Id.*

⁶ NNA's Closing Statement, p. 8.; "Bates Nissan is part of NNA's Central Region. During all relevant times, the Central Region was comprised of 14 states, including Texas." Ex. R-492, p. 3 ¶ 3 (Steiner Prefiled).

⁷ Numerous witnesses discussed the dynamics of "chasing the money." The following are just a few of them: Ex. C-338-1, pp. 90-96 (Bates); Ex. C-340, pp. 12-16 (Adams); Ex. C-341, pp. 3-11 (Miranda); Ex. C-339, pp. 34-41.

II. APPLICABLE LAW

A. California Law Does Not Apply⁸

NNA claims that because no conflict exists between the Code and the Dealer Agreement, the Dealer Agreement is therefore governed by California law.⁹ NNA cites to Ex. C-17 for this proposition rather than to any law. NNA then states that Texas law and California law are the same regarding contract construction issues in the case, which would moot this issue.

The Code makes it very clear that these disputes are governed by Texas law and the Dealer Agreement is superseded by the Texas Occupations Code Chapter 2301. For example, TOC § 2301.004 provides as follows: “Unless otherwise specifically provided by law not in conflict with this chapter, all aspects of the distribution and sale of motor vehicles are governed exclusively by this chapter.” That would include franchise terminations under TOC § 2301.453.

Tex. Occ. Code § 2301.003 provides that (a) The terms and conditions of a franchise are subject to this chapter, and (b)... “A term or condition of a franchise inconsistent with this chapter is unenforceable.” That would include Nissan’s franchise.

Most of the cases cited by Nissan for the propriety and enforceability of RSE are clearly not controlling in Texas. The applicable law is Texas Occupations Code §§ 2301.453 and 2301.455 which impose procedural requirements for termination or discontinuance of a franchise. These statutory sections override and modify a distributor’s contractual right to modify or terminate a franchised dealer’s franchise agreement. Where the contract conflicts with the statute, the statute controls.¹⁰

As a general proposition, courts follow the framework established in the Restatement (Second) *Conflicts of Laws* Section 187.¹¹ A choice of law provision will not be enforced if the following condition is satisfied, “(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in

⁸ NNA’s Exceptions, Section II, p. 5.

⁹ NNA’s Exceptions, Section II, p. 5.

¹⁰ See TOC § 2301.455(a)(6).

¹¹ Restatement (Second) *Conflicts of Laws* § 187.

the determination of the particular issue...¹² This exception is important because the Texas Occupations Code expressly supersedes the provisions in the franchise agreement.

The determination of whether enforcing a choice of law clause offends Texas' fundamental policy is decided on an issue-by-issue basis. Depending on the facts, a court could find that Texas has a materially greater interest than the state specified in the contract and that the chosen law would violate Texas' fundamental policy.¹³

Nevertheless, it is the burden of the party asserting that another state's law is applicable to show the existence of a true conflict and then demonstrate which law applies.¹⁴ NNA has not met that burden and has not established that there is a true conflict or that California law applies.

Furthermore, the argument that another state's law applies to a dispute can be waived.¹⁵ Under Rule 202 of the Texas Rules of Evidence, a court is required to take judicial notice of the law of another state when a party provides the court with "sufficient information" to enable it to comply with the request.¹⁶ Without a motion to apply the law of a different state, the court is permitted to simply presume that the law of another state is identical to Texas law.¹⁷ NNA has, therefore, waived this argument by not demonstrating the existence of a true conflict., nor the applicability of California law over Texas law.

Finally, the Austin Court of Appeals has long held that unless a specific, controlling statute provides otherwise, the burden of proof in contested case proceedings is the civil standard of a preponderance of the evidence.¹⁸ Nothing in NNA's Exceptions change the fact that NNA did not carry its burden of proof for establishing good cause for the notices of termination under TOC §§ 2301.453 and 455.

¹² See Tex. R. Evid. 202.

¹³ See e.g., *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990).

¹⁴ *Weatherly v. Deloitte & Touche*, 905 S.W.2d 642, 650 (Tex. App. 1995), writ dismissed w.o.j. (Mar. 7, 1996).

¹⁵ See *Pittsburgh Corning Corp. v. Walters*, 1 S.W.3d 759, 769 (Tex. App. — Corpus Christi 1999, no pet.) (motion to apply another state's law untimely after hearing on preliminary motions and made five days prior to trial; further, failure to include substantive law of the state also defeats the motion).

¹⁶ *Id.*

¹⁷ *Burlington Northern and Santa Fe Railway Co. v. Gunderson*, 235 S.W.3d 287, 290 (Tex. App. — Fort Worth 2007, pct. withdrawn).

¹⁸ See *Sw. Pub. Serv. Co. v. Pub. Util. Comm'n*, 962 S.W.2d 207, 213 (Tex. App.-Austin 1998, pet. denied); See also *Granek v. Tex. State Bd. of Med. Exam'rs*, 172 S.W.3d 761, 777 (Tex. App.-Austin 2005); *Pretzer v. Motor Vehicle Bd.*, 125 S.W.3d 23, 38-39 (Tex. App.-Austin 2003).

III. ARGUMENT

A. **RSE Is Not a Useful Tool for Evaluating Bates' Sales Performance Under Its Dealer Agreement**¹⁹

NNA argues that, "RSE Is a Proper 'Reasonable Criteria' for Evaluating Sales Performance Under the Dealer Agreement."²⁰ The ALJ, however, ruled that "...RSE is not a useful tool for measuring Bates' performance under its contractual obligations..."²¹ PFD F/F 73 states that, "Bates **did not fail to fulfill its Sales Obligation** under the Dealer Agreement."²²

1. **Bates' Contractual Sales Performance Obligation**

Bates' contractual sales performance obligation under Section 3.A, General Obligations of Dealer, of the Dealer Agreement is to, "actively and effectively promote through its own advertising and sales promotion activities the sale at retail...of Nissan Vehicles to customers located within Dealer's Primary Market Area."²³

In evaluating Bates' compliance with this contractual obligation, NNA relies upon Section 3.B's language that a "Dealer's performance of its sales responsibility...will be evaluated by Seller on the basis of such reasonable criteria as Seller may develop from time to time...."²⁴ NNA incorrectly argued that RSE (specifically RSE on a rolling 12-month basis), and simultaneously SSER (specifically SSER on a rolling 12-month basis), is incorporated into the Dealer Agreement.²⁵

Sub-Sections 3.B.1–4 include examples of "reasonable criteria," but do not describe RSE. NNA is limited, therefore, only to the "reasonable criteria" language in Section 3.B to measure Bates' obligation under Section 3.A. The use of the word "reasonable" prevents NNA from holding Bates to an arbitrary performance standard, solely because it is the standard.²⁶

¹⁹ NNA's Exceptions, Section III.A, pp. 5-8.

²⁰ NNA's Exceptions, Section III.A, pp. 5-8.

²¹ PFD, p. 12.

²² PFD, F/F 73, p. 40. (*emphasis added*)

²³ Ex. C-17, Standard Provisions, § 3.A, p. 4; Ex. C-16, Article Second: (b), BN 38; Tr. 460:4-11 (Bates).

²⁴ Ex. C-17, Standard Provisions, p. 4; NNA's Closing Statement, p. 3.

²⁵ NNA's Closing Statement, p. 8, "NNA's reasonable criterion at all relevant times was RSE, as measured on a 12-month rolling basis."; Ex. C-358, pp. 15:5-21, 19:1-10 (Steiner Depo); Tr. at 1080:21-1081:3 (Steincr).

²⁶ Ex. C-354, p. 90:3-15 (Farhat Depo).

2. Why RSE is Not a Reasonable Criteria or Useful Tool

In order to determine how reasonable RSE is in measuring Bates' obligation under Section 3.A, especially when being used as a basis for termination, it is important to analyze what RSE actually measures and does not measure. RSE is not a useful tool for evaluating Bates' contractual obligation for the following reasons.

One of the reasons that RSE is not a useful tool is that RSE only tells you if a dealer is good at hitting RSE.²⁷ Mr. Farhat agreed that the standard NNA chooses to apply to a dealer determines whether the dealer is compliant or not.²⁸ Compliance can change without changing the number of sales made, dealer operations, or dealer effort.²⁹ RSE does not tell you whether a dealer is meeting its contractual sales performance obligation to “actively and effectively promote through its own advertising and sales promotion activities the sale at retail...of Nissan Vehicles to customers located within Dealer’s Primary Market Area.”³⁰ NNA’s named decision maker, Mr. Patrick Steiner, testified that, “The RSE measurement is an output of the business. It does not measure effort.”³¹

Second, the use of only RSE leads to distorted judgments about the quality of Bates' actual sales efforts and abilities.³² RSE imposes expectations that are not tied to data that is directly tied to the evaluation of Bates Nissan.³³ Most pertinently, the RSE metric imposes an obligation on dealers to sell to customers outside of its PMA without properly measuring that opportunity. Specifically, a portion of the RSE standard imposed on Bates for termination depends entirely upon sales that Region dealers make to customers outside of their PMAs.³⁴

a. “Sales Within” vs. “Sales Outside” the PMA³⁵

NNA takes issue with the use of “sales inside” and “sales outside” of the PMA. Specifically, the use of “registrations” located within Bates' PMA. NNA argues that, “Sales do

²⁷ Tr. at 1538:18-23 (Farhat); Ex. C-354, pp. 19:22-5 (Farhat Depo).

²⁸ Ex. C-354, p. 111:17-25 (Farhat).

²⁹ *Id.*

³⁰ Ex. C-17, Standard Provisions, p. 4.

³¹ Tr. at 1130:17-1131:2 (Steiner).

³² Ex. C-1, p. 6 ¶ 15 (Stockton Report).

³³ Ex. C-2, pp. 16-17 ¶ 44 (Stockton Rebuttal Report).

³⁴ Ex. C-2, p. 21 (Stockton Rebuttal Report).

³⁵ Further discussed in Section E.1, *infra*.

not occur outside the PMA.”³⁶ This statement conflicts with the use of “registrations” in the RSE formula itself. The formula uses competitive “registrations” in the Region, and competitive “registrations” in the dealer’s PMA in order to determine the expectation. All sales are quantified as “registrations.” The use of registrations is, therefore, a proper way to determine whether Bates is “actively and effectively promot[ing] through its own advertising and sales promotion activities the sale at retail...of Nissan Vehicles to customers located within Dealer’s Primary Market Area.”³⁷ The problem that is that approximately half of the RSE standard is attributable to dealers’ sales that are outside of their PMAs and NNA has no data to evaluate the opportunity for the subject dealer’s sales outside of its PMA.³⁸

The ALJ reasoned that, “the vehicle’s registration location is the best way to determine whether the sale occurs inside the PMA and, consequentially, the number of competitive registrations inside the PMA.”³⁹

b. The PMA Definitions in the RSE Formula are Not Uniform

Another reason that RSE is not useful for evaluating Bates’ contractual sales performance obligations under Section 3.A is that the PMA definitions utilized in the RSE formula are not uniform. Despite NNA’s contention that, “Nissan’s method of assigning PMAs to its dealers is consistent with standard industry practice and is applied consistently across the country,”⁴⁰ this does not prove to be the case in practice.⁴¹ On cross-examination, Mr. Farhat was forced to acknowledge that NNA assigned substantially all of the territory that could be assigned to Bates, but used different criteria for Bates’ neighboring dealerships in carving open points from territory that would be assigned to other Nissan dealerships.⁴²

³⁶ NNA’s Exceptions, p. 6.

³⁷ Ex. C-17, Standard Provisions, p. 4.

³⁸ Tr. at 1564: 1-4 (Farhat); Ex. C-2, Tab 2R (Stockton Rebuttal Report) and Ex. C-1, Tabs 11 and 12 (Stockton Report).

³⁹ PFD, p. 14.

⁴⁰ Ex. R-492, p. 4 ¶ 8 (Steiner Prefiled).

⁴¹ See Bates’ Closing Statement IX.J., pp. 75-77.

⁴² Tr. at 1731:21-1733:25 (Farhat).

c. RSE is Not a Precise Measure of the Differences in the Quality of Dealers' Efforts Within Their PMAs

RSE is not sophisticated enough to tell the difference in a dealer's effort and ability between 99% and 100%.⁴³ Mr. Steiner agreed that RSE is not sufficiently precise to discern variations in differences in the quality of a dealer's sales efforts between 99% and 100% RSE.⁴⁴ Mr. Farhat agreed that it is possible for external market factors to be attributable for up to a 5% difference in RSE.⁴⁵ This is because many factors could affect the absolute and relative volume of sales made by a dealership within its PMA including demographics, availability of retail credit, amount of inter-brand or intra-brand competition, and connection between markets.⁴⁶

B. The PFD Construes the Dealer Agreement as a Whole⁴⁷

NNA argues that, "The PFD Fails to Construe the Dealer Agreement as a Whole."⁴⁸ What NNA really disagrees with is the ALJ's interpretation of the Dealer Agreement. The PFD does not ignore Section 3.B of the Dealer Agreement to read Section 3.A in isolation, as alleged by NNA. The PFD specifically discusses the metrics outlined under Section 3.B. In fact, the ALJ states that NNA's "metrics are not consistent with Bates' obligations under the Dealer Agreement."⁴⁹ The PFD even goes on to state that, "the 'obligations' language of the Dealer Agreement differs from what NNA's metric generally measures."⁵⁰ NNA is unable to disprove this in its Exceptions.

Further evidence that the ALJ construed the Dealer Agreement as a whole, including Section 3.B, is that the PFD specifically discusses Section 3.B and points out that:

Section 3.B of the Dealer Agreement identifies examples of evaluation methods that NNA may use to measure Bates' performance of its sales obligations. NNA's own expert, Sharif Farhat, testified in his deposition that the measurement tool actually used by NNA does not fall within any of the examples identified in Section 3.B. Bates Ex. C-354 at 84-88. Thus, it is not an evaluation method specifically

⁴³ Ex. C-1, p. 9 ¶ 27 (Stockton Report); Ex. C-2, pp. 5-6 ¶ 13, p. 16 ¶ 41 (Stockton Rebuttal Report).

⁴⁴ Ex. C-358, p. 115:15-22 (Steiner Depo); Tr. at 1136:20-1137:2 (Steiner); Ex. C-2, pp. 5-6 ¶ 13 (Stockton Rebuttal Report).

⁴⁵ Ex. C-354, pp. 46:17-20, 47:9-14, and 45:19-46:46:20 (Farhat Depo).

⁴⁶ Ex. C-2, p. 16 ¶ 42 (Stockton Rebuttal Report).

⁴⁷ NNA's Exceptions, Section III.B, p. 8.

⁴⁸ NNA's Exceptions, Section III.B, p. 8.

⁴⁹ PFD, p. 4.

⁵⁰ PFD, pp. 4-5.

identified in the Dealer Agreement.⁵¹

The PFD even goes as far to account for allowing the alternative, that RSE is a permissible evaluation method under Section 3.B, and states:

Ultimately, even if it is permissible as an evaluation method, it is not reasonably designed to measure Bates' identified sales obligations in Section 3.A and, thus, does not establish a violation of such sales obligations.⁵²

There is an important distinction between RSE being reasonable in the abstract or having some merit, and RSE being a "reasonable criteria" to measure Bates' sales obligations in Section 3.A. NNA has no factual or legal basis identified under APA § 2001.058(e) to change the ALJ's findings.

C. RSE Does Not Measure Bates' Sales Performance Obligations in the Dealer Agreement⁵³

NNA argues that, "When Read as a Whole, the Dealer Agreement Plainly Permitted Nissan to Terminate Bates' Based on its Poor Sales Performance."⁵⁴ NNA's argument fails on two bases.⁵⁵ First, RSE does not measure Bates' sales performance obligations under the Dealer Agreement.⁵⁶ Second, the Dealer Agreement is superseded by the Texas Occupations Code Chapter 2301 and TOC § 2301.455(b), which explicitly prohibits the desire by a distributor for market penetration by itself to justify good cause for termination in the state of Texas.⁵⁷

1. Bates' Sales Performance Obligations

NNA makes the argument that "RSE is a reasonable criteria to measure dealer sales performance."⁵⁸ This case is not a referendum on whether Regional Sales Effectiveness has some merit. Mr. Stockton even agrees that RSE is a "good first cut of analysis."⁵⁹ The referendum,

⁵¹ PFD, p. 5 fn 11.

⁵² PFD, p. 5 fn 11.

⁵³ NNA's Exceptions, Section III.C, pp. 8-13.

⁵⁴ NNA's Exceptions, Section III.C, pp. 8-13.

⁵⁵ See also Section III.B, *supra*.

⁵⁶ See Section III.A, *supra*.

⁵⁷ Furthermore, in assessing "good cause" for termination, and Bates' compliance with the franchise, TOC § 2301.455(a)(7), the board is required to consider "the enforceability of the franchise from a public policy standpoint, including issues of reasonableness of the franchise's terms...."

⁵⁸ NNA's Exceptions, p. 9.

⁵⁹ Tr. at 1792:22-24 (Stockton).

instead, is whether Bates' alleged failure to reach 100% of RSE on a rolling 12-month basis necessarily merits termination, regardless of other considerations, including Bates' contractual obligations under its Dealer Agreement and the limitations in the Texas Occupations Code.

NNA's position is that the "...actively and effectively promote..." language in Section 3 of the Dealer Agreement requires that Bates achieve and maintain 100% RSE on a 12-month rolling average basis.⁶⁰ **Section 3 of the Dealer Agreement does not include, define, or even describe RSE as a performance measure.**⁶¹

Mr. Steiner, NNA's Corporate Representative, testified that NNA does not hold Bates to a contractual duty to sell outside of its PMA.⁶² The unreasonableness occurs when the RSE metric applies just that obligation in order to hit the average.⁶³

a. Section 3.H – Evaluation of Dealer's Sales Performance

NNA argues that the PFD failed to consider Section 3.H, which states that, "Seller will periodically evaluate Dealer's performance of its responsibilities under this Section 3."⁶⁴ NNA argues that Section 3.H is part of "Bates' sales responsibilities..."⁶⁵ In fact, Section 3.H only provides the contractual right for NNA to perform evaluations and for the dealer to have "an opportunity to comment, in writing, on such evaluations."⁶⁶ Section 3.H does not provide a separate sales responsibility.

When the Dealer Agreement is read a whole, the evaluations under Section 3.H must comply with the conditions of Sections 3.A and 3.B.

b. Bates' Sales Performance Was Not Poor

Bates takes issue with NNA's characterization of its performance as poor. On the contrary, prior to the Notice of Termination issuing, Bates made substantial progress in

⁶⁰ Tr. at 1043-1044 (Steiner).

⁶¹ Ex. C-17, Standard Provisions, Section 3, pp. 4-5.

⁶² Ex. C-358, pp. 30:24-31:14 (Steiner Depo).

⁶³ Ex. C-2, p. 6 ¶ 14 (Stockton Rebuttal Report).

⁶⁴ Ex. C-17, Standard Provisions, § 3.H, p. 5.

⁶⁵ NNA's Exceptions, p. 11.

⁶⁶ Ex. C-17, Standard Provisions, § 3.H, p. 5.

November 2013 with an RSE score of 96.7%.⁶⁷ Exhibit C-213 evidences Bates' substantial progress and illustrates the monthly RSE score for Bates between September 2013 and August 2014.⁶⁸ Ex. C-213 shows that Bates exceeded 100% RSE on a monthly basis for six⁶⁹ of the 12 months depicted, with a rolling 12-month average RSE score of 96.9% for August 2014. We know that the decision for the Notice of Termination which issued December 23, 2013, was made based on September 30, 2013, data.⁷⁰ Ex. C-213 shows how immediately after Mr. Bates hired Mr. Kevin Adams in November 2013, the RSE scores began a dramatic improvement going from 70.5% RSE in September 2013 to 96.7% RSE in November 2013, and then to 125% RSE in December 2013, the same month the NOT went out.⁷¹ Mr. Farhat agreed that the September 2013-December 2013 progress was a "big improvement."⁷² According to Mr. Farhat's expert report, Ex. R-361, Tab A-44, from October 2013 through December 2013, Bates was at 100.8% RSE on a 3-month average.⁷³ This substantial progress is all based on efforts that existed prior to the NOT issuing and continued to the present.

Finally, Ex. C-365, evidences Bates' substantial progress and illustrates Bates' RSE scores by month between September 2014 and June 2015. The data only includes 10 months, but if you include the months of July 2014 (107.0% RSE) and August 2014 (108% RSE) from Ex. C-213, you see that Bates' June 2015 R12 RSE score was 104.65%.⁷⁴ In October 2014 Bates achieved 101.11% RSE on a rolling 12-month basis and as of the most current data in May 2015, Bates ranked higher in SSER performance than 27 other Texas Nissan dealers.⁷⁵

2. NNA's Desire for Market Penetration

By attempting to terminate Bates Nissan for failure to achieve and maintain 100% RSE on a rolling 12-month basis, NNA is motivated by a desire for NNA to increase its market penetration.⁷⁶ This plainly violates TOC § 2301.455(b). NNA considers any lack of performance

⁶⁷ Ex. C-213.

⁶⁸ Report titled, 979 Bates Nissan, Inc. All Geography RSE by Month as of August 2014 Data.

⁶⁹ December 2013 – 125%; February 2014 – 125%; May 2014 – 101.2%; June 2014 – 113.6%; July 2014 – 107%; August 2014 – 108%.

⁷⁰ Ex.-C-33, NOT pp. 3-4.

⁷¹ Ex. C-213.

⁷² Tr. at 1745:11-15 (Farhat).

⁷³ Ex. R-361, Tab A-44 (Farhat Report).

⁷⁴ Ex. C-231, Ex. C-365; *See also* Ex. C-367 at 104.48%.

⁷⁵ Ex. C-366; Tr. at 1004:22-1005:3 (Corrao).

⁷⁶ Ex. C-358, pp. 47:10-48:20 (Steiner Depo); Ex. C-354, p. 93:9-18; p. 94:12-22 (Farhat Depo).

by Bates to be lost sales to the brand.⁷⁷ NNA has a documented desire to increase market penetration.⁷⁸ In fact, NNA has a goal to increase market share to 10% by the end of 2017.⁷⁹

Mr. Stockton established that “the RSE system as perpetuated across the dealer body is strictly a market share or market penetration standard that maintains one-directional influence upon the dealer body to increase market share or market penetration for the brand.”⁸⁰ Mr. Farhat agrees that RSE is a mechanism that NNA uses to help increase its market share.⁸¹

D. Courts and Agencies in the United States Have Not All Come to the Same Conclusions on the Reasonableness of Sales Effectiveness and RSE for Evaluating a Dealer’s Sales Performance⁸²

NNA argues that, “The Courts and Agencies Across the United States Have Uniformly Arrived at the Same Conclusion that RSE is a Permitted Reasonable Criteria for Evaluating Dealer Sales Performance under the Nissan Dealer Agreement.”⁸³ Bates disagrees with NNA’s characterization of the uniformity of the courts’ and agencies’ conclusions in the United States regarding sales effectiveness measures such as RSE.⁸⁴ Further, a determination regarding the reasonableness of a standard is distinct from allowing a distributor to use that standard as the sole basis to terminate a dealer. Notwithstanding NNA’s claim that RSE is consistent with industry norms, it is subject to the limitations set forth under Texas law and the contractual limitations in its own Dealer Agreement.

1. Santa Cruz Nissan - California

NNA argues that California law should be applied in this case. It appears, however, that California law may be even more favorable to Bates than Texas law. In *Santa Cruz Nissan*, the State of California New Motor Vehicle Board adopted the proposed decision and conditionally sustained the dealer’s protest finding that NNA did not have good cause to terminate Santa Cruz

⁷⁷ Ex.-C-35, NOD, p. BN 3.

⁷⁸ Tr. at 1021:9-15 (Corrao); Mr. Williams also testified that increasing market share or penetration is an important consideration for a distributor. Ex. C-362, p. 93:3-13 (Williams).

⁷⁹ Tr. at 1021:24-1022:9 (Corrao); Tr. at 1608:10-1608:17 (Farhat); Ex. C-358, pp. 47:10-48:20 (Steiner Depo); Ex. C-354, p. 93:9-18; p. 94:12-22 (Farhat Depo).

⁸⁰ Ex. C-2, p. 17, ¶ 44 (Stockton Rebuttal Report).

⁸¹ Ex. C-354, pp. 95:15-96:1 (Farhat Depo).

⁸² NNA’s Exceptions, Section III.D, pp. 13-16.

⁸³ NNA’s Exceptions, Section III.D, pp. 13-16.

⁸⁴ See also Bates’ Closing Statement, pp. 56 and 64.

Nissan.⁸⁵ Here, similar to the instant case, NNA attempted to terminate a successful family-owned Nissan dealer of over 40 years in the city of Santa Cruz, California under the same Regional Sales Effectiveness measure.⁸⁶ In Santa Cruz Nissan's case, for having a 12-month rolling average RSE score of 37.3%.⁸⁷ One of the key differences is that compared to Santa Cruz Nissan, Bates Nissan is a much higher performing dealer on the RSE metric. NNA has been unable to distinguish *Santa Cruz Nissan* from the instant case.

In *Santa Cruz Nissan*, the California Board ruled that Section 3.B did not define RSE and adopted the following Finding of Fact:

111. Section 3.B of the Dealer Agreement describes the calculations Nissan will take to evaluate a dealers' sales performances. Using these calculations only leads to sales penetration percentages, and this does not describe Nissan's current---and complex---evaluation calculations.⁸⁸

The *Santa Cruz Nissan* ALJ analyzed the considerations that should be taken when attempting to evaluate a dealer for termination under the RSE measure. The ALJ held that, "In making the decision to terminate protestant's franchise, Nissan failed to temper the rigid 'performance metrics' with the inquiries that its own Dealer Agreement states are appropriate (Section 3.D. – 'Additional Factors for Consideration')." ⁸⁹

Santa Cruz Nissan also pointed out, "However, one of the limitations of Nissan's RSE calculations is its failure to account for intrabrand competition (i.e., competition with other Nissan dealers)." ⁹⁰

Finally, in Finding of Fact 133, the *Santa Cruz Nissan* ALJ found that, "In 2010, 35.4% of Nissan vehicles registered in the PMA were sold by SCN and in 2011, the figure increased to 43.0%. (Exh 200:H:4778)" ⁹¹ Here it was proper for the ALJ to consider how Santa Cruz Nissan

⁸⁵ SCN, p. 37, attached as Appendix Item B to Bates' Closing Statement.

⁸⁶ *Santa Cruz Nissan, Inc. v. Nissan North America, Inc.*, Protest No. PR-2358-13, State of California New Motor Vehicle Board, Proposed Decision (July 3, 2014), and Final Order ("SCN"), attached as Appendix Item B to Bates' Closing Statement.

⁸⁷ *Id.*

⁸⁸ *Santa Cruz Nissan, Inc. v. Nissan North America, Inc.*, Protest No. PR-2358-13, State of California New Motor Vehicle Board, Proposed Decision (July 3, 2014), and Final Order ("SCN"), attached as Appendix Item B to Bates' Closing Statement. SCN PFD, p. 21 ¶ 111.

⁸⁹ SCN pp. 33-34 ¶ 186, attached as Appendix Item B to Bates' Closing Statement.

⁹⁰ SCN p. 27, ¶ 142, attached as Appendix Item B to Bates' Closing Statement.

⁹¹ SCN p. 25, ¶ 133, attached as Appendix Item B to Bates' Closing Statement.

performed within its PMA based on the percentage of Nissan vehicles registered in the PMA. This conflicts with NNA's position that vehicles registered in the Bates' PMA is not a proper performance measure. The instant PFD's findings, therefore, comply not only with Texas law, but also with California law.

2. *Beck Chevrolet – New York*

On May 19, 2015, in *Beck Chevrolet Co., Inc. vs. General Motors LLC*, a New York termination case, the United States Court of Appeals, Second Circuit, certified two questions to the New York Court of Appeals.⁹² The relevant question to the instant case was:

Is a performance standard that requires 'average' performance based on statewide sales data in order for an automobile dealer to retain its dealership 'unreasonable, arbitrary or unfair' under New York Vehicle & Traffic Law section 463 (2) (gg) because it does not account for local variations beyond adjusting for the local popularity of general vehicle types?⁹³

Just as in *Elliott Chevrolet*, discussed *infra*, General Motors' ("GM") performance standard, called a Retail Sales Index or "RSI," uses an average penetration rate applied to segmented, industry registrations to calculate its "expectation," but was otherwise substantively identical to NNA's RSE formula in that they both use an average penetration to calculate expectation.⁹⁴ Mr. Farhat even referred to GM's RSI as "indistinguishable" from RSE.⁹⁵ Consequently, the same legal analysis can be applied to both sales effectiveness measures.

The Second Circuit opinion makes the following observations about the problems with the RSI performance standard:

The relevant facts regarding this performance standard are essentially undisputed. First, GM's performance metric is based on a statewide sales average that does not account for depressed brand popularity, i.e., the relative unpopularity of Chevrolet automobiles, in the relevant metro-area markets. Second, GM's metric does account for some local variation based on the popularity of a given vehicle segment, such as pickup trucks, small sport utility vehicles, and mid-size sedans. Third, under the relevant agreements, a failure to meet an RSI of 100 could result in GM's termination of the franchise or other remedial measures.⁹⁶

⁹² *Beck Chevrolet Co., Inc. vs. General Motors LLC*, 787 F.3d 663 (2nd Cir. 2015), dated May 19, 2015, attached as Appendix Item 1.

⁹³ *Id.* at 676.

⁹⁴ See *Elliott* Final Order, Finding of Fact 75, attached as Appendix Item C to Bates' Closing Statement.

⁹⁵ Tr. at 1705:20-1706:6 (Farhat).

⁹⁶ *Beck Chevrolet Co., Inc. vs. General Motors LLC*, 787 F.3d 663, 674 (2nd Cir. 2015).

Most importantly, and contrary to NNA's position, the *Beck Chevrolet* opinion addresses the lack of uniformity of sales effectiveness performance decisions around the county.

Specifically, the court stated that, "The few reported decisions addressing performance standards have not adopted consistent interpretations of what is reasonable or acceptable."⁹⁷ The court then lays out examples of the inconsistent interpretations as follows:

Several other administrative courts have reached the opposite conclusion, however, rejecting statewide performance standards in favor of those that take local variations into account. Most relevant for present purposes, the Administrative Law Judge ("ALJ") who considered Beck's challenge to GM's notice of termination concluded that "[f]or the New York City metropolitan area, the RSI standard of GM is unreasonable" in part because "it does not realistically reflect the Chevrolet sales challenges that Beck and other New York metropolitan dealers face." *Beck Chevrolet Co., Inc. v. Gen. Motors LLC*, No. FMD 2013-02, at 9 (N.Y. Dep't of Motor Veh. Oct. 6, 2014). Although Beck has not argued that we are bound by that decision, our desire to avoid potentially inconsistent results in state, federal, and administrative courts in part motivates our decision to certify this issue to the New York Court of Appeals.

Beck also relies heavily on *North Shore, Inc. v. General Motors Corp.*, No. MVRB 79-01 (Ill.Mot.Veh.Rev.Bd. May 28, 2003), *aff'd in relevant part sub nom. General Motors Corp. v. Illinois Motor Vehicle Review Board*, 361 Ill.App.3d 271, 836 N.E.2d 903 (2005), *aff'd*, 224 Ill.2d 1, 862 N.E.2d 209, 308 Ill. Dec. 611 (2007), in which an Illinois ALJ resolved a challenge to GM's proposed addition of dealerships in the greater Chicago area. The ALJ concluded that measuring sales performance based on comparisons between similar market areas was preferable to using a statewide or nationwide standard. *See Gen. Motors Corp. v. State Motor Vehicle Review Bd.*, 224 Ill.2d 1, 21-22, 862 N.E.2d 209, 223-24, 308 Ill.Dec. 611, 625-26 (2007) (discussing the state motor vehicle review board's decision). Although not decided under the New York Dealer Act or a provision similar to its section 463(2)(gg), the Illinois courts expressly decided that a standard that takes local variations, such as import bias, into account is a "superior" method of determining performance. *Id.*⁹⁸

The opinion in *Beck Chevrolet* even cites to the Texas administrative case of *Landmark Chevrolet Corp. v. Gen. Motors Corp.* to outline the problems with the RSI standard as follows:

An administrative court in Texas reached the same conclusion in a similar case, reasoning that it was patently unfair to conclude that a standard is appropriate for comparison with a given market if most of the markets used in creating the standard

⁹⁷ *Id.* at 674.

⁹⁸ *Id.* at 674-675.

are fundamentally dissimilar to the market at issue. Stated another way, [an] ALJ cannot endorse a process that characterizes a market as “underperforming” simply because it fails to meet a standard so profoundly influenced by markets bearing so little resemblance to the market in question.

Landmark Chevrolet Corp. v. Gen. Motors Corp., No. 02–0002 LIC at 20–21 (Tex.Mot.Veh.Bd. Sept. 16, 2004), *aff’d sub nom*

. *Austin Chevrolet, Inc. v. Motor Vehicle Bd.*, 212 S.W.3d 425 (Tex.App. 2006); *see also Halleen Chevrolet v. GMC*, No. 03–050MVDB–277–SS at 5 (Ohio Mot. Veh. Dealers Bd. July 21, 2006) (report and recommendation) (“[I]t is inappropriate to consider the expected Ohio average to an urban multi-dealer area such as the [designated area] in this case. Because single market dealers in rural areas tend to achieve about the expected state average and the urban dealers tend to achieve below, it seems that the average is somewhat flawed in a case such as this.”).⁹⁹

Bates references these cases to demonstrate that NNA’s argument claiming there is uniform agreement nationally regarding the reasonableness of sales effectiveness measures such as RSE, is neither accurate nor consistent.

On May 3, 2016, the New York Court of Appeals, New York’s highest court, issued its opinion on the certified questions presented to it by the Second Circuit in *Beck Chevrolet*.¹⁰⁰ The court answered the reformulated question:

Is a performance standard that uses “average” performance based on statewide sales data in order to determine an automobile dealer’s compliance with a franchise agreement “unreasonable, arbitrary, or unfair” under New York Vehicle & Traffic Law section 463(2)(gg) because it does not account for local variations beyond adjusting for the local popularity of general vehicle types?¹⁰¹

The court ruled that GM violated state law by trying to terminate Beck Chevrolet’s franchise for sales performance and that the, “use of such standard [RSI] to determine compliance with a franchise agreement is unlawful under the Dealer Act.”¹⁰²

The New York Court of Appeals also made the following pertinent rulings:

- “A performance standard that measures dealer success based on data that fails to accurately represent market challenges would appear to undermine

⁹⁹ *Id.* at 675–676.

¹⁰⁰ *Beck Chevrolet Co., Inc. vs. General Motors LLC*, No. 2016-03412, New York Court of Appeals, dated May 3, 2016, attached as Appendix Item 2.

¹⁰¹ *Id.* at p. 10.

¹⁰² *Id.* at p. 2.

the franchisor and dealer's common goal of selling and servicing vehicles and franchisor products.”¹⁰³

- “...the use of standards not based in fact or responsive to market forces because performance benchmarks that reflect a market different from the dealer’s sales area cannot be reasonable or fair.”¹⁰⁴
- “...GM's exclusion of local brand popularity or import bias rendered the standard unreasonable and unfair because these preference factors constitute market challenges that impact a dealer's sales performance differently across the state.”¹⁰⁵
- “...measuring the dealer's performance against a market the dealer never faces is not reasonable or fair...”¹⁰⁶
- “...if a franchisor intends to measure a dealer's performance based on a comparison to statewide data for other dealers, then the comparison data must take into account the market-based challenges that affect dealer success.”¹⁰⁷

The New York Court of Appeals’ analysis in *Beck Chevrolet* directly addresses NNA’s “industry norms” argument and states:

Notwithstanding GM’s claim that the RSI methodology is consistent with industry norms, it remains the case that any performance standard adopted by a franchisor to determine a dealer's compliance with a franchise agreement is subject to the limitations set forth in the Dealer Act. While we recognize that industry norms are important ... they are not beyond the reach of the statute.¹⁰⁸

The court sums it up best when it states that, “...GM may not rely on a standard that is unreasonable and unfair simply because of its prevalence within an industry the Legislature sought to regulate.”¹⁰⁹ When the same approach is applied to the instant case, it becomes clear that, similarly, NNA and its RSE measure is not beyond the reach of the Texas Occupations Code.

¹⁰³ *Beck Chevrolet Co., Inc. vs. General Motors LLC*, No. 2016-03412, New York Court of Appeals, p. 12, dated May 3, 2016, attached as Appendix Item 2.

¹⁰⁴ *Id.* at p. 12.

¹⁰⁵ *Id.* at p. 13.

¹⁰⁶ *Id.* at p. 14.

¹⁰⁷ *Id.* at p. 14.

¹⁰⁸ *Id.* at p. 15.

¹⁰⁹ *Id.* at p. 15.

3. *Elliott Chevrolet - Texas*

NNA's argument that RSE has been found a reasonable measure of sales performance also conflicts with the case of *Eaton Motor Company, Inc. v. General Motor Corporation*, MVD Docket No. 04-0019 LIC (2006) ("*Elliott Chevrolet*").¹¹⁰

Similar to *Beck Chevrolet*, in *Elliott Chevrolet*, a sales effectiveness formula substantively similar to NNA's RSE formula, called "RSI," was found "unreasonable as a matter of law." In *Elliott*, the MVD, the predecessor to the TxDMV, concluded, at Conclusion of Law 4, held:

General Motors Corporation's sales performance retail sales index 100 standards *are unreasonable as a matter of law* and they rely upon unwritten standards, which failed to fully disclose the actual criteria that are used to evaluate the proposed transfer, in violation of Code Section 2301.359(e).¹¹¹

If RSI was unreasonable in *Elliott* because it excluded approximately 50% of GM dealers from new points, then NNA's RSE formula is unreasonable as a basis on which to base a termination.

4. *Tejas Toyota - Texas*

In another Texas case, *Tejas Toyota, Inc. v. Gulf States Toyota*, MVD Docket No. 07-0027 LIC ("*Tejas Toyota*"), the agency found no evidence to support the reasonableness of Toyota's sales effectiveness formula.¹¹² In *Tejas*, the MVD ALJ made the following findings which were adopted by the director:

- FF 15: There is no record evidence demonstrating that GST's sales standard formula recognizes or accounts for any differences in the demographic composition, geographic conditions and economic forces that distinguish Tejas' market area from those of dealers in the rest of GST's five-state market.
- FF 17: The record contains insufficient evidence to support the conclusion that GST's 100% sales efficiency standard is reasonable.

¹¹⁰ *Eaton Motor Co., Inc., Complainant, Charles E. Elliott, Intervenor, v. General Motors Corporation, Respondent*, MVD Docket No. 04-0019 LIC (2006), PFD and Final Order attached as Appendix Item C to Bates' Closing Statement. Appealed at *General Motors Corporation v. Bray*, 243 S.W.3d 678 (Tex. App. Austin 2007).

¹¹¹ See *Elliott* PFD, p. 42, attached as Appendix Item C to Bates Closing Statement. (*emphasis added*).

¹¹² See *Tejas* PFD, p. 7 Findings of Fact 15-18, attached as Appendix Item D to Bates Closing Statement.

In the instant case, NNA did not meet its burden to support that 100% RSE is a reasonable standard for evaluating a dealer for termination.

E. The PFD Properly Construed Bates' Obligations Under the Dealer Agreement¹¹³

NNA argues that, "The PFD Also Failed to Properly Construe the Dealer Agreement because of a Fundamental Misunderstanding of Sales, Curbstoning and Registration."¹¹⁴ There was no misunderstanding as discussed below.

1. Sales vs. Registrations

As discussed in Section III.A.2.a *supra*, sales can occur inside or outside of a dealer's PMA depending on where they are registered. Registrations are the only proper way to compare the sales opportunity in a specific geography. It would be unreasonable to hold a dealer to a standard based on unmeasured opportunity outside of its PMA.

NNA's assertion that the use of the language, "both inside and outside of its PMA" demonstrates confusion is false. NNA's interpretation of "to customers located within Dealer's Primary Market Area" under Section 3.A to essentially mean "from its location" is strained. All sales are quantified as "registrations." NNA uses competitive registrations inside Bates' PMA in the RSE formula, so the use of registrations is proper. NNA does not just use competitive sales made from the dealers located inside of Bates' PMA, but all competitive registrations. If the use of registrations is incorrect, then NNA is calculating RSE completely wrong.

Mr. Stockton addressed this issue and testified why this "sales vs. registrations" argument is "untethered" from the RSE formula:

Everything about this formula is tethered -- everything about measuring automotive markets, I should say, is tethered to registrations, sales within a specific geographic area by saying, oh, what we're actually measuring is sales made at the dealership but registered anywhere. If that's really the standard, then the outcome becomes totally untethered from the measurement. So if dealers in Austin buy a lot of cars -- sell a lot of cars to customers in the Bates PMA, if that's really what you were trying to measure, you would have to take all of those cars out of Killcen, because the PMA that they purchased in was in Austin. So if that argument is made, it

¹¹³ NNA's Exceptions, Section III.E, pp. 17-20.

¹¹⁴ NNA's Exceptions, Section III.E, pp. 17-20.

untethers and completely erodes the basic structure of the metrics, RSE and visually every other metric.¹¹⁵

NNA contradicts itself if it defines PMA opportunity as any customer who shops there. The calculation of RSE is on the basis of competitive registrations within the PMA.¹¹⁶ The RSE standard imposed is directly linked to the number of competitive registrations in the dealer's PMA.

If true that PMA opportunity is something other than competitive registrations within, then NNA cannot carry its burden since all rankings and calculations are on the basis of PMA competitive registrations. If you assume that any activity within the PMA is the definition of PMA opportunity, then NNA does not attempt to measure it with RSE, and NNA would also have to adjust for sales registered in the Killeen PMA, but sold by dealerships outside of the PMA. Under this reasoning, that "opportunity" should be attributable to a PMA other than Bates' Killeen PMA. In short, if opportunity is defined by something other than PMA competitive registrations, then NNA does not define or calculate opportunity anywhere in this case.

2. Half of the RSE Expectation is Driven by Sales Outside the PMA

The design of RSE does not measure accurately, what it purports to evaluate.¹¹⁷ Again, note that Bates does not have a contractual duty to sell outside of its PMA.¹¹⁸ The ALJ ruled in F/F 36 that, "The Dealer Agreement imposes no sales obligations on Bates outside of its PMA."¹¹⁹

Sales outside its PMA tells us little about how Bates is performing within its PMA, especially when the opportunity outside the PMA isn't being measured by RSE. NNA never tests whether Bates should sell outside of its PMA to the same degree as other Nissan dealers do.¹²⁰ The absence of analysis of these factors distort the conclusions about Bates' sales performance within its PMA. In order to determine how reasonable RSE is in measuring Bates' sales

¹¹⁵ Tr. at 1830:8-23 (Stockton).

¹¹⁶ See Ex. C-11.

¹¹⁷ Ex. C-1, p. 5 ¶ 12 (Stockton Report).

¹¹⁸ Ex. C-358, pp. 30:24-31:14 (Steiner Depo).

¹¹⁹ PFD F/F 36, p. 37.

¹²⁰ Ex. C-2, p. 13 ¶ 34 (Stockton Report).

obligation, especially when being used as a basis for termination, it is important to focus on what RSE actually measures.

Mr. Stockton established that nearly half of the “expectation” in RSE is driven by dealers’ sales outside of the PMA, and remarkably, “over 10% of the sales expectation under RSE is driven by dealer sales into territories that NNA does not assign to any dealerships.”¹²¹ NNA is measuring Bates’ sales efforts within its PMA (which the contract requires) by applying a sales standard, RSE, driven by Region dealers’ sales into other dealers’ PMAs and unrepresented areas.¹²² That alone is reason that RSE is not a useful tool for evaluating Bates Nissan for termination.

Mr. Farhat said, “if it wants to focus only on its PMA, then it has to sell even more within the PMA to be at region average.”¹²³ This is not a reasonable expectation to put on a dealer in order to avoid termination.

NNA is penalizing Bates for an unquantified and assumed inability to sell outside of its PMA. Mr. Stockton demonstrated how, “the out-of-PMA portion of the RSE standard is the entire driver behind NNA’s basis for this termination.”¹²⁴ Now that it has been established that if you calculate RSE only on data specific to the dealer, and do not include the out-of-PMA requirement, Bates would be between the median and the average of Texas dealers. There would be no failure for Bates to cure since Texas dealers tend to outperform the region,¹²⁵ and Bates is likely above average when compared to the Region as a whole.¹²⁶

F. The Two Methods that the PFD Uses to Measure Bates’ Performance Demonstrate that there is No Good Cause for Termination¹²⁷

NNA argues that, “The Two Methods that the PFD Uses to Measure Bates’ Performance Lead to Unreasonable Results, Unintended Consequences and Bad Policy.”¹²⁸ NNA is the party

¹²¹ Ex. C-1, p. 5 ¶ 12 (Stockton Report).

¹²² Ex. C-2, p. 6 ¶ 15 (Stockton Rebuttal Report).

¹²³ Tr. at 1711:15-19 (Farhat).

¹²⁴ Ex. C-3, p. 11 ¶ 25 (Stockton Supplemental Report) citing to Ex. C-1, Tab 11, 12, 13 and 14 (Stockton Report).

¹²⁵ Tr. at 1852:15-19 (Stockton).

¹²⁶ This Texas Dealer comparison is actually a standard higher than RSE akin to SSER because it is a measure against only Texas dealers and does not include the benefit of selling into unrepresented areas.

¹²⁷ NNA’s Exceptions, Section III.F, pp. 20-26.

¹²⁸ NNA’s Exceptions, Section III.F, pp. 20-26.

with the burden to demonstrate that Bates' performance merits termination. NNA has not demonstrated and does not cite to any data showing the Bates is a poor performing dealer that looks at how much Bates sells and where those sales are made. Instead, NNA only says that Bates is performing below average on RSE.

1. The PFD's First Method – Sales Registered Within Its PMA¹²⁹

Bates' sales within its PMA are average or higher compared to other Nissan dealerships.¹³⁰ This is because Bates sells a higher percentage of Nissan registrations within its PMA than the average Texas dealer.¹³¹ This is true for the default period in 2012 and 9/2013 YTD.¹³² Specifically, Ex. C-1, Tab 11, Page 1R, shows all the Texas Nissan dealers and the percentage of sales they are registering within their own PMAs compared to the total amount of Nissan registrations in their PMA.

Ex. C-1, Tab 11 Page 1R demonstrates that, "Bates sells a higher percentage of Nissan registrations than the average Texas dealership."¹³³ Mr. Farhat agrees that at 71.42% Bates is performing better than the average Texas Nissan dealer in this regard.¹³⁴ This conflicts with Mr. Farhat's testimony that customers within Bates' PMA are rejecting the dealership.¹³⁵ In fact, the opposite is true, within Bates' PMA, customers are buying from Bates at a much higher percentage than the average Texas Nissan dealer.¹³⁶ Mr. Farhat had to correct this testimony, and finally stated, "the difference isn't due to the rejection of the Nissan brand."¹³⁷

2. The PFD's Second Method – Sales Registered as a Percentage of Expected Sales Within Its PMA¹³⁸

NNA argues that analyzing Bates' sales registered in its PMA as a percentage of the expected Nissan sales in Bates' PMA, leads to unreasonable results, bad consequences and bad

¹²⁹ NNA's Exceptions, Section III.F.1, p. 21.

¹³⁰ PFD F/F 101; Ex. C-1, p. 15 ¶ 47-48 and Tabs 11 and 12 (Stockton Report).

¹³¹ Ex. C-1, p. 15 and Tab 11 (Stockton Report).

¹³² *Id.*

¹³³ Ex. C-1, p. 15 ¶ 47 and Tab 11 (Stockton Report); Tr. at 1850:6-9 (Stockton).

¹³⁴ Tr. at 1709:19-21, 1710:7-15 (Farhat).

¹³⁵ Tr. at 1685:21-24, 1708:19-17-1712:2 (Farhat). Mr. Farhat refers to Ex. R-361, Tab A-27 as evidence that Killeen customers are rejecting Bates.

¹³⁶ Tr. at 1710:7-10 (Farhat).

¹³⁷ Tr. at 1709:22-1710:4 (Farhat).

¹³⁸ NNA's Exceptions, Section III.F.2.

policy.¹³⁹ Using RSE to measure the quality of a dealer's effort within its PMA is problematic when very few dealerships in Texas sell a sufficient number of vehicles with their own PMAs to reach Region average.¹⁴⁰

Mr. Stockton's analysis shows that by "[r]emoving only the portion of the RSE statistic applied to Bates and attributable to dealer sales into areas not assigned by NNA (and removing Bates' sales into those areas), Bates cured."¹⁴¹ This is evidenced by Ex. C-1, Tabs 11 and 12.¹⁴²

Ex. C-1, Tab 12 demonstrates that by, "Removing the portion of the RSE expectation attributable to sales outside of dealers' own PMAs, and removing Bates' sales outside of its own PMA, Bates was not defective in its sales performance; it was average or above."¹⁴³ Specifically, Ex. C-1, Tab 12 Page 1R, shows that, "Bates' sales in the PMA as a percentage of expected Nissan registrations (the number of registrations that would occur at Nissan's Region Represented average market share) is between median and average level among Texas dealerships."¹⁴⁴ Ex. C-1, Tab 12 Page 1R captures two things. First, it picks up the number of Nissan registrations in the Killeen PMA relative to competitive registrations.¹⁴⁵ The expectation is based on region average based only on sales that were registered with its PMA.

Second, it picks up how much of that Bates gets.¹⁴⁶ You can see that Bates is getting a very normal share of a very normal number.¹⁴⁷ In 2012, during the default period, Bates is above average.¹⁴⁸ Together with Tab 11, this shows that Bates does a better job than either the median or the overall average of Nissan dealers in Texas in terms of capturing the available sales in its PMA.¹⁴⁹

¹³⁹ NNA's Exceptions, Section III.F.2, p. 24.

¹⁴⁰ Ex. C-2, p. 8 and Tab 1R (Stockton Rebuttal Report).

¹⁴¹ Ex. C-2, p. 6 ¶ 15 (Stockton Rebuttal Report).

¹⁴² Ex. C-1, p. 15 ¶¶ 47 and 48 and Tabs 11 and 12 (Stockton Report).

¹⁴³ Ex. C-2, p. 6 ¶ 14 (Stockton Rebuttal Report).

¹⁴⁴ Ex. C-1, p. 15 ¶ 48 and Tab 12 Page 1 R (Stockton Report); Ex. C-1, Tab 12 Page 2R (Stockton Report) is the data for 2012.

¹⁴⁵ Tr. at 1852:3-8 (Stockton).

¹⁴⁶ Tr. at 1852:3-9 (Stockton).

¹⁴⁷ Mr. Farhat testified that he agreed that Bates is about average on this comparison. (Tr. at 1714:12-15 (Farhat)).

¹⁴⁸ Ex. C-1, Tab 12 Page 2R (Stockton Report).

¹⁴⁹ Tr. at 1712:3-14 (Judge Bennett/Stockton).

3. Even Under NNA's "Sales from the PMA" Standard, Bates Performs Well

NNA argues that sales within the PMA should be interpreted as "sales from the PMA." If NNA truly believes this reasoning, and their argument is not simply a post-hoc construction, then Bates would still prevail. First, if the standard is "sales from the PMA," then RSE fails to evaluate that standard. This is because RSE reflects sales made by dealers in any PMA, but registered to customers with addresses located in the Killeen PMA.

Second, if the standard to evaluate sales within the PMA is, indeed, sales from the PMA, then only one exhibit evaluates that standard, Ex. C-2, Tab 3A.¹⁵⁰ This exhibit compares sales from the PMA by Bates to sales from the PMA by other Killeen dealerships and registered anywhere. In this regard, Bates is essentially average among Killeen dealerships. Ex. C-2, Tab 3A shows that sales by Killeen dealerships nationwide (within and outside their areas) are about 81-82% of the number of vehicles registered within their areas.¹⁵¹ The average for the Killeen market in 2012 is 81.49% and the median is 80.99%.¹⁵² Bates Nissan is higher than the average and the median at 83.97%.¹⁵³ Similarly, looking at the year leading up to termination 10/2012 through 9/2013, the average for the Killeen market is 85.18% and the median is 83.86%.¹⁵⁴ Bates Nissan is higher than the median and very close to the average at 84.35%.¹⁵⁵ Therefore, among Killeen dealers, Bates is normal. This is a true test of the effects of the market. Consider this fact in context of Nissan's normal market share in Killeen.¹⁵⁶ Bates captures a normal share of business compared to other Killeen dealers;¹⁵⁷ Bates also captures a high share of Nissan business compared to other Nissan dealers.¹⁵⁸

Since RSE does not evaluate the standard that NNA suggests should prevail, and the one exhibit that does evaluate the standard that NNA suggests should prevail still favors Bates, yet NNA asks the Board to find that Bates fatally breached based on literally no credible evidence and to ignore credible evidence to the contrary. Now even if NNA insists on applying RSE, the

¹⁵⁰ See Bates Closing Statement, Section IX.F.1, pp. 62-64 for further discussion.

¹⁵¹ 81.49%, Ex. C-2, Tab 3A Page 1RR (Stockton Rebuttal).

¹⁵² Ex. C-2, Tab 3A Page 1RR (Stockton Rebuttal Report); Tr. at 1835:9-15 (Stockton).

¹⁵³ Ex. C-2, Tab 3A Page 1RR (Stockton Rebuttal Report); Tr. at 1835:9-15 (Stockton).

¹⁵⁴ Ex. C-2, Tab 3A Page 2RR 10/2012-9/2013 (Stockton Rebuttal Report); Tr. at 1835:5-8 (Stockton).

¹⁵⁵ Ex. C-2, Tab 3A Page 2RR (Stockton Rebuttal Report).

¹⁵⁶ Tr. at 1685:21-24 (Farhat) (discussing Ex. R-361, Tab A-27);

¹⁵⁷ Ex. C-3, Tab 3A Page 1RR (Stockton Rebuttal Report).

¹⁵⁸ Ex. C-1, Tab 11 Page 1R (Stockton Report).

net pump-in rate of about 18.5% (100%-81.49%) in 2012 and the net pump-in rate of 14.8% (100%-85.18%) from 10/2012 - 9/2013, would be a deficit faced by Killeen dealers, in and of itself, would explain the entirety of Bates' deficit to 100% RSE in many time periods.

G. The PFD Properly Interpreted "Sales in Relation to Sales in the Market" in TOC § 2301.455(a)(1)¹⁵⁹

The statute evaluates good cause for termination on the sales performance inquiry under TOC § 2301.455(a)(1) as "the dealer's sales in relation to the sales in the market." NNA argues that, "The PFD Misinterpreted 'Sales in Relation to Sales in the Market' in Code Section 2301.455(a)(1)."¹⁶⁰

NNA repeats the same argument regarding sales registered within and outside of the PMA. Under the statute, the dealer's "Sales" is compared to the "Sales in the Market." When the "market" is defined as the dealer's PMA, then the comparison must be limited to the PMA. The PFD is not adding language to the statute, but merely applying its plain meaning.

NNA offers the alternative interpretation of TOC § 2301.455(a)(1) and asks the Board, "find that RSE is the appropriate measure of Bates' sales in relation to sales in the market..."¹⁶¹ This interpretation fails because there is no question that RSE is not the same as "Dealer's Sales in Relation to Sales in the Market."

As demonstrated in Bates' Closing Brief, this statutory sales performance measurement standard is different and distinct from the RSE formula,¹⁶² and Section 3 of the Dealer Agreement. The definition of RSE is not equivalent to the statutory consideration of "the dealer's sales in relation to sales in the market," because, as Mr. Stockton described, "the RSE metric does not result in a measure of dealer sales in relation to sales in the market... because the out-of-PMA sales by a given dealership are not related by the RSE statistic to any measure of market opportunity specific to a given market or a given dealership."¹⁶³ When NNA's expert, Mr. Farhat was asked, "Would I be incorrect by defining RSE as the dealer sales in relation to the sales in

¹⁵⁹ NNA's Exceptions, Section III.G, pp. 26-29.

¹⁶⁰ NNA's Exceptions, Section III.G, pp. 26-29.

¹⁶¹ NNA's Exceptions, pp. 28-29.

¹⁶² Tr. at 1609:23-1610:10 (Farhat); Ex. C-354, 8:17-9:3 (Farhat Depo); Tr. at 1830:24-1831:4 (Stockton); Ex. C-2, p. 17 ¶ 45 (Stockton Rebuttal Report).

¹⁶³ Ex. C-2, p. 17 ¶ 45 (Stockton Rebuttal Report).

the market?”, he stated, “Yes, you’d be incorrect.”¹⁶⁴

H. Injury or Benefit to the Public Weighs in Favor of Bates Nissan¹⁶⁵

NNA excepts to Findings of Fact 107, 110 and 111, which finds that the public interest factor weighs in favor of Bates.¹⁶⁶ Tex. Occ. C. § 2301.455(a)(3) requires consideration of “injury or benefit to the public.” NNA takes exception to the PFD’s findings that termination of Bates would result in negative impact to the public.¹⁶⁷ NNA has no factual or legal basis identified under APA § 2001.058(e) to change the ALJ’s findings.

Public policy in Texas is to preserve dealerships which are performing for the distributor and providing jobs to Texas citizens.¹⁶⁸ It would also be extremely unfair to the dealership personnel who worked hard to cure the alleged sales performance deficiencies to terminate Bates Nissan.

I. All Existing Circumstances Includes Bates’ Existing Post-NOT Performance.¹⁶⁹

NNA excepts to the PFD’s determination that all existing circumstances includes all information available to the Board at the time of the decision.¹⁷⁰ Tex. Occ. C. § 2301.455(a) requires consideration of “all existing circumstances.” NNA takes exception to the PFD’s determination that all existing circumstances includes all information available to the Board at the time it makes its decision.¹⁷¹ The statutory inquiry is clear and considers whether there is now good cause for termination not whether there was good cause at some point prior to the Notice of Termination issuing. That would include the time leading up to the NOT all the way through the hearing. NNA’s citation to *Love Nissan*, out of Florida¹⁷² does not specifically address the statutory language under the Texas Occupations Code.

¹⁶⁴ Tr. at 1609:23-1610:10 (Farhat).

¹⁶⁵ NNA’s Exceptions, Section III.H.6, p. 46.

¹⁶⁶ NNA’s Exceptions, Section III.H.6, p. 46; See PFD, pp. 28-29, 44.

¹⁶⁷ NNA’s Exceptions, p. 46; PFD F/Fs 107-111.

¹⁶⁸ See TOC § 2301.001 “The distribution and sale of motor vehicles in this state vitally affects the general economy of the state and the public interest and welfare of its citizens. This chapter shall be liberally construed to accomplish its purposes....”

¹⁶⁹ NNA’s Exceptions, Section III.H.7, p. 46.

¹⁷⁰ NNA’s Exceptions, Section III.H.7, p. 46; See PFD, pp. 6-7.

¹⁷¹ PFD, pp. 6-7.

¹⁷² NNA’s Exceptions, p. 46.

J. Supplemental Notice of Termination – Tax Related, Capitalization, and Financial Statements Allegations¹⁷³

1. Specious Tax Fraud Allegations

When Nissan saw that Bates was curing its sales performance ground for termination it looked for another ground for termination. It asked for and received in discovery Bates financial statements and tax returns and determined that Bates was incorrectly writing down new and used car inventory under the lower of cost or market (“LCM”) inventory valuation methodology. Nissan characterized this practice as tax fraud and added it as a ground for termination.¹⁷⁴

Nissan tried to make a case for the proposition that since Bates was improperly writing down its inventory, while at the same time trying to maintain a \$75,000 gross income in the C Corporation, that therefore Bates was committing tax fraud. Nissan alleged that, by trying to adhere to the \$75,000 gross income by writing down inventory, Bates was acting unlawfully. It is not, however, unlawful to attempt to maintain a specific gross income in a C Corporation so long as it is done legally.¹⁷⁵ Incorrectly estimating inventory values under LCM is not unlawful either. It is so non-controversial and mundane that the tax laws allow the automatic correction of such incorrect estimates by filing a Form 3115. One of Bates’ accountants, Mr. Woodward testified that he represents over 200 franchised dealers and that many of them try to keep gross income in their C Corporations at or below \$75,000.¹⁷⁶

Despite all the hyperbole, Nissan never proved a single unlawful act by Bates. The SOAH ALJ found that Bates did not violate any tax laws or regulations. (*See* PFD F/F 98.)

2. Nissan Did Not Catch Bates

Prior to Nissan’s allegations being levied, Bates had hired a dealership accounting expert, Mr. Carl Woodward, to prepare a fair market valuation of the dealership for purposes of

¹⁷³ NNA’s Exceptions, Section III.H, pp. 29-46.

¹⁷⁴ In this case, Bates’ writing down inventory under LCM resulted in a lawful deferral of income from one tax year to the next as cars written down in the prior tax year are sold in the next and gross income recaptured. Tax fraud is typically taking a deduction wrongfully or hiding income where no taxes are ever paid versus deferring income from one year to the next. A lawful deferral of income cannot be tax fraud. Most dealers use LIFO to achieve this lawful deferral but Mr. Gautier, Bates’ tax preparer, did not know how to use LIFO and left Bates on LCM for decades after most dealers had switched to LIFO.

¹⁷⁵ Tr. at 1254:22 – 1255:2 (Linc).

¹⁷⁶ Tr. at 1496-1497 (Woodward).

supporting relevant statutory provisions concerning the dealer's investment and obligations¹⁷⁷ to be examined in this contested case. Through Mr. Woodward's review of Bates' financial documents, Mr. Woodward found inventory adjustments (reductions) inconsistent with what most other dealers post to their financial statements.

Mr. Woodward made Bates aware of this inconsistency and requested additional information to confirm the nature of the inventory reductions. Exs. C-70 – C-79 were provided to Mr. Woodward on September 17 and produced to Nissan on September 25, 2014. Mr. Woodward found Bates was using LCM to reduce its new vehicle inventory. Nissan claims it "caught Bates,"¹⁷⁸ it did not. It was only through Bates' discovery production of documents requested by Mr. Woodward, that Nissan was able to learn that inventory reductions were being made to Bates new vehicle inventory.

Mr. Woodward's initial report, Ex. C-4, also filed October 17, 2014, provided expert testimony on the matter for which Mr. Woodward was retained, which was the investment valuation of the dealership. Thus, while Mr. Walter's report, Ex. R-366, Nissan's expert, dated October 17, 2014, did attack Bates' inventory write-downs, Bates was already well aware of the issue because of Mr. Woodward's analysis. Bates and its counsel were pursuing methods to remedy the inventory valuation matter well before Nissan became aware and well before Nissan filed its Supplemental NOT in December 2014. Both sides went on to file rebuttal and supplemental reports after additional discovery, which became the basis for much of the facts surrounding the allegations in the Supplemental NOT.

Mr. Woodward advised Bates that, to be on the safe side, it should retain, Mr. Les Schneider, a prominent tax attorney in Washington, DC to assist in changing its method of inventory valuation to one in strict compliance with the Treasury Regs.¹⁷⁹ Bates hired Mr. Schneider, who, in turn, filed a Form 3115 which advised the IRS as to Bates' past methodology

¹⁷⁷ TOC § 2301.455(a).

¹⁷⁸ NNA's Exceptions, Section III.H, p. 31.

¹⁷⁹ Bates had made the same mistake as other small town dealers have made. In order to save money, it relied upon its local tax preparer to guide it in the uncertain seas of inventory valuation methodology. This individual, Mr. Buster Gautier, was not trained as an accountant, much less a CPA, and gave Mr. Bates some bad advice on what he could do under LCM and how to do it. Mr. Gautier approved Bates' write-downs which gave Nissan its opening for falsely alleging tax fraud. (See PFD F/F 75-77.)

and adopted a methodology promulgated by the Treasury Regs. (*See* PFD F/F 85-87.)¹⁸⁰ Bates is now, unquestionably, in full compliance with all Treasury Regs and tax laws.¹⁸¹ In short, Bates, at significant cost to itself, cured whatever complaints Nissan could possibly have regarding its tax and accounting methodology and began the process before Nissan ever raised the issue. No penalties or even criticisms have been levied against Bates by the IRS.

3. The False Filing Gambit

Bates' cure, however, was not enough for Nissan. Nissan wanted Bates terminated for its past accounting practices on the grounds that the incorrect write-downs, albeit briefly and temporarily, skewed the KPIs, or key performance indicators, the dealership reported to Nissan on the mandatory financial statements, the so-called 12-month or operating statements. Nissan had several complaints on this issue, including complaints about the timing of the reporting of profit recaptures and of year end write-downs.

4. Lower of Cost or Market (LCM)

The way LCM works is that a dealer (or any business for that matter) is allowed to write down its inventory to what it can demonstrate its market value to be in the pertinent tax year but must recapture as gross profit, any difference between the written down value and the retail sales price when the car is sold. During the period of time between write-down and sale, the write-down flows through to the balance sheet initially reducing the gross profit picture. When the written down cars are sold, however, and the write-down recaptured as gross profit on later 12-month statements, the profit picture is restored.¹⁸² This dynamic is the same for any business that

¹⁸⁰ The Treasury Regs applicable to LCM inventory valuations, 1.471-2(c) and 1.471-4(a-c), require a dealer to use a recognizable source such as the NADA Guide or Black Book to value used car inventory and to use it consistently and be prepared to prove up its use in the event of an audit. Mr. Bates, with the concurrence of its tax preparer, was using several sources for valuations, including his own subjective judgement. Mr. Schneider was unable to prove a consistent methodology and thus had to report all write-downs as gross profit and pay taxes on them over the next 4 years. This likely resulted in over payment of taxes by Bates because many of these write-downs would've been defensible under the Treasury Regs.

¹⁸¹ Nissan never proved that Bates was in violation of any tax laws because it never proved that Bates had underpaid any taxes. Nissan alleged tax fraud in the hope that the taint of saying so would turn this case against Bates.

¹⁸² Technically, when the written down cars are sold, the "new, written down" cost of the inventory is utilized to compute the gross profit at the point of sale effectively "recapturing" the write-down as a part of the sale transaction. Any unrecorded differences in market value that occurred after the write-down and prior to sale is also cleared to the income statement at the point of sale as a component of gross profit. Therefore, the gross profit at the point of sale embodies all of the ever changing market forces, including Bates' good faith estimates of decreases to value that may have occurred during the time that the inventory was held by Bates. These estimates are a normal part of

uses lower of cost or market to value its inventory. Nissan, however, calls it tax fraud and reporting fraudulent financial data to Nissan.

5. 13-Month Statements

The way 13-month statements worked in this case is that some dealers, including Bates, do not finish posting all expenses by the end of December of any particular tax year. Nissan requires December statements to be filed with it by January 10 of the following tax year. Those dealers prepare what is colloquially known as a “13-month” statement which wraps up the loose ends for the current tax year, including end of the year inventory write-downs. Gross profit recaptured from cars sold after the first of the following tax year are reflected on 12-month statements as the cars are sold. These 12-month statements are typically filed between January and March.

6. Nissan’s Rules Contributed to Its Complaints

Nissan’s complaint in this case was that since Bates did not sell its written down cars until after its December statements were filed with Nissan that therefore Bates was fraudulently stating its profits for that tax year. Its further complaint was that since Bates did not file 13-month statements with it, Nissan was not getting all of the inventory write-downs in real time. Nissan, however, had never required its dealers to file 13-month statements with it so Bates had no way to know that Nissan might want that. In fact, Nissan’s own 30-year executive, Mr. Steiner, testified that Nissan did not want 13-month statements filed with it because they were prepared for tax purposes and skewed the operational data that Nissan was after in requiring 12-month statements to be filed with it to begin with. (See PFD F/F 82, 81, 88-93.)

Nissan itself created, in part, the circumstances which allowed it to allege false filing against Bates. On the one hand Nissan requires dealers to follow generally accepted accounting principles (“GAAP”), which requires that when a car is sold the difference between its written down value and its sales price must be recaptured on the financial statements as gross profit or loss. At the same time Nissan did not require that 13 month statements on which some of the write-downs occurred be filed with it. Finally, Nissan required dealers to file end of the year

inventory valuation and can occur during the write-down process or even when a vehicle is traded in by a customer and subsequently held for sale by Bates to the public.

statements too soon after the end of the tax year, thus necessitating 13-month statements. Consequently, there would inevitably be a brief period of time, usually no more than 2 to 3 months, in which the write-downs were not offset by gross profit recapture. It is the profit picture created by this gap in time that Nissan calls fraudulent and on which it bases its termination. These are outrageous and false allegations and Nissan knows it, as revealed by the 3 business memos discussed at PFD F/F 90-98.

These memos clearly reveal that Nissan knew about the significant adjustments that can be made by 13-month statements and that if Nissan wanted a true profit picture for KPI's it should require their filing but it never did. For 40 years Bates' 13-month statements were not filed with Nissan without one word of complaint from Nissan.

7. Bates is Demonstrably Innocent

Bates filed nothing inaccurate much less fraudulent with Nissan.¹⁸³ The 12-month statements conveyed an accurate profit picture at the time they were filed. That profit picture naturally changed after the written down cars were sold. (See PFD F/F 94-95) The gross profit recapture for those sales were posted on the 13-month statement as well as on each monthly statement as the cars were sold. Each of these statements changed the profit picture to the degree that cars were sold and gross profit recaptured. Everything filed with Nissan by Bates was accurate, if not always in accordance with GAAP or the Treasury Regs. This ignorance of GAAP and the Treasury Regs, on Mr. Gautier's part, made filing the Form 3115 necessary. Had Nissan required 13-month statements to be filed with it, Nissan would have had no argument at all on the false filing issue.

Nissan is trying to terminate Bates over accounting peculiarities created by Nissan itself. (See F/F 94-95) Nissan wants to characterize the dynamics created by its own conflicting filing rules as fraud on Bates part.

8. The Management/Ownership Issue

Finally, and without any statutory notice, Nissan accused Bates at trial of breaching the

¹⁸³ Bates used estimates of value under LCM which is allowed by GAAP albeit utilizing incorrect procedures to arrive at those estimates under LCM. Utilizing estimates are all part of creating financial statements for Nissan or any other user of financial statements. Utilizing estimates are not fraudulent *per se*.

franchise by misrepresenting its ownership and management to Nissan. This arose out of an incident in which Bates had attempted to make Bobby Bates Dealer Principal replacing his father, Jimmy Bates, in the role. This was done in full compliance with the franchise agreement but Nissan claimed the proper procedure was not followed and again accused Bates of false filings. Judge Bennett, however, agreed with Bates, that no breach of the franchise occurred. (*See* PFD F/F 118-124.)

IV. CONCLUSION

The SOAH ALJ, Judge Bennett, has carefully considered all of Nissan arguments and all of Nissan's evidence and has come to the conclusion that NNA has not established good cause for terminating Bates Nissan. It should not be terminated on performance grounds because the RSE methodology, under which Bates was to be terminated, simply was not contemplated by the Nissan franchise agreement and Nissan had based its termination efforts on a failure of RSE scores as a breach of the franchise agreement. (*See* PFD F/F 73, 99, 101.)

Bates was not to be terminated for the inventory valuation methodology used by Bates because it was not unlawful. It was a lawful methodology but due to the misunderstanding of Mr. Gautier, Bates' tax preparer, was used too arbitrarily to pass muster under IRS Treasury Regs.¹⁸⁴ The lawful and approved means for correcting that, however, is not to put the dealership out of business or otherwise penalize it, but to have the dealership file a Form 3115 which acknowledges to the IRS that past inventory valuation methodology was based on subjective judgment rather than based on a consistent and documentable methodology.¹⁸⁵

In short, Bates is in full compliance with the tax laws and never acted fraudulently. (*See* PFD F/F 96-98.) None of the financial statements submitted by Bates to NNA were false. (*See* PFD F/F 94.) Nissan was unable to show any harm or prejudice whatsoever for the brief period of time in which Bates profit picture was out of sync and Nissan had shown no material harm

¹⁸⁴ Nissan never did prove that Bates' inventory reduction methodology was actually in breach of the Treasury Regs because Nissan made no effort to prove that the inventory valuations calculated by Bates differed materially from the valuations that IRS approved methodology would have calculated. Only an IRS audit could definitively decide this issue because only the IRS has jurisdiction over the issue. With the filing of the Form 3115, however, the issue is legally moot.

¹⁸⁵ The taxes on the gross profits referred by the written-down inventories must be paid over the following 4 years, which Bates is doing.

from anything that Bates had done. (*See* PFD F/F 95-98.)

In short, Judge Bennett would not allow a termination for innocent mistakes when the IRS was fully satisfied with Bates means of changing its inventory valuation methodology.¹⁸⁶

NNA's Exceptions are without merit and the fact is that there is substantial evidence in the record to support the proposed decision making NNA's Exceptions immaterial. Bates requests that Respondent's Exceptions be denied, its proposed alternate Findings of Fact and Conclusions of Law in its Attachment I be rejected. The ALJ's PFD in this matter should be adopted by the Board in its entirety without modification, and Bates Nissan be awarded all other relief to which it may be justly entitled.

Respectfully submitted,

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ATTORNEYS FOR COMPLAINANT

¹⁸⁶ Nissan claims that there is no evidence that the IRS has accepted Bates' Form 3115 filing. Once again, Nissan plays fast and loose with the law. The way 3115's work is that they are automatically approved. In other words, silence on the part of the IRS is approval, which is the very evidence that Nissan claims does not exist of the IRS's acceptance. As evidenced by Ex. C-205, Section 21.05 of Rev. Proc. 2015-14 includes as an accounting method change qualifying for automatic consent procedures. In particular, Appendix Section 21.05(l)(c)(ii) expressly covers a change where a taxpayer used judgment, rather than the current market price for valuing inventory under LCM.

CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing document was served by Email and First Class Mail on the Respondent's attorneys of record on the 8th day of June 2016.

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INDEX TO APPENDIX

- Appendix Item 1** *Beck Chevrolet Co., Inc. vs. General Motors LLC*, 787 F.3d 663 (2nd Cir. 2015), dated May 19, 2015.
- Appendix Item 2** *Beck Chevrolet Co., Inc. vs. General Motors LLC*, No. 2016-03412, New York Court of Appeals, dated May 3, 2016.

Appendix Item 1

Beck Chevrolet Co., Inc. vs. General Motors LLC,
787 F.3d 663 (2nd Cir. 2015), May 19, 2015

Page 663

787 F.3d 663 (2nd Cir. 2015)

**Beck Chevrolet Co., Inc.,
Plaintiff--Appellant-Cross-Appellee,**

v.

**General Motors LLC,
Defendant--Appellee-Cross-Appellant**

Nos. 13-4066, 13-4310

United States Court of Appeals, Second Circuit

May 19, 2015

Argued October 6, 2014.

Page 664

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Page 665

The plaintiff, a motor vehicle dealer, appeals from a July 13, 2012, order granting summary judgment to the defendant, a motor vehicle manufacturer, and a September 30, 2013, final judgment denying the plaintiff's two remaining claims for injunctive relief, entered in the United States District Court for the Southern District of New York (Alvin K. Hellerstein, Judge). The plaintiff's contract and New York Dealer Act claims arise principally out of a dispute over the defendant's performance standards, vehicle allocation system, and alleged unlawful modification of its franchise agreement with the plaintiff. We conclude that New York state law is insufficiently developed for us to ascertain its proper interpretation in the context of several issues raised on this appeal, and that questions as to what the applicable laws require should therefore be certified to the New York Court of Appeals. We further conclude that the district court did not err in dismissing the plaintiff's vehicle allocation claim, denying the plaintiff's request for attorney's fees, or dismissing the defendant's counterclaim for rescission.

We therefore AFFIRM in part and CERTIFY the remaining questions to the New York Court of Appeals.

RUSSELL P. MCRORY, Arent Fox LLP, New York, NY, for Plaintiff--Appellant-Cross-Appellee.

JAMES C. MCGRATH, Seyfarth Shaw LLP, (Christina Chan, Bingham McCutchen LLP, on the brief),

Boston, MA, for Defendant--Appellee-Cross-Appellant.

Before: SACK, LIVINGSTON, and LOHIER, Circuit Judges.

OPINION

Page 666

Sack, Circuit Judge :

This appeal requires us to address, apparently for the first time, several provisions contained in New York's Franchised Motor Vehicle Dealer Act (the " Dealer Act"), codified at New York Vehicle and Traffic Law sections 460 - 473. The plaintiff, Beck Chevrolet Co., Inc., is the proprietor of a Chevrolet dealership of the same name (the corporation and dealership are referred to hereinafter collectively as " Beck."). Beck brought suit against its franchisor, General Motors, LLC (" GM"), for claims arising under the Dealer Act, and state contract law claims, for imposition of unfair and unreasonable performance standards, unfair modification of the franchise agreement, and refusal to deliver vehicles. The district court (Alvin K. Hellerstein, *Judge*), granted GM's motion for summary judgment with respect to the claims in Beck's first amended complaint, but granted it leave to assert two claims for injunctive and declaratory relief under the Dealer Act, sections 463(2)(c) and (gg). Following a bench trial, the district court dismissed the second amended complaint and GM's counterclaim for rescission of the franchise agreement. It also denied each party's application for attorney's fees.

Several of the issues we must consider in order to resolve this appeal require that we address unsettled questions of New York law. Beck challenges the district court's rulings that GM's performance metrics are neither unfair nor unreasonable and that GM's expansion of Beck's sales area did not constitute a " modification" of its Franchise Agreement under section 463 of the Dealer Act. We conclude that New York state law is insufficiently developed in these areas to enable us to predict with confidence how the New York Court of Appeals would resolve these questions. We therefore certify to the Court of Appeals two questions concerning the application of the Dealer Act. We affirm the district court's dismissal of Beck's claims for attorney's fees and unfair allocation of vehicles, and GM's counterclaim for rescission of the Participation Agreement.

BACKGROUND

Beck, located in Yonkers, New York, is a retail dealer

in Chevrolet automobiles. It is operated under a set of franchise agreements entered into with the defendant, GM, which is a limited liability company whose sole member is a citizen of Delaware with its principal place of business in Michigan.

In 2009, General Motors Corp. (" Old GM") entered into widely reported bankruptcy proceedings in the United States Bankruptcy Court for the Southern District of New York. In the course of those proceedings, Old GM, the defendant GM's predecessor corporation, sought to shrink its dealer network in an effort to reduce competition among retail dealers in General Motors automobiles and improve the profitability of the remaining individual franchises.

As part of this effort, Old GM offered two types of agreements to its franchisees. Some were offered a Participation Agreement, under which their franchises would continue, while others were offered a Wind-Down Agreement, under which their

Page 667

franchises would be terminated in exchange for cash payments to them. Beck initially executed a Wind-Down Agreement in which it agreed to terminate its operations in or before October 2010 in exchange for a payment to Beck of approximately \$390,000.

Old GM subsequently sold substantially all of its assets and assigned its interest in all its Participation and Wind-Down Agreements with franchisees to GM, the defendant in this case. Beck asked GM to reconsider Old GM's decision to terminate the franchise. GM agreed to offer Beck a Participation Agreement in place of the Wind-Down Agreement. The parties executed that agreement in September 2009.

From that point on, two contracts governed Beck's relationship with GM: a Dealer Sales and Services Agreement (the " Dealer Agreement"), which contains standard provisions that set out the basic terms of the relationship between GM and any dealer franchise, and a September 2009 Participation Agreement, which further modified and supplemented the basic Dealer Agreement. Together, these agreements govern several issues central to this dispute, including Beck's primary geographic area of responsibility and the performance standards to which it is subject. The terms of these agreements are all subject to the Dealer Act, which also contains certain mandatory provisions governing the manufacturer-franchisee relationship.

Performance Monitoring Formula

The primary issue on appeal relates to GM's use of a Retail Sales Index (" RSI") to measure its dealers' sales

performance. In arriving at the RSI value for a particular dealership, GM assigns each dealer an " Area of Primary Responsibility" and, in some instances, an " Area of Geographic Sales and Service Advantage" (" AGSSA"). An Area of Primary Responsibility is a geographic area in which a dealer is expected to sell GM automobiles and otherwise represent GM. Urban Areas of Primary Responsibility, such as the part of Westchester County, New York, in which Beck is located, are typically served by more than one GM dealer. GM accordingly subdivides those areas into AGSSAs, for each of which a single dealer is responsible. Both the Areas of Primary Responsibility and the AGSSAs are composed of census tracts drawn by the U.S. Census Bureau.[1] AGSSAs and Areas of Primary Responsibility are non-exclusive -- dealers are allowed to sell and market vehicles to consumers outside of their own AGSSAs. The function of these territory markers is not to protect dealers from competition but to provide a benchmark against which GM can measure dealers' sales.

In determining an RSI for a Chevrolet dealer such as Beck, GM divides the dealer's actual retail sales by its expected sales, which are calculated as described below. Expressed as a formula:

Page 668

Dealer's Total Sales/Expected Sales Based on State Average x 100 = RSI Dealers are required to attain an RSI of at least 100, which GM contends is an " average" score.[2] " Total sales" measures all of a particular dealer's actual sales in a particular period of time. The " expected sales" metric is based not on the raw state average among dealers, but on an " adjusted" statewide average market share for Chevrolet products in the dealer's AGSSA.[3]

GM calculates each dealer's expected sales by first taking into account all new motor vehicle registrations in the United States. It then compiles the registrations by census tract and subdivides them into " segments" of the motor vehicle market, based on types of automobiles. To choose two examples, small sport utility vehicles are a segment, as are mid-size sedans.

GM adjusts the expected sales figure for statewide and local characteristics. First, it takes into account Chevrolet's market share within the segments in which it competes on a statewide basis. For example, because Chevrolet does not compete in the luxury sedan segment of the market, that segment is excluded when calculating Chevrolet's statewide market share. Chevrolet does compete in the markets for mid-size sedans and pickup trucks, however. If, hypothetically, there are 10,000 mid-size sedans sold in New York State and 600 of those are Chevrolets, Chevrolet will have a 6 percent market share in New York State among mid-size sedans. If there are 20,000 pickup trucks

sold in New York State, and 5,000 of those are Chevrolets. Chevrolet will have a 25 percent market share in New York State among pickup trucks.

Second, the expected sales figure takes into account the relative popularity of a particular segment in the dealer's AGSSA. In other words, the market-share percentages described above are used to calculate each dealer's expected sales. If Chevrolet is a particularly strong statewide competitor in the market for a particular type of car -- pickup trucks, for example -- but the market for pickup trucks in a particular (likely urban or suburban) AGSSA is relatively small, then the dealership's expected sales targets for pickup trucks would be relatively low. For example, a Chevrolet dealer in an AGSSA in which only four total pickup trucks are purchased in a given year would be expected to sell only one Chevrolet pickup truck, while a dealer in an AGSSA in which 100 pickup trucks are purchased in a given year would be expected to sell twenty-five. GM asserts

Page 669

that these segment-based adjustments reduced Beck's targets by more than twenty-five percent from the unadjusted state average. Beck does not contend otherwise.

Local adjustments do not account for local brand popularity, however. For example, dealers like Beck operating in the southern part of the state ("downstate") do not receive a downward adjustment in sales expectations even though Chevrolet, as a brand, is more popular in upstate markets than in Yonkers, Beck's location, and elsewhere in Westchester County and some nearby suburban counties.

Beck's Performance under the Current RSI Formula

The Dealer Agreement establishes the basic outlines of GM's performance evaluation process. Specifically, it provides that a dealer's RSI is "satisfactory" only if it is equal to or greater than 100. If the dealer's RSI is above 100 and in the top fifteen percent statewide, it is classified by GM as "superior."

If performance falls below satisfactory, GM is authorized by the Participation Agreement to take one or more remedial measures set forth in Article 13.2 of the Dealer Agreement. The ultimate step possible in this process is termination of the agreement on ninety days' prior written notice. The Participation Agreement further provides:

In addition to the [RSI, GM] will consider any other relevant factors in deciding whether to proceed under the provisions of Article 13.2 to address any failure by Dealer to adequately perform its sales responsibilities. [GM] will

only pursue its rights under Article 13.2 to address any failure by Dealer to adequately perform its sales responsibilities if [GM] determines that Dealer has materially breached its sales performance obligations under this Dealer Agreement.

J.A. 157. According to GM, GM prefers not to terminate dealers who fall below target levels, and has remedial programs to help improve performance at those dealerships.

Beck's RSI was considerably lower than 100 in the years leading up to GM's 2009 bankruptcy reorganization. The Participation Agreement established a roadmap for improving Beck's performance in stages, requiring Beck to attain an RSI of 70 in 2010, 85 in 2011, and 100 in 2012. But Beck's RSI fell far short of these targets, remaining close to 50 in each year. GM ultimately waived the Participation Agreement's performance requirements for the 2010 calendar year, but began enforcing performance targets in 2011.

Inventory Issues

Beck asserts that many of its performance issues derived from its inability to obtain adequate inventory from GM. GM uses a vehicle allocation system called "turn and earn," through which a dealer's allotted inventory is calculated as a function of past sales. While Beck was operating under the Wind-Down Agreement, it was not permitted to place orders for new vehicle inventory with GM. According to Beck, Beck's depressed inventory caused sales to slow. Beck argues that as a result of this slowdown, it could not order adequate inventory under the "turn and earn" process even after it entered into the Participation Agreement which permitted it to order vehicles from GM.

In an effort to boost sales, GM instituted a "special vehicle allocation process" that was in effect from October 2010 through January 2011. The program was designed to allow dealers to order more vehicles during those four months than the "turn and earn" program would have permitted. Despite its depressed inventory in the months leading up to the program's launch, Beck objected to the program as a

Page 670

"poison pill and recipe for disaster." Letter from Russell S. Geller, Vice President, Beck Chevrolet Co., Inc., to James W. Bunnell, General Manager--U.S. Sales operations, General Motors LLC (Oct. 11, 2010) (J.A. 185-86). The program, Beck asserted, would result "in the delivery of too many vehicles too quickly," and would overload Beck's facilities, imposing high additional costs. *Id.* The vehicles would be delivered in winter, an unpopular season for purchasing new cars in New York, and Beck would be

unlikely to sell them in a timely fashion. Beck opted not to participate heavily in the allocation program, declining 661, or 87 percent, of the vehicles GM offered to it. GM urged Beck to reconsider its approach in two letters sent in November 2010, but apparently to no avail.

After GM ended the program and resumed its ordinary "turn and earn" process, Beck started ordering more cars than GM allocated. For example, in January 2011, while the special allocation was in effect, GM offered Beck 177 vehicles; Beck ordered only 31. GM resumed its ordinary process in February 2011, at which point GM shipped only 18 vehicles. Beck ordered 67. This imbalance continued for the remainder of 2011, with Beck ordering between 22 and 84 vehicles each month, and GM shipping between 2 and 49 fewer vehicles than Beck had requested. Although Beck sold fewer cars than it had in its inventory in 2011, Beck contends that it could have sold more had GM honored its requests for an additional 218 vehicles between February and December 2011.

Extension of the Participation Agreement

As noted, Beck signed a Participation Agreement with GM in 2009. But during 2010, Beck operated under a short-term Dealer Agreement, which was set to expire on April 30, 2011. The parties anticipated renewing the Dealer Agreement only if Beck attained its 2010 performance target: an RSI of 70. But, because of the allocation issues, GM waived the performance requirements for 2010. Attaining an RSI of 70 for 2010 was no longer a prerequisite to gaining an extension. Instead, GM sent Beck a letter on April 6, 2011, offering to extend the Dealer Agreement to April 30, 2012, and conditioning any further extension on Beck meeting specified conditions:

If Dealer [Beck] meets its year end 2011 RSI and CSI ["Customer Satisfaction Index"] performance requirements under the Participation Agreement, and if Dealer is otherwise in compliance with its obligations under the Dealer Agreement, GM will then further extend the Dealer Agreement to April 30, 2013 to correspond with Dealer's year end 2012 RSI and CSI requirements.

However, should Dealer not meet its 2011 Performance Requirements, or should Dealer otherwise not be in compliance with its obligations under the Dealer Agreement, GM shall have no obligation to extend the Dealer Agreement beyond April 30, 2012.

Letter from William P. Flook, Jr., Zone Manager, General Motors LLC, to Leon Geller, Dealer Operator, Beck Chevrolet Co., Inc. (Apr. 6, 2011) (J.A. 229). GM noted that Beck would be deemed to have accepted the offer simply by opening for business on May 1, 2011.

Beck considered this to be an unlawful modification of the terms of its franchise because it conditioned renewal on accepting new terms. Beck brought suit in Supreme Court, Westchester County in an effort, *inter alia*, to stop the modification

Page 671

from going into effect.[4] One day later, on April 28, 2011, GM sent a follow-up letter explaining that the April 6 letter was intended "solely to extend the Chevrolet Dealer Sales and Service Agreement to April 30, 2012," not to modify the terms of existing agreements, and that the agreements applicable between the parties would remain in full effect according to their terms. Letter from William P. Flook, Jr., Zone Manager, General Motors LLC, to Leon Geller, Dealer Operator, Beck Chevrolet Co., Inc. (Apr. 28, 2011) (J.A. 232).

Enlarging Beck's Market Area

At about the same time, on April 22, 2011, GM informed Beck that based upon its review of its dealer network, GM had concluded that it should make changes to the Areas of Responsibility or AGSSAs for many GM dealerships. The letter, which stated that it was provided "pursuant to New York Vehicle & Traffic Law § 463(2)(ff)(1)," notified Beck that its AGSSA would be increased by four census tracts in Westchester and Fairfield Counties and reduced by seven census tracts in Bronx County. Letter from William P. Flook, Jr., Zone Manager, General Motors LLC, to Russell S. Geller and Leon Geller, Dealer Operators, Beck Chevrolet Co., Inc. (Apr. 22, 2011) (J.A. 234). The practical effect of this change was to increase Beck's expected sales.

Procedural History

On April 27, 2011, as noted, Beck brought suit against GM in New York State court alleging violations of the New York Dealer Act for, *inter alia*, modifying the franchise agreement without due cause, applying arbitrary or unfair sales performance standards, refusing to deliver vehicles, and unlawful nonrenewal of the franchise, as well as claims for breach of the Dealer Agreement, and breach of GM's fiduciary duties. Based on the diversity of citizenship of the parties, GM removed the case to the United States District Court for the Southern District of New York. Following Beck's filing of an amended complaint, GM moved for summary judgment. The district court granted GM's motion on July 13, 2012, dismissing Beck's first amended complaint in its entirety. Beck subsequently filed a second amended complaint, seeking declaratory and injunctive relief on two of its Dealer Act claims. GM counterclaimed for rescission of the Participation Agreement.

Following a September 2013 bench trial, the district court ruled in GM's favor on the claims in Beck's second amended complaint, denied both parties' applications for attorney's fees, and dismissed GM's counterclaim as moot and legally insufficient. Beck, on appeal, challenges most of the district court's rulings against it, and GM cross-appeals from the dismissal of its claim for rescission.

While this case was pending in the district court, GM sought to terminate Beck's franchise agreement. Beck initiated state administrative proceedings challenging the termination. On the same day that we heard oral argument in this appeal, the administrative court ruled that GM's statewide RSI standard was unreasonable as to downstate Chevrolet dealers and that GM had therefore failed to demonstrate due cause to terminate Beck's franchise agreement. *Beck Chevrolet Co., Inc. v. Gen. Motors LLC*, No. FMD 2013-02 (N.Y. Dept of Motor Veh. Oct. 6, 2014).

Page 672

DISCUSSION

Beck argues that: first, GM's method of calculating RSI is not fair or reasonable under Dealer Act section 463(2)(gg) because it does not account for local brand preferences; second, GM's expansion of Beck's AGSSA constituted a modification of Beck's franchise in violation of Dealer Act section 463(2)(ff); third, GM violated Dealer Act section 463(2)(a) by refusing to deliver all of the inventory Beck ordered; and fourth, Beck was the prevailing party on its price discrimination and unlawful modification claims and therefore is entitled to attorney's fees.[5] GM also appeals from the district court's dismissal of its counterclaim for rescission of the Participation Agreement. Finally, both sides challenge some of the district court's evidentiary rulings.

I. Standard of Review

" On appeal from a bench trial, the district court's findings of fact are reviewed for clear error and its conclusions of law are reviewed *de novo*." *Mobil Shipping & Transp. Co. v. Wonsild Liquid Carriers Ltd.*, 190 F.3d 64, 67 (2d Cir. 1999). The application of law to undisputed facts is also subject to *de novo* review, *Deegan v. City of Ithaca*, 444 F.3d 135, 141 (2d Cir. 2006), as are mixed questions of law and fact, *Man Ferrostaal, Inc. v. M/V Akili*, 704 F.3d 77, 82 (2d Cir. 2012).

To the extent that Beck also appeals from the district court's dismissal of its first amended complaint, we review that summary judgment award *de novo*, " construing the evidence in the light most favorable to the non-moving party. We will affirm . . . only where there is no genuine issue of material fact, and the moving party is entitled to

judgment as a matter of law." *Lynch v. City of New York*, 737 F.3d 150, 156 (2d Cir. 2013) (citation omitted).

II. Reasonableness of GM's Performance Metrics

Beck's primary contention on appeal is that GM's performance standards are "unreasonable, arbitrary or unfair" under Dealer Act section 463(2)(gg). The district court granted GM's motion for summary judgment on Beck's claim for damages under that section and, following a bench trial, ruled in GM's favor on Beck's request for injunctive relief. Beck contends that the district court erred in reading an "egregiousness" requirement into the Dealer Act, misread relevant case law, and improperly constrained Beck's ability to present its case.

Insofar as we and the parties can determine, neither the New York Court of Appeals nor the Appellate Division of the New York Supreme Court has interpreted section 463(2)(gg)'s prohibition of "unreasonable, arbitrary or unfair sales or other performance standard[s]." The parties therefore rely principally on legislative history, administrative decisions, and several out-of-state cases interpreting more or less similar state laws.

We look to the Dealer Act's legislative history primarily in an effort to understand the scope of judicial involvement in overseeing franchisor/franchisee relationships that the New York State legislature envisioned. Unfortunately, the legislative history is largely inconclusive on this point. There is support for both the position that the state legislature intended the courts to

Page 673

correct unequal bargaining power and cabin franchisors' ability to impose conditions on dealers and the position that it simply intended to protect franchisees against arbitrariness and gross injustice.

The Dealer Act was passed in 1983 in order to " promote the public interest and the public welfare" by

regulat[ing] motor vehicle manufacturers, distributors and factory or distributor representatives and . . . dealers of motor vehicles doing business in this state in order to prevent frauds, impositions and other abuses upon its citizens and to protect and preserve the investments and properties of the citizens of this state.

N.Y. Veh. & Traf. Law § 460. Beck argues that the legislature further intended to " establish an equilibrium of bargaining power between the motor vehicle manufacturer and the motor vehicle dealer." Assembly Mem. in Support, Bill Jacket, L.1983, ch. 815, at 6. Establishing equilibrium was apparently thought necessary in light of the " great disparity in bargaining power between motor vehicle

manufacturer and motor vehicle dealer." *Id.* The bill therefore sought " to provide certain basic protections for the dealer in areas where such protection [wa]s deemed necessary." *Id.*

Section 463(2)(gg), added by amendment in 2008, established new dealer protection, making it unlawful for a franchisor " [t]o use an unreasonable, arbitrary or unfair sales or other performance standard in determining a franchised motor vehicle dealer's compliance with a franchise agreement." The parties disagree about the proper reading of this provision. Beck contends that a performance standard that fails to take into account external forces that affect dealers' performances, such as local brand preferences, is unreasonable. GM argues that only unjust, deceptive, irrational, or capricious standards run afoul of section 463's protections, and that its requirements are none of those.

More specifically, Beck contends that the district court erroneously read an " egregiousness" requirement into section 463(2)(gg), under which a court will reverse only egregious or deceptive decisions of the franchisor. The district court expressed agreement with the First Circuit's position in *Coady Corp. v. Toyota Motor Distributors, Inc.*, 361 F.3d 50 (1st Cir. 2004), interpreting the Massachusetts " Dealer's Bill of Rights," Mass. Gen. Laws ch. 93B, that "[a] distributor acting honestly is entitled to latitude in making commercial judgments[,] and . . . [i]n this context, it is only the egregious decision that should be labeled 'arbitrary' or 'unfair.'" *Coady Corp.*, 361 F.3d at 56. Chapter 93B forbade " arbitrary or unfair" modifications to franchise agreements. *See id.* at 55. The court reasoned that the applicable Massachusetts provision did " not demand perfection in allocation or warrant a substitution of judicial for business judgment." *Id.* at 56. Instead, the " egregiousness" standard imposed by the law is highly deferential to the franchisor. *See id.*

Beck contends that it was inappropriate for the district court to adopt that interpretation of section 463(2)(gg). The New York provision, Beck argues, casts " a wide net," forbidding not only arbitrary standards but also unreasonable ones. Beck Reply Br. at 6. It is possible that the inclusion of " unreasonable" in section 463(2)(gg) is meant to signify a higher bar for franchisors' actions than non-arbitrariness review. *See, e.g.*, N.Y. Stat. Law § § 231-32 (instructing that each word in a statute should be given distinct effect according to its ordinary meaning). That reading might also comport with the law's general purpose to protect motor vehicle dealers " against the superior economic

Honda Motor Co., 934 F.Supp. 596, 608 (S.D.N.Y. 1996), *aff'd on the opinion of the district court*, 113 F.3d 329, 330 (2d Cir. 1997) (per curiam).

It is not clear, however, that the 2008 amendment that created section 463(2)(gg) was intended to have such a broad effect. Some of the legislative history suggests that the legislature was primarily concerned with performance standards that were too confusing or too poorly communicated to be understood and followed by automobile dealers. *See N.Y. Sponsor's Mem., Bill Jacket*, 2008 S.B. 8678, ch. 490, at 13 (emphasizing that the amendment " brings more openness in dealer franchisor communications"); N.Y. Mem. in Support, Bill Jacket, 2008 S.B. 8678, ch. 490, at 42-44 (Mark Schienberg, President of the Greater New York Automobile Dealers Association, explained that section 463(2)(gg) will " prevent misunderstandings" and override performance standards that are too complicated and insufficiently communicated). It may be, then, that the statute was designed only to ensure that franchisors' performance standards are transparent and comprehensible, and that their substantive requirements are not egregious.

Assuming *arguendo* that Beck's reading of the statute is correct, we address its core contention that the statewide average GM uses to determine expected sales is unreasonable for its failure to account for local variations in brand popularity. The relevant facts regarding this performance standard are essentially undisputed. First, GM's performance metric is based on a statewide sales average that does not account for depressed brand popularity, *i.e.*, the relative unpopularity of Chevrolet automobiles, in the relevant metro-area markets. Second, GM's metric does account for some local variation based on the popularity of a given vehicle segment, such as pickup trucks, small sport utility vehicles, and mid-size sedans. Third, under the relevant agreements, a failure to meet an RSI of 100 could result in GM's termination of the franchise or other remedial measures.

On these facts, the district court decided that the use of a statewide average was administratively convenient, objective, and easily understood, and that GM's formula adequately adjusted for local conditions through its segmentation analysis. The court appeared to adopt GM's contention that applying a more localized standard would " doom[] the entire make of Chevrolet vehicles to mediocrity" because it would not encourage better sales in underperforming areas. Trial Tr. at 669 (Sept. 24, 2013) (Special App'x 108). For these reasons, it concluded that the metric was reasonable.

The few reported decisions addressing performance standards have not adopted consistent interpretations of what is reasonable or acceptable. In a related context, the

Page 674

power of the franchisors." *Bronx Auto Mall, Inc. v. Am.*

New York Department of Motor Vehicles recently determined that although Honda's use of statewide averages to gauge sales effectiveness was "not a perfect system," it was also not "patently unreasonable, arbitrary, or unfair." *Hartley Buick GMC Truck, Inc. v. Am. Honda Motor Co.*, No. FMD 2010-05 at 5, 8-9 (N.Y. Dep't of Motor Veh. Nov. 1, 2011), *aff'd*, No. 28447 (N.Y. Dep't of Motor Veh. Admin. App. Bd. Feb. 28, 2012).

Several other administrative courts have reached the opposite conclusion, however, rejecting statewide performance standards in favor of those that take local variations into account. Most relevant for present purposes, the Administrative Law Judge ("ALJ") who considered Beck's challenge to GM's notice of termination concluded that "[f]or the New York City metropolitan

Page 675

area, the RSI standard of GM is unreasonable" in part because "it does not realistically reflect the Chevrolet sales challenges that Beck and other New York metropolitan dealers face." *Beck Chevrolet Co., Inc. v. Gen. Motors LLC*, No. FMD 2013-02, at 9 (N.Y. Dep't of Motor Veh. Oct. 6, 2014). Although Beck has not argued that we are bound by that decision,[6] our desire to avoid potentially inconsistent results in state, federal, and administrative courts in part motivates our decision to certify this issue to the New York Court of Appeals.

Beck also relies heavily on *North Shore, Inc. v. General Motors Corp.*, No. MVRB 79-01 (Ill. Mot. Veh. Rev. Bd. May 28, 2003), *aff'd in relevant part sub nom. General Motors Corp. v. Illinois Motor Vehicle Review Board*, 361 Ill.App.3d 271, 836 N.E.2d 903, 297 Ill.Dec. 172 (2005), *aff'd*, 224 Ill.2d 1, 862 N.E.2d 209, 308 Ill.Dec. 611 (2007), in which an Illinois ALJ resolved a challenge to GM's proposed addition of dealerships in the greater Chicago area. The ALJ concluded that measuring sales performance based on comparisons between similar market areas was preferable to using a statewide or nationwide standard. *See Gen. Motors Corp. v. State Motor Vehicle Review Bd.*, 224 Ill.2d 1, 21-22, 862 N.E.2d 209, 223-24, 308 Ill.Dec. 611, 625-26 (2007) (discussing the state motor vehicle review board's decision). Although not decided under the New York Dealer Act or a provision similar to its section 463(2)(gg), the Illinois courts expressly decided that a standard that takes local variations, such as import bias, into account is a "superior" method of determining performance. *Id.*

An administrative court in Texas reached the same conclusion in a similar case, reasoning that it was

patently unfair to conclude that a standard is appropriate for comparison with a given market if most of the markets used

in creating the standard are fundamentally dissimilar to the market at issue. Stated another way, [an] ALJ cannot endorse a process that characterizes a market as "underperforming" simply because it fails to meet a standard so profoundly influenced by markets bearing so little resemblance to the market in question.

Landmark Chevrolet Corp. v. Gen. Motors Corp., No. 02-0002 LIC at 20-21 (Tex. Mot. Veh. Bd. Sept. 16, 2004), *aff'd sub nom. Austin Chevrolet, Inc. v. Motor Vehicle Bd.*, 212 S.W.3d 425 (Tex.App. 2006); *see also Halleen Chevrolet v. GMC*, No. 03-050MVDB-277-SS at 5 (Ohio Mot. Veh. Dealers Bd. July 21, 2006) (report and recommendation) ("[I]t is inappropriate to consider the expected Ohio average to an urban multi-dealer area such as the [designated area] in this case. Because single market dealers in rural areas tend to achieve about the expected state average

Page 676

and the urban dealers tend to achieve below, it seems that the average is somewhat flawed in a case such as this.").

And the United States District Court for the Southern District of New York recently denied a defendant's motion to dismiss a similar claim under the New York Dealer Act. *See CMS Volkswagen Holdings, LLC v. Volkswagen Grp. of Am., Inc.*, 25 F.Supp.3d 432, 441-42 (S.D.N.Y.), *reconsideration and reargument denied*, 2014 WL 4961769, (S.D.N.Y. Oct. 3, 2014).

These decisions are, of course, not binding on us, but they are instructive. That several ALJs who routinely consider disputes between franchisors and franchisees have concluded that statewide averages are not reasonable performance indicators gives us pause. It seems sensible enough to conclude that car dealers located in different parts of a single state would face different barriers to success, including variations in local brand preferences. By failing to take this into account, the existing performance standards make it likely that the lowest-performing dealers will be concentrated in the areas in which GM's brands are the weakest.

At the same time, however, section 463(2)(gg) does not mandate that franchisors impose individually tailored or perfectly just performance standards. It prohibits only performance standards that are "unreasonable, arbitrary or unfair." And, as the district court recognized, GM's performance standards have significant virtues, including ease of administration, predictability, uniformity, and encouragement of innovation in struggling markets. They give GM greater flexibility to demand changes or shut down unproductive dealerships. And, importantly, they

appear to represent the industry standard.

Recognizing these competing considerations and the absence of existing guidance from the New York Court of Appeals, we think it best to certify the following question to it for its determination:

(1) Is a performance standard that requires "average" performance based on statewide sales data in order for an automobile dealer to retain its dealership "unreasonable, arbitrary, or unfair" under New York Vehicle & Traffic Law section 463(2)(gg) because it does not account for local variations beyond adjusting for the local popularity of general vehicle types?

III. Modification of the Dealer Agreement

Beck also appeals from the district court's grant of summary judgment against it on its claim that changes to its AGSSA constituted an unfair "modification" of its Dealer Agreement under section 463(2)(ff)(1)-(2) of the New York Vehicle & Traffic Law. That subsection provides that it is

unlawful for any franchisor, notwithstanding the terms of any franchise contract . . . [t]o modify the franchise of any franchised motor vehicle dealer unless the franchisor notifies the franchised motor vehicle dealer, in writing, of its intention to modify the franchise of such dealer at least ninety days before the effective date thereof, stating the specific grounds for such modification.

N.Y. Veh. & Traf. Law § 463(2)(ff)(1). "Modification" is defined as "any change or replacement of any franchise if such change or replacement may substantially and adversely affect the new motor vehicle dealer's rights, obligations, investment or return on investment." *Id.* § 463(2)(ff)(2). Upon receiving notice of an intended modification, the franchisee may challenge the modification as unfair. A modification is "unfair if it is not undertaken in good faith;

Page 677

is not undertaken for good cause; or would adversely and substantially alter the rights, obligations, investment or return on investment of the franchised motor vehicle dealer under an existing franchise agreement." *Id.* § 463(2)(ff)(3).

The April 22, 2011, letter notifying Beck that GM had increased Beck's AGSSA by four census tracts stated that it was provided "pursuant to New York Vehicle & Traffic Law § 463(2)(ff)(1)." Letter from William P. Flook, Jr., Zone Manager, General Motors LLC, to Russell S. Geller and Leon Geller, Dealer Operators, Beck Chevrolet Co., Inc. (Apr. 22, 2011) (J.A. 234). Beck argues that GM thereby acknowledged that the revision constituted a "modification" under the Dealer Act for which GM failed to

demonstrate good cause. The Dealer Agreement states, however, that GM "retains the right to revise the Dealer's Area of Primary Responsibility at General Motors[]" sole discretion consistent with dealer network objectives." J.A. 143. If the agreement expressly reserves to GM the power to unilaterally revise the Area of Primary Responsibility, such a revision might not constitute a contract modification.

The district court concluded that the exercise of contractually conferred discretion generally does not constitute a modification of the contract. *See also, e.g., Subaru Distribs. Corp. v. Subaru of Am., Inc.*, 47 F.Supp.2d 451, 459 n.3 (S.D.N.Y. 1999) (periodic quota amendments contemplated by contract did not constitute amendments to dealer agreement); *In re Kerry Ford, Inc.*, 106 Ohio App.3d 643, 651-52, 666 N.E.2d 1157, 1162-63 (1995) (use of service bulletins to provide updated service standards did not modify the contract where they were contemplated by the sales and service agreement). But we are not convinced that the Dealer Act contemplated that result. If the act was designed to protect franchisees from manufacturers' disproportionate bargaining power, we might read section 463(2)(ff)(1) to proscribe contractual provisions that allow manufacturers to circumvent the Act's protections by retaining unilateral discretion to revise specified elements of the Dealer Agreement.

Moreover, under the Dealer Act, a modification is "any change . . . of any franchise if such change or replacement may substantially and adversely affect the new motor vehicle dealer's rights, obligations, investment or return on investment." N.Y. Veh. & Traf. Law § 463(2)(ff)(2). GM argues that the word "franchise" refers to the Dealer Agreement, and because a change to the AGSSA has no impact on the Dealer Agreement, a change to the AGSSA is not a modification. But the statute defines a "franchise" not in terms of a single agreement, but as a "written arrangement." N.Y. Veh. & Traf. Law § 462(6). This "arrangement" might extend beyond the Dealer Agreement to include secondary documents, including those defining Beck's AGSSA. Only one New York court has addressed this issue so far as we know, and it concluded that a change to the dealer's Area of Primary Responsibility does constitute a modification under section 463(2)(ff). *See Van Wie Chevrolet, Inc. v. Gen. Motors LLC*, No. 2012-0284 at 2-3 (N.Y. S.Ct. Onondaga Cnty. June 13, 2014).

On the other hand, if the Dealer Act was designed to do no more than ensure clarity in communications and negotiations between franchisor and franchisee, it most likely would not apply to GM's express reservation of the right to modify Beck's AGSSA. In the absence of any state appellate court decisions indicating how the New York Court of Appeals would rule on

Page 678

this issue, we also certify the following question for its determination:

(2) Does a change to a franchisee's Area of Primary Responsibility or AGSSA constitute a prohibited "modification" to the franchise under section 463(2)(ff), even though the standard terms of the Dealer Agreement reserve the franchisor's right to alter the Area of Primary Responsibility or AGSSA in its sole discretion?

IV. Vehicle Allocation

Beck next contends that the district court erred in granting summary judgment on its claim that GM wrongly refused to deliver requested vehicles. This claim also arises under the Dealer Act, but unlike the claims discussed above, we are confident that we can correctly resolve this question without certification to the New York Court of Appeals. See *Licci ex rel. Licci v. Lebanese Canadian Bank, SAL*, 673 F.3d 50, 74 (2d Cir. 2012) (" [W]e need not certify if we are confident that we can correctly resolve the matter at issue ourselves . . . ").

Under the Dealer Act, it is unlawful to "refuse to deliver in reasonable quantity and within a reasonable time after receipt of a dealer's order to any franchised motor vehicle dealer any vehicle covered by such franchise which is publicly advertised by such franchisor to be available for immediate delivery." N.Y. Veh. & Traf. Law § 463(2)(a). Although "[d]isputes over reasonableness are usually fact questions for juries," *Lennon v. Miller*, 66 F.3d 416, 421 (2d Cir. 1995), "[s]ummary judgment . . . is [] appropriate when the non-moving party has failed to set forth any facts that go to an essential element of the claim," *King v. Crossland Sav. Bank*, 111 F.3d 251, 259 (2d Cir. 1997).

Beck relies on an affidavit submitted by its vice-president to support its claim. We conclude that the uncontested facts asserted in it are insufficient to allow Beck to prevail. They establish only the following: Beck had low inventory entering 2010 as a result of having entered into the Wind-Down Agreement in 2009. Under that agreement, Beck was not allotted any new inventory. GM had a "turn and earn" vehicle allocation system by which dealers were allocated inventory based on prior sales. Beck argues that low inventory under the Wind-Down Agreement yielded low sales in 2009, which made it difficult to re-build its inventory after it signed the 2010 Participation Agreement.

Beck acknowledges, however, that it had sufficient inventory to meet demand at all times in 2010 and 2011 and that it refused cars offered to it. In 2010, for example, Beck received 358 vehicles and sold only 289, leaving 69 (plus

any remaining inventory from 2009) unsold entering 2011. GM administered its special allocation program from October 2010 through January 2011, which would have enabled Beck to receive additional inventory each month. Beck acknowledges that it refused to take part in the program, arguing that it would have resulted in too much inventory during the low-sale winter months. But Beck's own ordering patterns appear to disprove Beck's explanation of the basis for its refusal to participate in the special allocation program. GM offered Beck 177 vehicles in January 2011. Beck ordered only 31, refusing the other 146. In the next two months, after the special allocation program had ended but still during winter, Beck ordered 151 cars -- significantly more than its allocation. Beck offers no explanation for its refusal to take the 146 extra cars offered in January in light of its substantial order in the following two months. Moreover, Beck had more than adequate inventory to satisfy its 2011 sales of 347 cars.

Page 679

On these facts, the district court properly determined that "the admissible evidence [wa]s insufficient to permit a rational juror to find in favor of the plaintiff." *Amorgianos v. AMTRAK*, 303 F.3d 256, 267 (2d Cir. 2002). Even if Beck could have benefited from a different vehicle allocation system, and even if it could have sold additional vehicles had GM allocated them, Beck provides no evidence suggesting that GM's system for allocating vehicles was unreasonable or unfair. To the contrary, GM employed an equitable allocation system based on past performance. When it became clear that the system was inadequate for dealers who had entered Wind-Down Agreements before signing Participation Agreements, GM modified the system to offer additional inventory. Beck refused the vast majority of what GM offered, including 146 of the vehicles offered in January 2011. Nevertheless, it ordered 151 vehicles beyond GM's allocation in the following two months. GM's refusal to deliver to Beck exactly the number of vehicles it asked for in the month it asked for them does not constitute a failure to deliver a "reasonable quantity [of vehicles] [] within a reasonable time." N.Y. Veh. & Traf. Law § 463(2)(a).

V. Attorney's Fees

Beck also asserts that it is entitled to attorney's fees on two claims dismissed by the district court, arguing that it was the "prevailing party" as to those claims because GM voluntarily abandoned the policies that Beck had challenged. Although attorney's fees frequently are statutorily limited to prevailing parties, see, e.g., 42 U.S.C. § 12205 ("In any action or administrative proceeding commenced pursuant to this chapter, the court or agency, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee."); 17 U.S.C. §

505 (" Except as otherwise provided by this title, the court may also award a reasonable attorney's fee to the prevailing party as part of the costs."), a party need not qualify as a " prevailing party" in order to receive a fee award under the Dealer Act.

The Dealer Act provides that " the court may award necessary costs and disbursements plus a reasonable attorney's fee to any party." N.Y. Veh. & Traf. Law § 469(1). The district court declined to grant attorney's fees to either party both because the "[p]laintiff [wa]s the losing party and because an award of attorneys' fees would not be appropriate . . . given the good faith nature of the claims and defenses. . . ." Order at 2 (Sept. 25, 2013) (Special App'x 91). We review a district court's fee determination for abuse of discretion. *McDaniel v. Cnty. of Schenectady*, 595 F.3d 411, 416 (2d Cir. 2010).

Setting aside the question whether Beck was required to be the prevailing party in order to qualify for an attorney's fee award, the district court did not abuse its discretion in denying Beck's fee request. The court's denial of fees was not based on " an erroneous view of the law or on a clearly erroneous assessment of the evidence." *In re Sims*, 534 F.3d 117, 132 (2d Cir. 2008) (internal quotation marks omitted). On the contrary, its decision to deny fees because of the " good faith nature of the claims and defenses," Order at 2 (Sept. 25, 2013) (Special App'x 91), was " located within the range of permissible decisions," particularly in light of section 469's permissive language. *Sims*, 534 F.3d at 132 (internal quotation marks omitted).

VI. GM's Counterclaim for Rescission

GM appeals from the district court's dismissal of its counterclaim for rescission of the Participation Agreement as moot. The

Page 680

crux of GM's counterclaim is that Beck failed to meet the state average RSI -- an essential element of the Participation Agreement. Having dismissed Beck's claims against GM and apparently believing that the dismissal would be dispositive of the related termination proceeding in the Motor Vehicle Department, the district court determined that GM no longer had any need to bring suit for rescission. But in light of the Motor Vehicle Department's ruling against GM in its effort to terminate the franchise, we do not think that GM's counterclaim for rescission is moot. We nonetheless affirm the district court's dismissal, albeit on a different basis.

Rescission is an equitable remedy, the use of which is generally left to the courts' discretion. But that discretion may be displaced by " clear and valid legislative

command." *United States v. Oakland Cannabis Buyers' Coop.*, 532 U.S. 483, 496, 121 S.Ct. 1711, 149 L.Ed.2d 722 (2001). In other words, where the legislature has clearly expressed its intent to cabin a court's discretion to fashion equitable remedies, the court must respect those limitations. Such is the case here. Section 463(2)(d)-(e) of the New York Vehicle and Traffic Law expressly requires due cause, notice, and an opportunity to cure before the franchisor may terminate the franchise. N.Y. Veh. & Traf. Law § 463(2)(d)-(e). " Terminate" is defined to include " rescission." *Id.* § 462(17). As a result, we would only be empowered to grant rescission to GM if it had first demonstrated due cause for rescission and provided Beck with both notice and the opportunity to cure. GM failed to satisfy those prerequisites, and we therefore affirm the district court's dismissal of this claim.

VII. Evidentiary Issues

Finally, Beck and GM each challenge several of the district court's evidentiary rulings. We review evidentiary rulings for abuse of discretion. *Ret. Plan of UNITE HERE Nat'l Ret. Fund v. Kombassan Holdings A.S.*, 629 F.3d 282, 287 (2d Cir. 2010). We will grant a new trial " if the district court committed errors that were a clear abuse of discretion that were clearly prejudicial to the outcome of the trial," measuring prejudice " by assessing the error in light of the record as a whole." *Marshall v. Randall*, 719 F.3d 113, 116 (2d Cir. 2013) (internal quotation marks omitted). We address each of the parties' challenges briefly, concluding that none has merit.

First, Beck challenges the district court's exclusion of a portion of an expert witness report comparing the number of non-GM competitor dealerships in upstate New York and downstate New York. Beck sought to use the report to cross-examine GM's witness about whether GM should consider inter-brand competition in designing performance metrics. But even assuming that the district court erred in excluding the expert report, Beck suffered no prejudice. *See United States v. Gupta*, 747 F.3d 111, 133-34 (2d Cir. 2014) (setting forth several factors that are to be considered by a reviewing court in determining whether any error was harmless, including the " importance of . . . un rebutted assertions," duplication of evidence, and the strength of the opposing party's evidence on that point (alteration in original)). Counsel for Beck questioned GM's expert at length about the same topic addressed in the report. The expert responded that RSI should not be adjusted by regional differences in inter-brand competition, and that existing segmentation captures those disparities. Beck was thus able to elicit the same testimony without the report that it would have been able to with it, making introduction of the report duplicative and unnecessary to rebut GM's case.

Page 681

Second, Beck challenges the district court's exclusion of a document reflecting the amount of advertising money spent nationwide and in New York City, which purportedly would show that GM spent less on advertising in the New York City area in 2010 and 2011 than in 2009 and 2012. The district court properly excluded the report both because Beck sought to use it to cross-examine GM's expert witness, Sharif Farhat, on a topic that was beyond the scope of his direct examination, *see* Fed.R.Evid. 611(b); *United States v. Koskerides*, 877 F.2d 1129, 1136 (2d Cir. 1989), and any comparison that did not include relative spending upstate and downstate was minimally useful, at best, *see* Fed.R.Evid. 401, 403. The possible explanations for Beck's poor performance in 2010 and 2011 are not at issue in this case. The question is whether it was and is reasonable for GM to compare Beck's performance to the performance of upstate dealers. While evidence that GM spent less on advertising in the New York City area relative to what it spent upstate might enhance Beck's argument, then, evidence that GM spent less on advertising in New York City in 2010 and 2011 relative to 2009 and 2012, or even relative to the rest of the country, does not.

Third, the district court did not err in foreclosing Beck's attempt to cross-examine GM's expert on whether GM's exit from the market for leasing vehicles to drivers could have adversely impacted downstate dealers. The expert had not testified about leasing on direct examination, and he testified on cross-examination that leasing did not have an impact on RSI calculations and that he was unaware of any bearing it may have had on Beck's situation. The district court plainly acted within its discretion in curtailing this line of questioning under Rule 611, which instructs that "[c]ross-examination should not go beyond the subject matter of the direct examination and matters affecting the witness's credibility." Fed.R.Evid. 611(b); *see also Koskerides*, 877 F.2d at 1136.

Finally, GM challenges the district court's exclusion of evidence that Beck's own operational decisions were at fault for its poor performance. As noted, this evidence would not have been relevant to the question whether GM employed an "unreasonable, arbitrary or unfair sales or other performance standard," N.Y. Veh. & Traf. Law § 463(2)(gg), and was therefore properly excluded. *See* Fed.R.Evid. 401, 403. To the extent that GM's performance standard is unreasonable, it is so because it compares dealerships whose sales are influenced by distinct market factors. That Beck could have made certain operational changes is not relevant.

CONCLUSION

For the foregoing reasons, we **AFFIRM** the district

court's judgment in part and **CERTIFY** the remaining questions to the New York Court of Appeals.

Certification

In this Circuit, "[i]f state law permits, the court may certify a question of state law to that state's highest court." 2d Cir. R. 27.2(a). The New York state law permitting certification is N.Y. Comp. Codes R. & Regs. tit. 22, § 500.27(a), which provides, "Whenever it appears to . . . any United States Court of Appeals . . . that determinative questions of New York law are involved in a case pending before that court for which no controlling precedent of the [New York] Court of Appeals exists, the court may certify the dispositive questions of law to the Court of Appeals." We have discretion to certify questions to the New York Court of Appeals even where,

Page 682

as here, the parties have not requested certification. *See Licci*, 673 F.3d at 74.

Several factors guide our decision to exercise this discretion. "First, and most important, certification may be appropriate if the New York Court of Appeals has not squarely addressed an issue and other decisions by New York courts are insufficient to predict how the Court of Appeals would resolve it." *Penguin Grp. (USA) Inc. v. Am. Buddha*, 609 F.3d 30, 42 (2d Cir. 2010). "Second, the question on which we certify must be of importance to the state, and its resolution must require [] value judgments and important public policy choices that the New York Court of Appeals is better situated than we to make." *Licci*, 673 F.3d at 74 (citations and internal quotation marks omitted; brackets in original). Finally, certification is appropriate if the question or questions are "determinative of a claim before us." *Id.* (internal quotation marks omitted).

None of the provisions of the New York Dealer Act implicated in this case has been addressed by the New York Court of Appeals or, at any length or depth, by another state court. The disposition of this case could have a substantial impact not only on the relationship between General Motors and its franchisees, but also on other franchisor/franchisee relationships in New York State. And GM's performance metrics are industry standard. A ruling that the standard violates the New York Dealer Act could therefore result in statewide--or perhaps even broader--challenges and changes. And deciding these issues would require us to determine the level of judicial intervention in the franchisor/franchisee relationship that the New York Legislature intended. Such a determination implicates significant policy issues and is, we think, best decided by state courts.

We accordingly certify the following two questions to the New York Court of Appeals:

(1) Is a performance standard that requires "average" performance based on statewide sales data in order for an automobile dealer to retain its dealership "unreasonable, arbitrary, or unfair" under New York Vehicle & Traffic Law section 463(2)(gg) because it does not account for local variations beyond adjusting for the local popularity of general vehicle types?

(2) Does a change to a franchisee's Area of Primary Responsibility or AGSSA constitute a prohibited "modification" to the franchise under section 463(2)(ff), even though the standard terms of the Dealer Agreement reserve the franchisor's right to alter the Area of Primary Responsibility or AGSSA in its sole discretion?

"As is our practice, we do not intend to limit the scope of the Court of Appeals' analysis through the formulation of our questions, and we invite the Court of Appeals to expand upon or alter these questions as it should deem appropriate." *Licci*, 673 F.3d at 75 (internal quotation marks and brackets omitted).

It is hereby ORDERED that the Clerk of this Court transmit to the Clerk of the New York Court of Appeals this opinion as our certificate, together with a complete set of the briefs, the appendix, and the record filed in this Court by the parties. The parties shall bear equally any fees and costs that may be imposed by the New York Court of Appeals in connection with this certification. This panel will resume its consideration of this appeal after the disposition of this certification by the New York Court of Appeals.

Notes:

[1]According to the United States Census Bureau,

Census Tracts are small, relatively permanent statistical subdivisions of a county or equivalent entity that are updated by local participants prior to each decennial census as part of the Census Bureau's Participant Statistical Areas Program. The Census Bureau delineates census tracts in situations where no local participant existed or where state, local, or tribal governments declined to participate. The primary purpose of census tracts is to provide a stable set of geographic units for the presentation of statistical data.

Geographic Terms and Concepts -- Census Tract, U.S. Census Bureau, http://www.census.gov/gco/reference/gtc/gtc_ct.html (last visited Apr. 20, 2015).

[2]We refer to this rather imprecisely as an "average" score because it reflects the requirement that each dealer's market share equal GM's average statewide market share. Unless all dealers attain the exact same market share, one would expect a substantial number of dealers to score higher than average each year. It necessarily follows that a substantial number will fall short, as well. And as dealer performance improves, the sales required to achieve an RSI of 100 will increase.

[3]GM has used a weighted statewide average since 1999, when it switched from using a national average. GM's method is thus in keeping with the industry standard; the vast majority of GM's competitors use a statewide or regional average, and some still compare their dealers' performance to a national average.

[4]GM removed the case to federal court on April 28, 2011. The removed action is the case before us on appeal.

[5]To the extent that Beck intended to pursue its contract claim against GM for "sabotaging Beck's reputation and its ability to increase its sales," Beck Br. at 2-3, it has abandoned . . . [that] claim[] by failing to give [it] more than cursory treatment in its brief on appeal." *Giuffre Hyundai, Ltd. v. Hyundai Motor Am.*, 756 F.3d 204, 207 n.2 (2d Cir. 2014).

[6]Beck notified the court of the Department of Motor Vehicles' decision in a letter filed pursuant to Federal Rule of Appellate Procedure 28(j). It did not suggest that the administrative decision did or might have a preclusive effect on any aspect of this action and we accordingly consider the argument waived. We recognize, however, that if the issue of whether GM's RSI was reasonable was "necessarily raised and decided" by the Motor Vehicle Department, that determination could have preclusive effect here. *Ryan v. N.Y. Tel. Co.*, 62 N.Y.2d 494, 499-500, 467 N.E.2d 487, 489-90, 478 N.Y.S.2d 823 (1984). Faced with a similar issue, however, the Department of Motor Vehicles concluded that the Southern District of New York's 2013 decision in this action had no preclusive effect on the dispute before it. *Beck Chevrolet*, No. FMD 2013-02, at 6 (deciding that "the issue of reasonableness of the RSI is not precluded by the Federal Court decision as the burden of proof in this proceeding has shifted from Beck to GM" and explaining differences in the evidence put forth and considered in the two actions).

Appendix Item 2

Beck Chevrolet Co., Inc. vs. General Motors LLC,
No. 2016-03412, New York Court of Appeals, May 3, 2016

This opinion is uncorrected and subject to revision before
publication in the New York Reports.

No. 48
Beck Chevrolet Co., Inc.,
Appellant,
v.
General Motors LLC,
Respondent.

Russell P. McRory, for appellant.
James C. McGrath, for respondent.
Greater New York Automobile Dealers Association; Evans
Chevrolet; New York State Automobile Dealers Association; New
York State Automobile Dealers Association; Alliance of Automobile
Manufacturers et al., amici curiae.

RIVERA, J.:

The United States Court of Appeals for the Second
Circuit certified to this Court questions requiring our
interpretation of two provisions of New York's Franchised Motor
Vehicle Dealer Act (Dealer Act), codified at Vehicle and Traffic
Law § 460 et seq. The first question concerns the propriety of a

- 2 -

No. 48

franchisor sales performance standard that relies on statewide data and some local variances, but fails to account for local brand popularity. Based on our reformulation of the question, we conclude that use of such a standard to determine compliance with a franchise agreement is unlawful under the Dealer Act. The second question asks whether a franchisor's unilateral change of a dealer's geographic sales area constitutes a prohibited modification to the franchise. We conclude that it does not.

I.

The underlying federal action involves a dispute between franchisor and Chevrolet car manufacturer General Motors LLC (GM), and a Westchester County-based franchised motor vehicle dealer, Beck Chevrolet Co., Inc. (Beck). Beck is a long-time automobile dealership with a Chevrolet franchise dating back to GM's predecessor-in-interest. During the predecessor's bankruptcy proceeding, Beck entered a Wind-Down agreement to terminate its franchise in exchange for a money payout. After GM acquired certain of the predecessor's assets, GM rescinded the Wind-Down agreement and entered a Participation Agreement with Beck. The Participation Agreement, along with Beck's Dealer Sales and Services Agreement with incorporated Standard Provisions (Dealer Agreement), allows Beck to operate as a GM franchise operation.

Under these agreements GM required Beck to achieve a

- 2 -

- 3 -

No. 48

specified level of sales performance within a geographic location designated by GM, referred to as an Area of Geographic Sales and Service Advantage (AGSSA). The AGSSA consists of U.S. census tracts closest in proximity to the dealer, subject to certain traffic condition adjustments. GM carves out an individual dealer's AGSSA from a geographic sales region known as an Area of Primary Responsibility (APR), which is shared by a group of dealers in the same urban location. Dealers, like Beck, are responsible for the sale and marketing of Chevrolet vehicles and products within their respective AGSSA.

GM measured Beck's sales performance based on a Retail Sales Index (RSI), a methodology commonly employed by vehicle manufacturers in the United States, and applied by GM to all its dealers. The RSI is a percentage determined by a fractional equation, which divides a dealer's actual total retail sales during a particular time period, by the dealer's expected sales. In other words, the mathematical representation of an RSI is actual sales (the numerator) over expected sales (the denominator), multiplied by 100.

Expected sales are determined using a multistep formula, whereby GM determines Chevrolet's statewide market share for a particular type of vehicle segment--for example a mid-sized sedan or pickup truck--then multiplies that number by the total retail motor vehicle registrations in the dealer's AGSSA for that same segment, and repeats the process for each vehicle segment.

- 3 -

- 4 -

No. 48

The results for each segment are combined to achieve the dealer's total expected sales in its AGSSA. By way of illustration, assume in a given year that Chevrolet has a particular mid-sized sedan model and that the sales of that model represent 12% of all mid-sized sedans sold in New York State (constituting one vehicle segment). Further assume that the number of mid-sized sedan registrations in a dealer's AGSSA is 1500, meaning there are 1500 mid-sized sedans registered in the AGSSA. In that case, 1500 is multiplied by the 12% statewide share, equaling 180 expected sales for this segment. This same mathematical formula is repeated for each segment of vehicles in which Chevrolet competes, meaning in each segment for which Chevrolet has a model that could be sold in New York state. Assume four segments total, and that the formula results in the following expected sales by segment: 180, 120, 75, 25. These are added together for a combined number of 400. The 400 represents the dealer's total expected sales and will be the denominator in the equation used to determine the dealer's RSI.

As stated, GM includes in the dealer's expected sales only registrations for vehicle segments in which Chevrolet competes, and does not include registrations for non-Chevrolet vehicle segments. Through this segmentation or "segment-adjustment" GM accounts for local popularity of particular types of vehicles. For example, if pickup trucks are less popular in a given AGSSA, compared to the rest of the state,

- 4 -

- 5 -

No. 48

a dealer's expected sales are adjusted downward.

A 100 RSI constitutes satisfactory performance of a dealer's sales obligations under the Dealer Agreement. Nevertheless, GM treats this not as a perfect score but as an average score, and as explained in the Dealer Agreement, GM expects dealers below 100 "to pursue available sales opportunities exceeding this standard." GM's Dealer Rating System classifies dealers as follows: "Superior" for a 100 or greater RSI, and the dealer is in the top 15% of all dealers in the state; "Satisfactory" for a 100 RSI and the dealer is not in the top 15%; "Needs Improvement" for a 85 to 99.9 RSI; "Needs Significant Improvement" for an 84.9 or lower RSI and the dealer is not in the bottom 15% of dealers in the state; and "Unsatisfactory" for an 84.9 or less RSI and the dealer is in the bottom 15%.

Applying this rating system to the hypothetical dealer in the prior example, if the dealer sells 400 Chevrolet cars, because its expected sales were also 400, the dealer's RSI is 100 (400 divided by 400 equals 1, multiplied by 100 to achieve an RSI as a percentage). Since the dealer achieved its target sales, which constitutes an average sales performance, the dealer would be rated "superior" if the dealer is in the top 15% of all dealers statewide, or "satisfactory" if the dealer is not in the top 15%. If the dealer with the same expected sales of 400 sells instead 200 Chevrolets, then its RSI is 50 (200 divided by 400,

- 5 -

- 6 -

No. 48

equals .5, multiplied by 100 to achieve an RSI as a percentage). The dealer achieved only half of its target sales, and would be rated as "needs significant improvement" if the dealer is not in the bottom 15% of all dealers, or "unsatisfactory" if the dealer is in the bottom 15%.

Unless all dealers meet or exceed their expected target sales, there will be some dealers who score below 100. A below 100 score is below average performance. Since the expected sales number is based on an adjusted state market average, as the number of sales increases, so do the number of actual sales necessary to achieve a 100 RSI. In other words, the RSI sales performance measure moves upward (or downward) depending on market variations. Consequently, a dealer's performance is dependent on the performance in the market against which the dealer is measured, and the statewide market is subject to local variations, only one of which is reflected in the RSI (vehicle segment preference).

Under the Participation Agreement, GM required Beck to trend-up to the 100 RSI average benchmark within three years. In the first year Beck had to attain an RSI of 70, in the second year an 85 RSI, and a 100 RSI in its third year. When Beck failed to timely achieve these RSI scores it defaulted on the Participation Agreement, and potentially became subject to a "needs significant improvement" or "unsatisfactory" dealer rating.

- 6 -

- 7 -

No. 48

In the middle of the second year, GM notified Beck that it would extend the dealer agreement into future years on condition that Beck met its performance requirements, including achieving the 85 RSI by the second year's end, and the 100 RSI in the third year. Failure to achieve the 85 RSI in the second year meant that "GM shall have no obligation to extend the Dealer Agreement." By separate letter GM also informed Beck that it was increasing its AGSSA by four census tracts in Westchester County, and reducing the AGSSA by seven tracts in Bronx County.

After Beck sued GM in State court alleging violations of the Dealer Act based on the performance standard and changes in the AGSSA, GM removed the action to the United States District Court for the Southern District of New York. After procedural history not relevant to the questions certified to us, Beck filed a second amended complaint asserting, inter alia, two Dealer Act claims for injunctive and declaratory relief. The first claim alleged that GM used an unreasonable, arbitrary and unfair performance standard in determining Beck's compliance with its agreements, pursuant to VTL § 463 (2) (gg), and sought to enjoin GM from using a New York statewide average to calculate Beck's sales performance. Beck claimed the RSI was unreasonable and unfair as a matter of law because it failed to account for local customer preferences and low brand popularity in New York's downstate region. The second claim alleged that GM's unilateral change to Beck's AGSSA was an unfair modification within the

- 7 -

- 8 -

No. 48

meaning of VTL § 463 (2) (ff), because the new area enlarged Beck's sales territory, with the effect of increasing Beck's sales targets and facility requirements.

The district court held against Beck on both claims, and Beck appealed. The Second Circuit determined that resolution of the appeal depended on unsettled New York law, and certified two questions concerning the propriety of GM's performance standard and unilateral modification under the Dealer Act (787 F3d 663 [2d Cir 2015]). The first certified question as framed by the Second Circuit asks

"Is a performance standard that requires 'average' performance based on statewide sales data in order for an automobile dealer to retain its dealership 'unreasonable, arbitrary or unfair' under New York Vehicle & Traffic Law section 463 (2) (gg) because it does not account for local variations beyond adjusting for the local popularity of general vehicle types?"

The second certified question concerns GM's revision of Beck's AGSSA, and asks

"Does a change to a franchisee's Area of Primary Responsibility or AGSSA constitute a prohibited 'modification' to the franchise under section 463 (2) (ff), even though the standard terms of the Dealer Agreement reserve the franchisor's right to alter the Area of Primary Responsibility or AGSSA in its sole discretion?"

II.

A. FIRST CERTIFIED QUESTION

As a threshold matter we consider GM's recommendation

- 8 -

- 9 -

No. 48

that we reformulate the first certified question because it is predicated on the incorrect presumption that GM terminates all dealers who have a below-average sales performance, when, in fact, GM bases termination on the RSI and other relevant factors. Beck objects to the proposed reframing of the question, arguing that the consequences that flow from the application of a manufacturer's sales performance metric are relevant to the statute's interpretation, and that Beck was threatened with nonrenewal of its franchise solely because of its RSI score.

We agree with the parties that the question certified by the Second Circuit posits a case in which below-average sales performance results in termination of a dealership. Section 463 (2) (gg), in contrast, makes no mention of termination, and instead applies to standards used to assess dealer compliance with a franchise agreement. Such assessment may lead to franchisor conduct short of termination, but which nonetheless adversely impacts a dealer.

We do not adopt the approach taken by our dissenting colleague to the first certified question because whether a franchisor's standard complies with VTL § 463(2) (gg) is in the first instance a legal question concerning the propriety of the general criteria by which a dealer is measured. Contrary to the dissent's view of the statute, a standard can appear facially unreasonable, arbitrary or unfair, without reference to facts particular to any individual dealer. While a standard that

- 9 -

- 10 -

No. 48

appears fair as written may be applied in an unfair manner, and a standard that is reasonable in the abstract may have irrational consequences in practice, resolution of the reframed question does not require the type of as-applied analysis advocated by the dissent. Instead, we consider the standard's lawfulness against benchmarks as framed by GM, which rely on general data and not an individual dealer's facts.

Therefore, to provide appropriate guidance on the statute's anticipated coverage, and in accordance with our discretion in these matters, we proceed to answer the following reformulated question,

Is a performance standard that uses "average" performance based on statewide sales data in order to determine an automobile dealer's compliance with a franchise agreement "unreasonable, arbitrary, or unfair" under New York Vehicle & Traffic Law section 463(2)(gg) because it does not account for local variations beyond adjusting for the local popularity of general vehicle types?

(see Barenboim v Starbucks Corp., 21 NY3d 460, 469 [2013]

[reformulating the certified question to track the language of the statute at issue]; Commodity Futures Trading Comm'n v Walsh, 17 NY3d 162, 177-178 [2011] [reformulating a certified question]).

As our well-established rules of statutory construction direct, we begin our analysis with the language of the statute, recognizing that "our primary consideration is to ascertain and give effect to the intention of the Legislature" (People v

- 10 -

- 11 -

No. 48

Ballman, 15 NY3d 68, 72 [2010], quoting Matter of DaimlerChrysler Corp. v Spitzer, 7 NY3d 653, 660 [2006][internal quotation marks and citation omitted]). In this endeavor we are guided by the principle that "the text of a provision 'is the clearest indicator of legislative intent and courts should construe unambiguous language to give effect to its plain meaning' " (Albany Law School v New York State Off. of Mental Retardation and Dev. Disabilities, 19 NY3d 106, 120 [2012], quoting Matter of DaimlerChrysler Corp., 7 NY3d at 660).

As its title makes clear, section 463 of the Dealer Act protects dealers from "Unfair business practices by franchisors." Section 463 (2) (gg) provides that,

"[i]t shall be unlawful for any franchisor, notwithstanding the terms of any franchise contract: . . . [t]o use an unreasonable, arbitrary or unfair sales or other performance standard in determining a franchised motor vehicle dealer's compliance with a franchise agreement. Before applying any sales, service or other performance standard to a franchised motor vehicle dealer, a franchisor shall communicate the performance standard in writing in a clear and concise manner."

(VTL § 463 [2] [gg]).

The Dealer Act does not define what constitutes "unreasonable, arbitrary or unfair" performance standards. However, these determinates of impermissible conduct are familiar concepts in the law (see Black's Law Dictionary [10th ed. 2014] [unreasonable: "Not guided by reason; irrational or capricious"; arbitrary: "founded on prejudice or preference rather than on

- 11 -

reason or fact"; unfair: "Inequitable in business dealings"])). Notably, a standard need only violate one of these proscriptions to run afoul of VTL § 463 (2) (gg). As a consequence, the statute limits a range of performance standards made unlawful by the Dealer Act.

Whether a performance standard is "unreasonable, arbitrary or unfair" depends on considerations unique to the franchise business, which is driven by sales in a competitive market. A performance standard that measures dealer success based on data that fails to accurately represent market challenges would appear to undermine the franchisor and dealer's common goal of selling and servicing vehicles and franchisor products. At a minimum, VTL § 463 (2) (gg) forbids the use of standards not based in fact or responsive to market forces because performance benchmarks that reflect a market different from the dealer's sales area cannot be reasonable or fair.

The standard employed here reflects GM's acceptance that market forces matter in assessing dealer sales performance. The RSI is based on an equation in which the market--actual and aspirational--sets the foundation for measuring a dealer's achievement. As GM's standard recognizes, a dealer works within a constructed market--one set both by externalities and by GM's business needs. Thus, GM measures a dealer's sales performance by comparison to a statewide class of dealers, but adjusts the standard to reflect certain local market peculiarities with

- 13 -

No. 48

respect to one metric: local consumer purchasing preferences for certain vehicle types. Although having made the determination to incorporate local concerns in its dealer performance standard, GM has also specifically chosen to exclude from its measure the impact of customer brand preference on dealership sales. Yet, customer purchases are influenced not solely by preferences for a type of vehicle, for which GM accounts through its segmentation formula, but also by brand popularity and import bias. Moreover, those dealers, like Beck, who service an assigned area in which Chevrolet is less popular are disadvantaged when measured against dealers in other parts of the state in which the Chevrolet brand is stronger and facilitates dealer sales performance. Therefore, once GM determined that statewide raw data must be adjusted to account for customer preference as a measure of dealer sales performance, GM's exclusion of local brand popularity or import bias rendered the standard unreasonable and unfair because these preference factors constitute market challenges that impact a dealer's sales performance differently across the state. It is unlawful under section 463 (2) (gg) to measure a dealer's sales performance by a standard that fails to consider the desirability of the Chevrolet brand itself as a measure of a dealer's effort and sales ability.

GM contends that inclusion of these factors is both undesirable and unduly burdensome. GM essentially argues that it can set a standard that misrepresents external market forces.

- 13 -

- 14 -

No. 48

However, measuring the dealer's performance against a market the dealer never faces is not reasonable or fair within the meaning of section 463 (2) (gg). It is the equivalent of holding a dealer in New York State to a standard based on the market of a foreign country or another state without appropriate adjustments for local differences. In both cases, the dealer is measured against a sales landscape that is not within the dealer's experience.

GM claims that the standard has a certain utility because it is intended to identify dealers in need of improvement. This boils down to GM desiring to rid itself of ineffective dealers in order to increase its brand market share. Certainly a franchisor has a business interest in addressing weaknesses in its sales force. However, in doing so, a franchisor must not deploy unreasonable, arbitrary or unfair performance standards. The standard used by GM excludes local variance in market competitiveness, and masks the dealer mediocrity of which GM complains. To comply with the Dealer Act, if a franchisor intends to measure a dealer's performance based on a comparison to statewide data for other dealers, then the comparison data must take into account the market-based challenges that affect dealer success. Here, if Beck cannot keep up with comparably placed dealers in its sales area, then termination may be appropriate, but as it stands the RSI excludes an important measure of comparability.

- 14 -

- 15 -

No. 48

Notwithstanding GM's claim that the RSI methodology is consistent with industry norms, it remains the case that any performance standard adopted by a franchisor to determine a dealer's compliance with a franchise agreement is subject to the limitations set forth in the Dealer Act. While we recognize that industry norms are important because they express the wisdom borne of experience, and reflect considered thought on the part of industry members, they are not beyond the reach of the statute. We are especially cautious in this regard because this is an industry in which the parties hold unequal bargaining positions, and an industry standard may reflect the entrenchment of the very inequality and favoritism that the Legislature sought to counterbalance in the Dealer Act. Thus, GM may not rely on a standard that is unreasonable and unfair simply because of its prevalence within an industry the Legislature sought to regulate.

Relatedly, assuming arguendo that the use of statewide data reflects a certain administrative convenience, the standard would still be unlawful because although it might not be unreasonable or arbitrary, it is still unfair. Moreover, section 463 (2) (gg) prohibits unfair practices in order to protect dealers, not to alleviate a franchisor's potential administrative burdens associated with its performance standards.

Our analysis also furthers the Act's statutory purpose. By enacting the Dealer Act, the Legislature sought to address a

- 15 -

- 16 -

No. 48

historical inequality in the vehicle franchise business that favored automobile manufacturers over motor vehicle dealers (Assembly Mem in Support of Legislation, Bill Jacket, L. 1983, ch. 815, § 1, at 7; see New Motor Vehicle Bd. of Cal. v Orrin W. Fox Co., 439 US 96, 100-101 n 4 [1978], quoting S.Rep. No. 2073, 84th Cong., 2d Sess., 2 [1956] [US Senate finding that the "highly concentrated" automobile industry created a "vast disparity in economic power and bargaining strength" between automobile manufacturers and their dealers, in which manufacturers "determine arbitrarily the rules by which the two parties conduct their business affairs"]; see also Automobile Dealers' Day in Court Act, 15 USC §§ 1221-1225). The imbalance placed dealers at the mercy of manufacturers who were able to draft and impose protectionist agreements favorable to manufacturers, placing at risk a dealer's financial investment (see Assembly Mem in Support, at 7). As the Memorandum in Support of Legislation explained,

"[t]here is a great disparity in bargaining power between the motor vehicle manufacturer and the motor vehicle dealer. The franchise agreements which have been developed over a long course of dealing between the manufacturer and the dealer have reached a point where the dealer has few if any rights in comparison to those of the motor vehicle manufacturer. This results in an undue imbalance in bargaining power and the dealer is in many cases at the mercy of the manufacturer. In reality, the motor vehicle dealer who frequently has millions of dollars invested in dealership real property,

- 16 -

- 17 -

No. 48

equipment and good will can do nothing to oppose the will of the manufacturer without jeopardizing this substantial investment. This bill seeks to provide certain basic protection for the dealer in areas where such protection is deemed necessary. If enacted, the protection afforded the dealer through the terms of the bill would counterbalance the numerous protections afforded the manufacturer under the terms of its franchise agreement with the dealer. The result would be a healthier marketplace for all parties concerned"

(id at 7; see New Motor Vehicle Bd. of Cal., 439 US at 100-101 n 4 [manufacturer's arbitrary "rules are incorporated in the sales agreement or franchise which the manufacturer has prepared for the dealer's signature"])). The legislature expanded protections for dealers by enacting the Dealer Act in derogation of common law contract rules, statutorily overriding agreement provisions that were unfair to dealers (see VTL § 463 [2] [making the 2008 amendments applicable "notwithstanding the terms of any franchise contract"])). The legislature thereby sought to affirmatively "establish an equilibrium of bargaining power" (L. 1983, ch. 815, at 7). Furthermore, by amending the statute to include section 463 (2) (gg), thereby imposing a writing requirement to ensure transparency and a substantive measure of lawfulness, the legislature identified the misuse of performance standards as one unfair business practice that needed to be reined in.

Our interpretation of VTL § 463 (2) (gg) should not be understood as an invitation for a court to substitute its opinion for a franchisor's determination of how best to achieve its

- 17 -

- 18 -

No. 48

bottom-line business goals. Decisions about how best to improve the quality of dealerships and increase dealer sales involve business judgments rightly left to franchisors, and not the courts. Nevertheless, the legislature, by its enactment of the Dealer Act, has determined it is in the interest of the state to subject a franchisor's performance standards to statutory limits in order to prevent unfair business practices, and has seen fit to place review of franchisor standards squarely within the authority of the courts.

B. SECOND CERTIFIED QUESTION

The second certified question concerns GM's revision of Beck's AGSSA, and asks

"Does a change to a franchisee's Area of Primary Responsibility or AGSSA constitute a prohibited 'modification' to the franchise under section 463 (2) (ff), even though the standard terms of the Dealer Agreement reserve the franchisor's right to alter the Area of Primary Responsibility or AGSSA in its sole discretion?"

We conclude that such change is not an impermissible modification within the meaning of the statute.

Under VTL § 463 (2) (ff) (1), "it shall be unlawful for any franchisor, notwithstanding the terms of any franchise contract [t]o modify the franchise of any franchised motor vehicle dealer, unless the franchisor notifies the . . . dealer in writing . . . at least ninety days before the effective date, stating the specific grounds for such modification." A "modification" is "any change or replacement of any franchise if

- 18 -

- 19 -

No. 48

such change or replacement may substantially and adversely affect the new motor vehicle dealer's rights, obligations, investment or return on investment" (id. § 463 [2] [ff] [2]). A franchise is statutorily defined as

"a written arrangement for a definite or indefinite period in which a manufacturer or distributor grants to a franchised motor vehicle dealer a license to use a trade name, service mark or related characteristics and in which there is a community of interest in the marketing of motor vehicles or services related thereto"

(VTL § 462 [6]). Thus, a modification is not limited to a change in the franchise contract because other documents may be constituent parts of the parties' written arrangement, reflecting their shared interest in the sales and servicing of vehicles and other franchisor products.

The statute provides the dealer with a private right of action to challenge a modification, and places on a franchisor "the burden of proving that such modification is fair and not prohibited" (VTL §§ 463 [2] [ff] [3]; 469). Under the statute "[a] modification is deemed unfair if it is not undertaken in good faith; is not undertaken for good cause; or would adversely and substantially alter the rights, obligations, investment or return on investment of the franchised motor vehicle dealer under an existing franchise agreement" (id. § 463 [2] [ff] [3]).

To the extent section 463 (2) makes unlawful certain franchisor abuses, "notwithstanding the terms of any franchise contract," this section abrogates contract principles which

- 19 -

- 20 -

No. 48

traditionally bind parties to their agreements (see B & F Bldg. Corp. v Liebig, 76 NY2d 689, 693 [1990] ["The Legislature is presumed . . . to have abrogated the common law only to the extent that the clear import of the language of the statute requires"]). As a consequence, a franchisor may not insulate itself from the requirements and proscriptions of section 463 (2) (ff) by contractually reserving in the standard Dealer Agreement the power to revise an AGSSA, as GM did in this case. Otherwise, a franchisor with superior bargaining power could easily circumvent the purpose of the Dealer Act by reserving the right to change franchise terms at will, even where a change results in significant adverse affects on the dealer.

The fact that the Dealer Agreement does not contain details about the AGSSA does not remove a franchisor's revision of the AGSSA from the ambit of section 463 (2) (ff) because a change in the AGSSA is a change to the franchise. The AGSSA is a subset of a dealer's APR, which is specifically referenced in the Dealer Agreement. The AGSSA defines the dealer's geographic sales area and serves as an essential metric of a dealer's sales performance. As such it affects a dealer's competitive position and ability to comply with its obligation under the Dealer Agreement to "effectively sell[], servic[e] and otherwise represent[] General Motors Products" in the dealer's designated APR. In other words, a revised AGSSA has the potential to significantly impact the franchise arrangement. GM recognized

- 20 -

- 21 -

No. 48

this very fact in its letter to Beck informing it of the revisions to its AGSSA, which GM described as a notice "provided pursuant to New York Vehicle & Traffic Law § 463(2) (ff) (1)."

However, by its terms, section 463 (2) (ff) (1) is concerned only with those modifications that result in negative consequences for the dealer, and which meet its requirements for determining whether a change is statutorily impermissible. Thus, the only prohibited modification is one that "may substantially and adversely affect the new motor vehicle dealer's rights, obligations, investment or return on investment." In addition, the modification must be deemed unfair, meaning "it is not undertaken in good faith; is not undertaken for good cause; or would adversely and substantially alter the rights, obligations, investment or return on investment of the franchised motor vehicle dealer under an existing franchise agreement" (VTL § 463 [2] [ff] [3]).

Given this statutory language, we cannot say that a revision to a dealer's geographic sales area categorically violates section 463 (2) (ff). The revised area may not have a substantial impact or be adverse to a dealer's interests within the meaning of the statute. Indeed, a change could improve a dealer's sales performance opportunities and competitive position, for example by assigning a geographic area with greater sales potential, by reducing the dealer's geographic area thereby improving the dealer's RSI, or by leveling the playing field

- 21 -

- 22 -

No. 48

among dealers within the same dealer network. Thus, a revision of the AGSSA is not perforce violative of section 463 (2) (ff). Rather, such change must be assessed on a case-by-case basis, upon consideration of the impact of the revision on a dealer's position.

Accordingly, the first certified question, as reformulated, should be answered in accordance with this opinion and the second certified question answered in the negative.

- 22 -

Beck Chevrolet Co., Inc. v General Motors, LLC

No. 48

PIGOTT, J.(dissenting, in part):

Vehicle and Traffic Law § 463 (2) (gg) makes it unlawful for any franchisor, regardless of the terms of a franchise contract, "[t]o use an unreasonable, arbitrary or unfair sales or performance standard in determining a franchised motor vehicle dealer's compliance with a franchise agreement."¹ These general and amorphous adjectives "unreasonable," "arbitrary" and "unfair" are similar to those found in the Uniform Commercial Code and lend themselves to varying interpretations depending on the circumstances of a particular business situation. A performance standard that may be "unreasonable, arbitrary or unfair" as applied to one dealer, in a metropolitan area, may be perfectly reasonable when applied to another in another area of the state. Because in my view a determination concerning the reasonableness, arbitrariness or unfairness of a particular sales performance standard necessarily requires a factual, rather than a legal, determination, I dissent from the majority's response to the first certified question.

District Court conducted a bench trial over several

¹ Beck does not claim that GM failed to "communicate the performance standard in writing in a clear and concise manner," which is also required by section 463 (2) (gg).

- 2 -

No. 48

days and rendered a determination that the RSI performance standard, which uses a statewide sales average adjusted for local conditions, was not unreasonable, arbitrary or unfair. In making that determination, District Court considered and rejected the testimony of Beck's expert that the standard did not account for brand popularity and import bias, holding that the Retail Sales Index's (RSI) use of "segmentation" adequately accounted for those particular variables. Crediting the testimony of GM's two experts, District Court also determined that the RSI standard was "administratively convenient," "objective," and "uniformly applied." That factual determination concerning the performance standard should not be disturbed unless there is no record evidence to support it.

The majority reaches a different factual conclusion, however, stating that "GM's exclusion of local brand popularity or import bias rendered the [RSI] standard unreasonable and unfair because these preference factors constitute market challenges that impact a dealer's sales performance differently across the state" (majority op, at 12-13). Putting aside that what constitutes an "unreasonable," "arbitrary" or "unfair" standard is a factual determination, I do not believe it is this Court's role or function to determine, as a matter of law, that GM's failure to include these particular "preference factors" as part of its currently-formulated RSI violated section 463 (2) (gg). We should be mindful that our decision will apply not only

- 2 -

- 3 -

No. 48

to the particular facts in this case, but to all automobile manufacturers and dealerships in this state. Indeed, the Second Circuit acknowledges that GM's performance standards "appear to represent the industry standard" (787 F3d 663, 676 [2d Cir 2015]).

Contrary to the majority's subjective conclusion, GM's use of the RSI with a segmented adjustment does not amount "to GM desiring to rid itself of ineffective dealers in order to increase its brand market share" (majority op, 13) -- a fact that we are not empowered to determine. However, if that were GM's true motive, it would have stuck with the Wind-Down Agreement that Beck signed instead of entering into the Participation Agreement with Beck instead. Nor would GM have continued working with Beck from 2010 through 2012 to improve Beck's performance had it been GM's intention that the Beck dealership fail. It is evident from the record that the RSI is a tool utilized by GM to determine if a franchisee is achieving certain benchmarks, and, if not, the RSI operates as a canary in the coal mine to alert GM that the franchisee needs assistance.

In my view, the majority's opinion sets a standard that will require other franchisors to follow suit, and, to that extent, its interpretation of section 263 (2) (gg) goes beyond what the legislature intended. Therefore, I dissent.

- 3 -

* * * * *

Following certification of questions by the United States Court of Appeals for the Second Circuit and acceptance of the questions by this Court pursuant to section 500.27 of the Rules of Practice of the New York State Court of Appeals, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, first certified question answered in accordance with the opinion herein and second certified question answered in the negative. Opinion by Judge Rivera. Chief Judge DiFiore and Judges Abdus-Salaam, Stein and Fahey concur. Judge Pigott dissents in part in an opinion. Judge Garcia took no part.

Decided May 3, 2016

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State Office of Administrative Hearings



Cathleen Parsley
Chief Administrative Law Judge

August 18, 2016

Daniel Avitia, Director
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VIA FACSIMILE (512)465-3666

RE: Docket No. 608-14-3211.LIC; MVD Docket No. 14-0010-LIC and 15-0013.LIC; Bates Nissan, Inc. v. Nissan North America Inc.

Dear Mr. Avitia:

I have reviewed the exceptions filed in the above-referenced matter. At this time, I have no changes to make to my analysis, recommendation, or proposed findings and conclusions. I do, however, wish to clarify some matters in response to the exceptions. While there are many items in the exceptions I could respond to, I will let the Proposal for Decision (PFD) and the opposing party's response to exceptions address most matters. Instead, I address only a limited number of items in this letter.

In exceptions, Nissan North America, Inc. (NNA) asserts that I have entirely disregarded its Regional Sales Effectiveness (RSE) analysis as a reasonable method for evaluating dealer performance, despite many courts and regulatory bodies throughout the United States approving its use. NNA's assertion is misplaced. In fact, I find RSE to be a very reasonable measure of dealer performance in general. However, NNA's dealer agreement with Bates Nissan, Inc. (Bates) places different obligations on Bates than those measured by RSE. This is the crux of my analysis: The dealer agreement itself has not caught up with NNA's use of the RSE tool. To the extent that NNA wishes to use RSE as the primary evaluator of Bates' performance, then it ought to update its dealer agreement language and obligations to match the RSE evaluation method.

Further, as noted in Bates' reply to exceptions, not *all* courts and regulatory bodies have come to the conclusion that RSE does accurately measure the dealer's obligations under NNA's dealer agreement. In fact, other tribunals have reached conclusions similar to those reached by me in this case about the use of RSE or a comparable evaluation tool, as noted in Bates' response.

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NNA also asserts that I disregarded Section 3.B of the dealer agreement that allows NNA to use reasonable criteria to measure a dealer's performance. I did not disregard that provision, but noted that even NNA's own expert testified that the RSE tool does not fall within the examples of tools that may be used to evaluate a dealer's performance. Specifically, in footnote 11 in the PFD, I noted:

“Section 3.B of the Dealer Agreement identifies examples of evaluation methods that NNA may use to measure Bates' performance of its sales obligations. NNA's own expert, Sharif Farhat, testified in his deposition that the measurement tool actually used by NNA does not fall within any of the examples identified in Section 3.B. Bates Ex. C-354 at 84-88. Thus, it is not an evaluation method specifically identified in the Dealer Agreement. Ultimately, even if it is permissible as an evaluation method, it is not reasonably designed to measure Bates' identified sales obligations in Section 3.A and, thus, does not establish a violation of such sales obligations.”

Accordingly, I did not disregard Section 3.B of the dealer agreement but explained why I thought it did not directly allow RSE as a tool to measure a violation of Bates' sales obligations under Section 3.A. While I understand that the examples listed in Section 3.B are not exclusive, I also noted that RSE does not appear to measure the obligations under Section 3.A and, thus, would not qualify as a reasonable measurement tool under Section 3.B.

NNA also asserts that my recommendations are flawed because of my discussion in the PFD regarding the location of sales. In particular, NNA takes issue with an example I give in the PFD and contends that it shows a fundamental misunderstanding of “curbstoning” prohibitions. I agree that the particular example given was poorly chosen—although such sales certainly happen (*i.e.*, a sale where the purchaser never comes to the dealership to close the sale, and the dealer delivers the vehicle directly to the customer). But, I disagree that my discussion was flawed because of the example used. The example was not the main point made, but rather was more of an aside. The main point, expanded upon in the following paragraphs of the PFD, is the same—whether a sale is considered to be to a customer in the PMA or outside the PMA is based upon the registration location of the vehicle. Even NNA makes such distinctions in its metrics, and my analysis is not changed by the curbstoning prohibition.

The sales obligation in issue under Section 3.A of the dealer agreement is tied not to where a sale takes place, but rather to where the customer resides. Specifically, the sales obligation is to “customers located within Dealer's Primary Market Area.” Given the fact that sales metrics distinguish where vehicles are registered, it is clear that the focus is on the location of the customer as the measure of the dealer's effectiveness in sales under Section 3.A. In this regard, the location of the registration is critical in determining this. That is the essence of my analysis of this issue and its relevance, and the poor example used by me should not detract from this overarching point. When the PFD talks about “sales” in and outside the PMA, it is intended to refer not to the location of the sale *per se*, but the location of the customer to whom the sale is made, which is relevant for evaluating Bates' effectiveness in selling to “customers located within Dealer's Primary Market Area” as referenced in the dealer agreement. I should have been more precise in my language to make this clear, but that was the intent of the discussion in the PFD regarding distinguishing between sales in the PMA and outside the PMA. The insertion of the phrase “to customers” after the word “sales” would likely have alleviated this confusion.

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EXCEPTIONS LETTER

PAGE 3

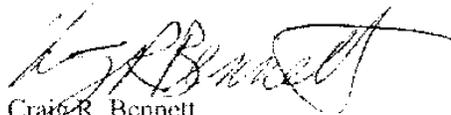
NNA also takes issue with the different methods I use to evaluate Bates' performance under the dealer agreement, arguing that these methods would result in nonsensical results. I disagree, but my primary response is that the flaw is not with my analysis, but rather with NNA's dealer agreement language that place a sales obligation on a dealer to customers only within its own PMA. NNA should simply modify its dealer agreement language if it believes that dealers should be evaluated on overall sales, whether to customers inside or outside of the dealer's PMA.

NNA asserts that my findings that Bates' write downs were not taken on the "good faith" basis of the vehicles' values and were "unjustified" should automatically lead to the conclusion that Bates "willfully failed" to comply with tax laws and regulations and intentionally submitted false financial information to NNA. I disagree. My statements about Bates' lack of good faith extended only to the basis of its determination of vehicle values (namely, Bates did not rely on some specific method for determining values), and not to its actions in believing it could lawfully take the write-downs it took. In that regard, I see no inconsistency in my conclusions. To analogize, I might truly believe I can charge whatever I want for an item I want to sell, but at the same time I may have no good faith basis for coming up with the sales price. Namely, I could be entirely arbitrary in selecting a price, but still believe that my actions are lawful and proper. That is what I believe the evidence shows Bates did in this case. While Bates acted without a good faith accounting basis, I believe it did so with the belief that its actions were permissible.

NNA discusses the meaning of the term "willful" in the body of its exceptions using California law, and then cites Texas law regarding the term only in a footnote—admitting that Texas law is quite different (see p. 35, fn. 32 of NNA's exceptions). Such an action by NNA is a bit disconcerting, since Texas law applies to this case and should have been the focus of NNA's discussion and not relegated to a footnote. As NNA notes in its footnote, in Texas, "willful" means with evil intent or legal malice or without reasonable ground for believing the act to be lawful. NNA then asserts that Bates had no reasonable ground for believing its action to be lawful. I disagree. As noted in the PFD, Bates questioned its enrolled tax agent whether it could take the write-downs and received an affirmation that it could from the tax agent. Further, Bates submitted the write-downs to its tax agent for inclusion in its tax returns, trusting that anything amiss would be caught by the tax agent. Thus, the evidence supports that Bates had a reasonable ground for believing its actions to be lawful.

In closing, I continue to stand by the recommendations, findings, and conclusions in the PFD. At this time, this case is now ready for consideration and final action by the Board.

Sincerely,



Craig R. Bennett
Administrative Law Judge

CRB/ept

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SERVICE LIST

AGENCY: Motor Vehicles, Texas Department of (TDMV)
STYLE/CASE: BATES NISSAN INC. v. NISSAN NORTH AMERICAN INC.
SOAH DOCKET NUMBER: 608-14-3211.LIC
REFERRING AGENCY CASE: 14-0010 LIC

**STATE OFFICE OF ADMINISTRATIVE
 HEARINGS**

ADMINISTRATIVE LAW JUDGE
ALJ CRAIG R. BENNETT

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Note: CONSOLIDATED WITH DOCKET NO. 608-15-2684.LIC

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Elizabeth Tschudi

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Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: David Duncan, General Counsel, Office of General Counsel
Agenda Item: 10
Subject: Adoption of Rules under Title 43, Texas Administrative Code, Chapter 206, Management Amendments to §206.131, Digital Certificates
Adoption of Rules under Title 43, Texas Administrative Code, Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and Salvage Vehicle Rebuilders
Amendments to §§221.16, 221.53, and 221.73

RECOMMENDATION

Approve adoption of amendments for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of these amendments is to implement House Bill 2739, 84th Legislature, Regular Session, 2015, which added Business and Commerce Code, §506.001, Concealed Handgun License as Valid Proof of Identification.

FINANCIAL IMPACT

There will be no fiscal implications related to the amendments.

BACKGROUND AND DISCUSSION

House Bill 2739, added Business and Commerce Code, §506.001, which prohibits a person from denying the holder of a Texas concealed handgun license access to goods, services, or facilities because the holder presents a concealed handgun license, instead of a driver's license or other acceptable form of personal identification.

The amendments add an unexpired concealed handgun license and a license to carry a handgun issued under Government Code, Chapter 411, Subchapter H, to the list of documents the department may use to verify the identity of an individual.

Additionally, the amendments modify the rules for consistency with other department rules, which state that a Texas driver's license or identification certificate must not be expired if the individual chooses to use one of these forms of identification. Other amendments renumber and reorganize some of the divisions within the rules, modify language for internal consistency, and modify language to improve the grammar within the rules.

The proposed amendments were published in the *Texas Register* for public comment on January 27, 2017. The comment period closed on February 27, 2017. No comments were received.

If the board adopts the amendments during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*; and
- an effective date of July 2, 2017.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTION 206.131, DIGITAL CERTIFICATES

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 206, Management, Subchapter G, Electronic Signatures, §206.131, Digital Certificates.

The preamble and the amendments are attached to this resolution as Exhibits A-B, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rule is adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

David Duncan, General Counsel
Office of General Counsel

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 206, Management

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to Chapter 206, Subchapter G, §206.131, Digital
4 Certificates, without changes to the proposed text as published
5 in the January 27, 2017, issue of the *Texas Register* (42 TexReg
6 300). The rule will not be republished.

7

8 EXPLANATION OF ADOPTED AMENDMENTS

9 House Bill 2739, 84th Legislature, Regular Session, 2015, added
10 Business and Commerce Code, §506.001, which prohibits a person
11 from denying the holder of a Texas concealed handgun license
12 access to goods, services, or facilities because the holder
13 presents a concealed handgun license, instead of a driver's
14 license or other acceptable form of personal identification.

15

16 An amendment to §206.131 adds an unexpired concealed handgun
17 license and a license to carry a handgun issued under Government
18 Code, Chapter 411, Subchapter H, to the list of documents the
19 department may use to verify the identity of an individual
20 regarding a digital certificate.

21

22 An amendment modifies §206.131 to be consistent with other
23 department rules which state that a Texas driver's license or

Texas Department of Motor Vehicles
Chapter 206, Management

1 identification certificate must not be expired if the individual
2 chooses to use one of these forms of identification. Other
3 amendments renumber some of the subparagraphs and modify the
4 language in §206.131 for internal consistency.

5

6 COMMENTS

7 No comments on the proposed amendments were received.

8

9 STATUTORY AUTHORITY

10 The amendments are adopted under Transportation Code, §1002.001,
11 which provides the board of the Texas Department of Motor
12 Vehicles with the authority to establish rules to implement the
13 powers and duties of the department under the Transportation
14 Code and other laws of this state.

15

16 CROSS REFERENCE TO STATUTE

17 Business and Commerce Code, §506.001.

Texas Department of Motor Vehicles
Chapter 206, Management

1 SUBCHAPTER G. ELECTRONIC SIGNATURES

2 §206.131. Digital Certificates.

3 (a) General. This section prescribes the requirements that
4 govern the issuance, use, and revocation of digital certificates
5 issued by the Texas Department of Motor Vehicles (department)
6 for electronic commerce in eligible department programs. The
7 provisions of 1 TAC Chapter 203, Subchapter B govern this
8 section in the event of a conflict between that subchapter and a
9 provision of this section.

10 (b) Definitions. The following words and terms, when used
11 in this section, shall have the following meanings, unless the
12 context clearly indicates otherwise.

13 (1) Business entity--An entity recognized by law
14 through which business is conducted with the department,
15 including a sole proprietorship, partnership, limited liability
16 company, corporation, joint venture, educational institution,
17 governmental agency, or non-profit organization.

18 (2) Certificate holder--An individual to whom a
19 digital certificate is issued.

20 (3) Digital certificate--A certificate, as defined by
21 1 TAC §203.1, issued by the department for purposes of
22 electronic commerce.

23 (4) Digital signature--Has the same meaning assigned

Texas Department of Motor Vehicles
Chapter 206, Management

1 by 1 TAC §203.1.

2 (5) Division director--The chief administrative
3 officer of a division of the department.

4 (c) Program authorization. A division director may
5 authorize the use of digital signatures for a particular program
6 based on whether the applicable industries or organizations are
7 using such technology, the frequency of document submission, and
8 the appropriateness for the program. The solicitation
9 documentation for eligible programs will include the information
10 that digital signatures may be used.

11 (d) Application and issuance of digital certificate.

12 (1) A request for a digital certificate shall be in
13 writing and shall be signed by the individual authorized by the
14 business entity to request a digital certificate.

15 (2) The department may request information necessary
16 to verify the identity of the individual requestor or the
17 identity of the individual to whom the certificate is to be
18 issued. [~~business entity that has authorized the request.~~] To
19 verify identity under this paragraph a person shall present:

20 (A) an unexpired [a] Texas driver's license or
21 identification certificate with a photograph;

22 (B) an unexpired concealed handgun license or
23 license to carry a handgun issued by the Texas Department of

Texas Department of Motor Vehicles
Chapter 206, Management

1 Public Safety under Government Code, Chapter 411, Subchapter H;

2 (C)~~(B)~~ an unexpired United States passport;

3 (D)~~(C)~~ a United States citizenship

4 (naturalization) certificate with identifiable photograph;

5 (E)~~(D)~~ an unexpired United States Bureau of

6 Citizenship and Immigration Services document that:

7 (i) was issued for a period of at least one
8 year;

9 (ii) is valid for not less than six months
10 from the date it is presented to the department with a completed
11 application; and

12 (iii) contains verifiable data and an
13 identifiable photograph;

14 (F)~~(E)~~ an unexpired United States military
15 identification card for active duty, reserve, or retired
16 personnel with an identifiable photograph; or

17 (G)~~(F)~~ a foreign passport with a valid or
18 expired visa issued by the United States Department of State
19 with an unexpired United States Bureau of Citizenship and
20 Immigration Services Form I-94:

21 (i) that was issued for a period of at least
22 one year, is marked valid for a fixed duration, and is valid for
23 not less than six months from the date it is presented to the

Texas Department of Motor Vehicles
Chapter 206, Management

1 department with a completed application; or

2 (ii) that is marked valid for the duration
3 of the person's stay and is accompanied by appropriate
4 documentation.

5 (3) The department may take actions necessary to
6 confirm that the individual who signed the request is authorized
7 to act on behalf of the business entity, including requiring the
8 individual requestor or the person authorizing the request to
9 personally appear at the department location responsible for the
10 issuing of the certificate.

11 (4) The department shall issue a digital certificate
12 only to an individual. Information identifying the business
13 entity that authorized the issuance of the certificate may be
14 embedded in the digital certificate.

15 (e) Refusal to issue a digital certificate. The department
16 shall not issue a digital certificate if the identity of the
17 individual to whom the certificate is to be issued, or the
18 identity of the individual requesting the certificate on behalf
19 of a business entity, cannot be established. The department will
20 not issue a digital certificate if the business entity on whose
21 behalf the request is allegedly being made does not authorize
22 its issuance.

23 (f) Responsibilities of certificate holder. A certificate

Texas Department of Motor Vehicles
Chapter 206, Management

1 holder shall:

2 (1) maintain the security of the digital certificate;

3 (2) use the certificate solely for the purpose for
4 which it was issued; and

5 (3) renew the certificate in a timely manner, if
6 continued use is intended.

7 (g) Responsibilities of business entity. A business entity
8 is responsible for:

9 (1) determining what individual may request a
10 certificate for the business entity;

11 (2) determining to what individual a certificate is to
12 be issued; and

13 (3) requesting within a reasonable time the revocation
14 of the business entity's certificate if the security of the
15 certificate has been compromised or if the business entity is
16 changing its certificate holder.

17 (h) Revocation of certificate. The department shall revoke
18 a digital certificate:

19 (1) upon receipt of a written request for revocation
20 of the business entity's certificate, signed by an individual
21 authorized to act on behalf of the business entity for which it
22 was issued;

23 (2) for suspension or debarment of the individual or

Texas Department of Motor Vehicles
Chapter 206, Management

1 business entity; or

2 (3) if the department has reason to believe that
3 continued use of the digital certificate would present a
4 security risk.

5 (i) Use of digital certificate.

6 (1) A digital signature issued by the department shall
7 only be used for the purpose of digitally signing electronic
8 documents filed with the department. A digital signature is
9 binding on the individual to whom the certificate was issued and
10 the represented business entity, as if the document were signed
11 manually.

12 (2) The department may use the digital certificate to
13 identify the certificate holder when granting or verifying
14 access to secure computer systems used for electronic commerce.

15 (j) Forms. The department may prescribe forms to request,
16 modify, or revoke a digital certificate.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES
RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTIONS 221.16, 221.53, AND 221.73
RELATING TO SALVAGE VEHICLE DEALERS, SALVAGE POOL
OPERATORS AND SALVAGE VEHICLE REBUILDERS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and Salvage Vehicle Rebuilders; Subchapter B, Licensing, §221.16, Required Attachments to the License Application; Subchapter C, Licensed Operations, §221.53, Casual Sales; and Subchapter D, Records, §221.73, Content of Records.

The preamble and the amendments are attached to this resolution as Exhibits A-D, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rules are adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

David Duncan, General Counsel
Office of General Counsel

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to §221.16, Required Attachments to the License
4 Application; §221.53, Casual Sales; and §221.73, Content of
5 Records, without changes to the proposed text as published in
6 the January 27, 2017, issue of the *Texas Register* (42 TexReg
7 301). The rules will not be republished.

8

9 EXPLANATION OF ADOPTED AMENDMENTS

10 House Bill 2739, 84th Legislature, Regular Session, 2015, added
11 Business and Commerce Code §506.001, which prohibits a person
12 from denying the holder of a Texas concealed handgun license
13 access to goods, services, or facilities because the holder
14 presents a concealed handgun license, instead of a driver's
15 license or other acceptable form of personal identification.

16

17 Amendments to §§221.16, 221.53, and 221.73 add a concealed
18 handgun license and a license to carry a handgun issued under
19 Government Code, Chapter 411, Subchapter H, to the list of
20 documents the department may use to verify the identity of an
21 individual. Other amendments renumber divisions within the
22 rules, reorganize existing rule language, and improve the

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 grammar within the rules.

2

3 COMMENTS

4 No comments on the proposed amendments were received.

5

6 STATUTORY AUTHORITY

7 The amendments are adopted under Transportation Code, §1002.001,
8 which provides the board of the Texas Department of Motor
9 Vehicles (board) with the authority to establish rules to
10 implement the powers and duties of the department under the
11 Transportation Code and other laws of this state; and more
12 specifically, Occupations Code, §2302.051, which requires the
13 board to adopt rules as necessary to administer Chapter 2302;
14 and Occupations Code, §2302.204(1), which requires the board to
15 adopt rules as necessary to regulate casual sales by salvage
16 vehicle dealers, insurance companies, and salvage pool
17 operators.

18

19 CROSS REFERENCE TO STATUTE

20 Business and Commerce Code, §506.001.

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 SUBCHAPTER B. LICENSING

2 §221.16. Required Attachments to the License Application.

3 (a) If the applicant is a sole proprietor or general
4 partnership, in addition to the information required by §221.15
5 of this title (relating to Required License Application
6 Information), the applicant must submit a legible copy of one of
7 the following types of identification that is valid and active
8 at the time of application for the sole proprietor and each of
9 the general partners~~[partner's current]~~:

10 (1) driver's license, Department of Public Safety
11 identification, or state identification certificate issued by a
12 state or territory of the United States;

13 (2) concealed handgun license or license to carry a
14 handgun issued by the Department of Public Safety under
15 Government Code, Chapter 411, Subchapter H;

16 (3)~~[+2]~~ United States or foreign passport;

17 (4) United States Department of Homeland Security,
18 United States Citizenship and Immigration Services, or United
19 States Department of State Identification document;

20 (5)~~[+3]~~ United States military identification card;
21 or

22 (6)~~[+4]~~ North Atlantic Treaty Organization

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 identification or identification issued under a Status of Forces
2 Agreement. [~~;-or~~]

3 [~~(5) United States Department of Homeland Security,~~
4 ~~United States Citizenship and Immigration Services, or United~~
5 ~~States Department of State Identification document]~~

6 (b) If the applicant is a limited partnership, limited
7 liability company, or a corporation, the applicant must submit a
8 legible copy of one of the following current types of
9 identification that is valid and active at the time of
10 application for each partner of the limited partnership, each
11 member of the limited liability company, and for each officer of
12 the corporation:

13 (1) driver's license, Department of Public Safety
14 identification, or state identification certificate issued by a
15 state or territory of the United States;

16 (2) concealed handgun license or license to carry a
17 handgun issued by the Department of Public Safety under
18 Government Code, Chapter 411, Subchapter H;

19 (3)[(-2)] United States or foreign passport;

20 (4) United States Department of Homeland Security,
21 United States Citizenship and Immigration Services, or United
22 States Department of State Identification document;

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 (5)[(+3)] United States military identification card;

2 or

3 (6)[(+4)] North Atlantic Treaty Organization

4 identification or identification issued under a Status of Forces
5 Agreement. [~~;-or~~]

6 [~~(5) United States Department of Homeland Security,~~
7 ~~United States Citizenship and Immigration Services, or United~~
8 ~~States Department of State Identification document]~~

9 (c) If the applicant is a corporation, the applicant must
10 submit a copy of the certificate of incorporation issued by the
11 secretary of state or a certificate issued by the jurisdiction
12 where the applicant is incorporated, and a verification that, at
13 the time the application is submitted, all business franchise
14 taxes of the corporation have been paid.

15 (d) If the applicant is a limited partnership, the
16 applicant must submit a copy of the certificate of partnership
17 issued by the secretary of state or a certificate issued by the
18 jurisdiction where the applicant is formed, and verification
19 that, at the time the application is submitted, all business
20 franchise taxes of the limited partnership have been paid.

21 (e) Upon request by the department, the applicant shall
22 submit documents demonstrating that the applicant owns the real

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 property on which the business is situated or has a written
2 lease for the property that has a term of not less than the term
3 of the license.

4 (f) If the applicant is a sole proprietor or general
5 partnership, in addition to the information required by §221.15,
6 the applicant must submit a legible copy of the Assumed Name
7 Certificate (DBA) issued by the county clerk in which the
8 business is located.

9 (g) If the applicant is a limited partnership, limited
10 liability company, or a corporation, the applicant must submit a
11 legible copy of the Assumed Name Certificate (DBA) as registered
12 with the Texas Secretary of State's office.

13 (h) If the applicant is a sole proprietor or general
14 partnership, in addition to the information required by §221.15,
15 the applicant must submit a legible copy of the Texas Sales and
16 Use Tax Permit.

17 (i) If the applicant is a limited partnership, limited
18 liability company, or a corporation, the applicant must submit a
19 legible copy of the Texas Sales and Use Tax Permit.

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 SUBCHAPTER C. LICENSED OPERATIONS

2 §221.53. Casual Sales.

3 (a) A license holder may not make more than five (5) casual
4 sales of salvage motor vehicles or non-repairable motor vehicles
5 during a calendar year to the same person.

6 (b) A license holder must maintain records of each casual
7 sale made during the previous 36 months, as provided by §221.72
8 of this title (relating to Record Retention). Such records must
9 contain the following information regarding each casual sale:

10 (1) the complete name, address and phone number of the
11 purchaser;

12 (2) a copy of one of the following current photo
13 identification documents for the purchaser:

14 (A) driver's license, Department of Public Safety
15 identification, or state identification certificate issued by a
16 state or territory of the United States;

17 (B) concealed handgun license or license to carry
18 a handgun issued by the Department of Public Safety under
19 Government Code, Chapter 411, Subchapter H;

20 (C)[~~B~~] United States or foreign passport;

21 (D) United States Department of Homeland
22 Security, United States Citizenship and Immigration Services, or

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 United States Department of State Identification document;

2 (E)~~(C)~~ United States military identification

3 card; or

4 (F)~~(D)~~ North Atlantic Treaty Organization

5 identification or identification issued under a Status of Forces

6 Agreement; and~~or~~

7 ~~(E) United States Department of Homeland~~

8 ~~Security, United States Citizenship and Immigration Services, or~~

9 ~~United States Department of State Identification document; and]~~

10 (3) the year, make, model, color and vehicle

11 identification number for the salvage motor vehicle or non-

12 repairable motor vehicle.

13 (c) A person who~~that~~ purchases a salvage motor vehicle or

14 a non-repairable motor vehicle through a casual sale may not

15 sell that salvage motor vehicle or non-repairable motor vehicle

16 until the salvage vehicle title, salvage record or title, non-

17 repairable vehicle title or non-repairable record of title, as

18 applicable, is in the person's name.

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 SUBCHAPTER D. RECORDS

2 §221.73. Content of Records.

3 (a) The records of a salvage vehicle dealer for purchases
4 and sales shall include:

5 (1) the date of purchase of the salvage motor vehicle,
6 or non-repairable motor vehicle;

7 (2) the name and address of the person who~~[that]~~ sold
8 the salvage motor vehicle or non-repairable motor vehicle to the
9 salvage vehicle dealer;

10 (3) if the person who~~[that]~~ sold the salvage motor
11 vehicle or non-repairable motor vehicle to the salvage motor
12 vehicle dealer is not an insurance company or a salvage pool
13 operator, a photocopy of one of the following current photo
14 identification documents of the person who~~[that]~~ sold the
15 salvage motor vehicle or non-repairable motor vehicle to the
16 salvage vehicle dealer:

17 (A) driver's license, Department of Public Safety
18 identification, or state identification certificate issued by a
19 state or territory of the United States;

20 (B) concealed handgun license or license to carry
21 a handgun issued by the Department of Public Safety under
22 Government Code, Chapter 411, Subchapter H;

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 (C)~~(B)~~ United States or foreign passport;

2 (D) United States Department of Homeland

3 Security, United States Citizenship and Immigration Services, or

4 United States Department of State Identification document;

5 (E)~~(C)~~ United States military identification

6 card; or

7 (F)~~(D)~~ North Atlantic Treaty Organization

8 identification or identification issued under a Status of Forces

9 Agreement; [~~or~~]

10 [~~(E) United States Department of Homeland~~

11 ~~Security, United States Citizenship and Immigration Services, or~~

12 ~~United States Department of State Identification document;]~~

13 (4) a description of the salvage motor vehicle or non-

14 repairable motor vehicle, including the model, year, make, and

15 vehicle identification number, if applicable;

16 (5) the ownership document number and state of

17 issuance of the salvage motor vehicle or non-repairable motor

18 vehicle ownership document, if applicable;

19 (6) a copy of the salvage record of title or non-

20 repairable record of title, if applicable, or a copy of the

21 front and back of the ownership document for the salvage motor

22 vehicle or non-repairable motor vehicle;

Texas Department of Motor Vehicles
Chapter 221, Salvage Vehicle Dealers, Salvage Pool Operators and
Salvage Vehicle Rebuilders

1 (7) a copy of the form if the ownership document has
2 been surrendered to the department; and

3 (8) any evidence indicating that the motor vehicle was
4 scrapped or destroyed.

5 (b) If the salvage motor vehicle has been rebuilt,
6 repaired, or reconstructed by the salvage vehicle dealer the
7 salvage vehicle dealer's records must also include a form
8 prescribed by the department for "Rebuilt Vehicle Statement,"
9 listing all repairs made to the motor vehicle, and, when
10 required to be completed, a form prescribed by the department
11 for "Component Part(s) Bill of Sale."



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Linda M. Flores, Chief Financial Officer; and Jeremiah Kuntz, Director, Vehicle Titles and Registration
Agenda Item: 11
Subject: Adoption of Rule under Title 43, Texas Administrative Code, Chapter 209, Finance Amendments, §209.2, Charges for Dishonored Checks

RECOMMENDATION

Approve adoption of amendments for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of these amendments will be to provide a mechanism for the TxDMV to be reimbursed for any charges passed on to the agency by Texas.gov's financial institution in the event of an electronic payment that is rejected for lack of sufficient funds.

FINANCIAL IMPACT

There will be no major fiscal implications related to the amendments.

BACKGROUND AND DISCUSSION

The amendments add language to provide a mechanism for the collection of any charges assessed for a dishonored electronic payment by a banking institution to the operator of Texas.gov that are passed on to the TxDMV.

The proposed amendments were published in the *Texas Register* for public comment on March 24, 2017. The comment period closed on April 24, 2017. No comments were received.

If the board adopts the amendments during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*;
- an effective date of July 2, 2017;
- implementation by the department immediately thereafter.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTION 209.2, CHARGES FOR DISHONORED CHECKS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 209, Finance, Subchapter A, Collection of Debts, §209.2, Charges for Dishonored Checks.

The preamble and the amendments are attached to this resolution as Exhibits A-B, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rule is adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chair
Board of the Texas Department of Motor Vehicles

Recommended by:

Jeremiah Kuntz, Director
Vehicle Titles and Registration

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 209, Finance

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to Chapter 209, Finance, Subchapter A, Collection of
4 Debts, §209.2, Charges for Dishonored Checks without changes to
5 the proposed text as published in the March 24, 2017, issue of
6 the *Texas Register* (42 TexReg 1389). The rule will not be
7 republished.

8

9 EXPLANATION OF ADOPTED AMENDMENTS

10 Amendments to §209.2 add language to provide a mechanism for the
11 collection of any charges assessed for a dishonored electronic
12 payment by a banking institution to the operator of Texas.gov
13 that are passed on to the Texas Department of Motor Vehicles.

14

15 COMMENTS

16 No comments on the proposed amendments were received.

17

18 STATUTORY AUTHORITY

19 The amendments are adopted under Transportation Code, §1002.001,
20 which provides the board of the Texas Department of Motor
21 Vehicles with the authority to adopt rules that are necessary
22 and appropriate to implement the powers and duties of the
23 department.

Texas Department of Motor Vehicles
Chapter 209, Finance

- 1 CROSS REFERENCE TO STATUTE
- 2 Business and Commerce Code, §3.506.

Texas Department of Motor Vehicles
Chapter 209, Finance

1 SUBCHAPTER A. COLLECTION OF DEBTS

2 §209.2. Charges for Dishonored Checks.

3 (a) Purpose. Business and Commerce Code, §3.506, authorizes
4 the holder of a dishonored check, seeking collection of the face
5 value of the check, to charge the drawer or endorser of the
6 check a reasonable processing fee, not to exceed \$30. This
7 section prescribes policies and procedures for the processing of
8 dishonored checks made payable to the department and the
9 collection of fees because of the dishonor of a check made
10 payable to the department.

11 (b) Definitions. The following words and terms, when used
12 in this section, shall have the following meanings, unless the
13 context clearly indicates otherwise.

14 (1) Department--The Texas Department of Motor
15 Vehicles.

16 (2) Dishonored check--A check, draft, order,
17 electronic payment, or other payment device that is drawn or
18 made upon a bank or other financial institution, and that is not
19 honored upon presentment because the account upon which the
20 instrument has been drawn or made does not exist or is closed,
21 or does not have sufficient funds or credit for payment of the
22 instrument in full.

23 (c) Processing of dishonored checks. Upon receipt of notice

Texas Department of Motor Vehicles
Chapter 209, Finance

1 from a bank or other financial institution of refusal to honor a
2 check made payable to the department, the department will
3 process the returned check using the following procedures.

4 (1) The department will send a written notice by
5 certified mail, return receipt requested, to the drawer or
6 endorser at the drawer or endorser's address as shown on:

7 (A) the dishonored check;

8 (B) the records of the bank or other financial
9 institution; or

10 (C) the records of the department.

11 (2) The written notice will notify the drawer or
12 endorser of the dishonored check and will request payment of the
13 face amount of the check, any payment processor charges, and a
14 \$30 processing fee no later than 10 days after the date of
15 receipt of the notice. The written notice will also contain the
16 statement required by Penal Code, §32.41(c)(3).

17 (3) The face amount of the check, any payment
18 processor charges, and the processing fee must be paid to the
19 department:

20 (A) with a cashier's check or money order, made
21 payable to the Texas Department of Motor Vehicles; or

22 (B) with a valid credit card, approved by the
23 department, and issued by a financial institution chartered by a

Texas Department of Motor Vehicles
Chapter 209, Finance

1 state or the United States, or a nationally recognized credit
2 organization.

3 (4) Payments made by credit card must include the fee
4 required by §209.23 of this chapter (relating to Methods of
5 Payment).

6 (5) If payment is not received within 10 days after
7 the date of receipt of the notice, the obligation will be
8 considered delinquent and will be processed in accordance with
9 §209.1 of this title (relating to Collection of Debts).

10 (d) Supplemental collection procedures. In addition to the
11 procedures described in §209.1, the department may notify
12 appropriate credit bureaus or agencies if the drawer or endorser
13 fails to pay the face amount of a dishonored check, any payment
14 processor charges, and the processing fee, or may refer the
15 matter for criminal prosecution.

16 (e) Any payment to the department from the drawer or
17 endorser of a dishonored check will be applied first to the
18 processing fee.



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: William P. Harbeson, Director, Enforcement Division
Agenda Item: 12
Subject: Adoption of Rule under Title 43, Texas Administrative Code, Chapter 215, Motor Vehicle Distribution Amendments, §215.140, Established and Permanent Place of Business

RECOMMENDATION

Approve adoption of amendments for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of the amendments is to clarify that the premises requirements apply to each dealer when multiple dealers are licensed at the same location.

FINANCIAL IMPACT

There will be no fiscal implications related to the amendments.

BACKGROUND AND DISCUSSION

The amendments clarify for motor vehicle dealer license applicants the requirements for conducting business as a dealer and impend dealers' intent on violating the off-site sales law from using a single office at which multiple dealers will be licensed.

The proposal was published in the *Texas Register* on March 24, 2017. The comment period closed on April 24, 2017. A comment was submitted by Amber Hackett Crosby on behalf of the Texas Independent Automobile Dealers Association (TIADA), which is included in these materials. TIADA is in support of the department's proposed amendments to §215.140.

If the board adopts the amendments during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*; and
- an effective date of July 2, 2017.



April 21, 2017

Mr. David Duncan
General Counsel
Texas Department of Motor Vehicles
4000 Jackson Ave.
Austin, TX 78731

Sent via email: rules@txdmv.gov

Re: Proposed TAC, Chapter 215 §215.140 Amendments published in the Texas Register March 24, 2017

Dear Mr. Duncan:

The Texas Independent Automobile Dealers Association (TIADA) thanks you for the opportunity to submit the following comments with regard to general distinguishing numbers.

The association supports the rule amendments as proposed. TIADA has been fortunate to work with the Enforcement Division on numerous occasions to address premises rule violations. TIADA appreciates the agency's effort to clarify rules required for dealer locations and to prevent off-site vehicle sales.

TIADA looks forward to working with the agency in the future. Please feel free to contact me directly with any questions or concerns you may have.

Sincerely,

A handwritten signature in black ink that reads "Amber H. Crosby". The signature is written in a cursive style.

Amber Hackett Crosby
TIADA Director of Dealer Compliance and Education

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTION 215.140, ESTABLISHED AND PERMANENT PLACE OF BUSINESS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 215, Motor Vehicle Distribution, Subchapter E, General Distinguishing Numbers, §215.140, Established and Permanent Place of Business.

The preamble and the amendments are attached to this resolution as Exhibits A-B, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rule is adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

William P. Harbeson, Director
Enforcement Division

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to Chapter 215, Motor Vehicle Distribution,
4 Subchapter E, General Distinguishing Numbers, §215.140,
5 Established and Permanent Place of Business without changes to
6 the proposed text as published in the March 24, 2017, issue of
7 the *Texas Register* (42 TexReg 1390). The rule will not be
8 republished.

9

10 EXPLANATION OF ADOPTED AMENDMENTS

11 Amendments to §215.140 clarify that the premises requirements
12 apply to each dealer when multiple dealers are licensed at the
13 same location.

14

15 COMMENTS

16 The department received a comment from Amber Hackett Crosby on
17 behalf of the Texas Independent Automobile Dealers Association
18 (TIADA). TIADA is in support of the department's proposed
19 amendments to §215.140. TIADA appreciates the agency's effort to
20 clarify rule required for dealer locations and to prevent off-
21 site vehicle sales.

22

23 STATUTORY AUTHORITY

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

- 1 The amendments are adopted under Transportation Code, §1002.001,
2 which provides the board of the Texas Department of Motor
3 Vehicles (board) with the authority to adopt rules that are
4 necessary and appropriate to implement the powers and the duties
5 of the department under the Transportation Code; and more
6 specifically, Transportation Code, §503.002, which authorizes
7 the board to adopt rules to administer Chapter 503, Dealer's and
8 Manufacturer's Vehicle License Plates.
- 9
- 10 CROSS REFERENCE TO STATUTE
- 11 Transportation Code, §§503.029, 503.030, and 503.032.

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 SUBCHAPTER E. GENERAL DISTINGUISHING NUMBERS

2 §215.140. Established and Permanent Place of Business.

3 A dealer must meet the following requirements at each licensed
4 location and maintain the requirements during the term of the
5 license. If multiple dealers are licensed at a location, each
6 dealer must maintain the following requirements during the
7 entire term of the license.

8 (1) Business hours for retail dealers.

9 (A) A retail dealer's office shall be open at
10 least four days per week for at least four consecutive hours per
11 day.

12 (B) The retail dealer's business hours for each
13 day of the week must be posted at the main entrance of the
14 retail dealer's office that is accessible to the public. The
15 owner or a bona fide employee of the retail dealer shall be at
16 the retail dealer's licensed location during the posted business
17 hours for the purposes of buying, selling, exchanging, or
18 leasing vehicles. If the owner or a bona fide employee is not
19 available to conduct business during the retail dealer's posted
20 business hours due to special circumstances or emergencies, a
21 separate sign must be posted indicating the date and time the
22 retail dealer will resume operations. Regardless of the retail
23 dealer's business hours, the retail dealer's telephone must be

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 answered from 8:00 a.m. to 5:00 p.m. weekdays by a bona fide
2 employee, answering service, or answering machine.

3 (2) Business hours for wholesale motor vehicle
4 dealers. A dealer that holds only a wholesale motor vehicle
5 dealer's license must post its business hours at the main
6 entrance of the wholesale motor vehicle dealer's office. A
7 wholesale motor vehicle dealer shall be at the wholesale motor
8 vehicle dealer's licensed location at least two weekdays per
9 week for at least two consecutive hours per day. Regardless of
10 the wholesale motor vehicle dealer's business hours, the
11 wholesale motor vehicle dealer's telephone must be answered from
12 8:00 a.m. to 5:00 p.m. weekdays by a bona fide employee,
13 answering service, or answering machine.

14 (3) Business sign requirements for retail dealers. A
15 retail dealer must display a conspicuous, permanent sign with
16 letters at least six inches in height showing the retail
17 dealer's business name or assumed name substantially similar to
18 the name reflected on the retail dealer's license under which
19 the retail dealer conducts business. The sign must be
20 permanently mounted at the address listed on the application for
21 the retail dealer's license. A retail dealer may use a temporary
22 sign or banner if that retail dealer can show proof that a sign
23 that meets the requirements of this paragraph has been ordered.

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 (4) Business sign requirements for wholesale motor
2 vehicle dealers. A wholesale motor vehicle dealer must display a
3 conspicuous, permanent sign with letters at least six inches in
4 height showing the wholesale motor vehicle dealer's business
5 name or assumed name substantially similar to the name reflected
6 on the wholesale motor vehicle dealer's license under which the
7 wholesale motor vehicle dealer conducts business. The sign must
8 be permanently mounted on the business property and shall be on
9 the main door to the wholesale motor vehicle dealer's office or
10 on the outside of the building that houses the wholesale motor
11 vehicle dealer's office. If the wholesale motor vehicle dealer's
12 office is located in an office building with one or more other
13 businesses and an outside sign is not permitted by the landlord,
14 a business sign permanently mounted on or beside the main door
15 to the wholesale motor vehicle dealer's office with letters at
16 least two inches in height is acceptable. A wholesale motor
17 vehicle dealer may use a temporary sign or banner if the
18 wholesale motor vehicle dealer can show proof that a sign that
19 meets the requirements of this paragraph has been ordered.

20 (5) Office structure for a retail dealer and a
21 wholesale motor vehicle dealer.

22 (A) A dealer's office must be located in a
23 building with connecting exterior walls on all sides.

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 (B) A dealer's office must comply with all
2 applicable local zoning ordinances and deed restrictions.

3 (C) A dealer's office may not be located within a
4 residence, apartment, hotel, motel, or rooming house.

5 (D) The physical address of the dealer's office
6 must be recognized by the U.S. Postal Service or capable of
7 receiving U.S. mail. The department will not mail a license or a
8 metal dealer's license plate to an out of state address.

9 (E) A portable-type office structure may qualify
10 as an office only if the structure meets the requirements of
11 this section and is not a readily moveable trailer or other
12 vehicle.

13 (6) Required office equipment for a retail dealer and
14 a wholesale motor vehicle dealer. At a minimum, a dealer's
15 office must be equipped with:

16 (A) a desk;

17 (B) two chairs;

18 (C) internet access; and

19 (D) a working telephone number listed in the
20 business name or assumed name under which the dealer conducts
21 business.

22 (7) Number of retail dealers in one office. Not more
23 than four retail dealers may be located in the same business

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 structure. Each retail dealer located in the same business
2 structure must meet the requirements of this section.

3 (8) Number of wholesale motor vehicle dealers in one
4 office. Not more than eight wholesale motor vehicle dealers may
5 be located in the same business structure. Each wholesale dealer
6 located in the same business structure must meet the
7 requirements of this section.

8 (9) Office sharing prohibition for retail dealers and
9 wholesale motor vehicle dealers. Unless otherwise authorized by
10 the Transportation Code, a retail dealer and a wholesale motor
11 vehicle dealer licensed after September 1, 1999, may not be
12 located in the same business structure.

13 (10) Dealer housed with other business.

14 (A) If a person conducts business as a dealer in
15 conjunction with another business owned by the same person and
16 under the same name as the other business, the same telephone
17 number may be used for both businesses. If the name of the
18 dealer differs from the name of the other business, a separate
19 telephone listing and a separate sign for each business is
20 required.

21 (B) A person may conduct business as a dealer in
22 conjunction with another business not owned by that person only
23 if the dealer owns the property on which business is conducted

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 or has a separate lease agreement from the owner of that
2 property that meets the requirements of this section. The same
3 telephone number may not be used by both businesses. The dealer
4 must have separate business signs, telephone listings, and
5 office equipment required under this section.

6 (11) Display area requirements.

7 (A) A wholesale motor vehicle dealer is not
8 required to have display space at the wholesale motor vehicle
9 dealer's business premises.

10 (B) A retail dealer must have an area designated
11 as display space for the retail dealer's inventory. A retail
12 dealer's designated display area must comply with the following
13 requirements.

14 (i) The display area must be located at the
15 retail dealer's business address or contiguous with the retail
16 dealer's address. A noncontiguous storage lot is permissible
17 only if there is no public access and no sales activity occurs
18 at the storage lot. A sign stating the retail dealer's name,
19 telephone number, and the fact the property is a storage lot is
20 permissible.

21 (ii) The display area must be of sufficient
22 size to display at least five vehicles of the type for which the
23 GDN is issued. Those spaces must be reserved exclusively for the

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 retail dealer's inventory and may not be shared or intermingled
2 with another business or a public parking area, a driveway to
3 the office, or another dealer's display area.

4 (iii) The display area may not be on a
5 public easement, right-of-way, or driveway unless the governing
6 body having jurisdiction of the easement, right-of-way, or
7 driveway expressly consents in writing to use as a display area.
8 If the easement, right-of-way, or driveway is a part of the
9 state highway system, use as a display area may only be
10 authorized by a lease agreement.

11 (iv) If the retail dealer shares a display
12 or parking area with another business, including another dealer,
13 the dealer's vehicle inventory must be separated from the other
14 business's display or parking area by a material object or
15 barrier that cannot be readily removed.

16 (v) The display area must be adequately
17 illuminated if the retail dealer is open at night so that a
18 vehicle for sale can be properly inspected by a potential buyer.

19 (vi) The display area may be located inside
20 a building.

21 (12) Dealers holding a license issued under
22 Occupations Code, Chapter 2302. If a dealer also holds a license
23 issued under Occupations Code, Chapter 2302, each salvage motor

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 vehicle that is offered for sale on the premises of the dealer's
2 display area must be clearly and conspicuously marked with a
3 sign informing a potential buyer that the vehicle is a salvage
4 motor vehicle. This requirement does not apply to a licensed
5 salvage pool operator.

6 (13) Lease requirements. If the premises from which a
7 dealer conducts business, including any display area, is not
8 owned by the dealer, the dealer must maintain a lease that is
9 continuous during the period of time for which the dealer's
10 license will be issued. The lease agreement must be on a
11 properly executed form containing at a minimum:

12 (A) the name of the landlord as the lessor of the
13 premises and the name of the dealer as the tenant or lessee of
14 the premises;

15 (B) the period of time for which the lease is
16 valid;

17 (C) the street address or legal description of
18 the property, provided that if only a legal description of the
19 property is included, the applicant must attach a statement that
20 the property description in the lease agreement is the street
21 address identified on the application; and

22 (D) the signature of the landlord as the lessor
23 and the signature of the dealer as the tenant or lessee.

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 (14) Dealer must display license. A dealer must display
2 the dealer's license issued by the department at all times in a
3 manner that makes the license easily readable by the public and
4 in a conspicuous place at each place of business for which the
5 dealer's license is issued. If the dealer's license applies to
6 more than one location, a copy of the original license may be
7 displayed in each supplemental location.



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Jeremiah Kuntz, Director, Vehicle Titles and Registration
Agenda Item: 13
Subject: Adoption of Rule under Title 43, Texas Administrative Code, Chapter 215, Motor Vehicle Distribution Amendment, §215.155, Buyer's Temporary Tags

RECOMMENDATION

Approve adoption of an amendment for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of this amendment is to clarify the amount, applicability, and disposition of the buyer's temporary tag fee.

FINANCIAL IMPACT

There will be no fiscal implications related to the amendment.

BACKGROUND AND DISCUSSION

Transportation Code, §503.063(g) requires a dealer to charge the buyer a fee of not more than \$5 as prescribed by the department for each buyer's temporary tag issued. The statute directs this fee to be sent to the comptroller for deposit to the credit of the Texas Department of Motor Vehicles fund.

The amendment adds subsection (f) to establish the \$5 fee and clarify that if the vehicle is sold to an out-of-state buyer and the dealer is making payment through the department's electronic title system, the entire fee shall be remitted to the department for deposit to the credit of the Texas Department of Motor Vehicles fund. All other buyer's temporary tag fees shall be remitted to the county for deposit to the credit of the Texas Department of Motor Vehicles fund. The amendment also clarifies that the buyer's temporary tag fee shall not be charged if the vehicle is exempt from payment of certain registration fees (exempt registration, all-terrain vehicle or recreational off-highway vehicle or off-highway motorcycle).

The proposal was published in the *Texas Register* on March 24, 2017. The comment period closed on April 24, 2017. A comment was submitted by Amber Hackett Crosby on behalf of the Texas Independent Automobile Dealers Association (TIADA), which is included in these materials. TIADA supports the rule amendments as proposed.

If the board adopts the amendment during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*;
- an effective date of July 2, 2017; and
- implementation of direct payment to the department when required programming complete.



April 21, 2017

Mr. David Duncan
General Counsel
Texas Department of Motor Vehicles
4000 Jackson Ave.
Austin, TX 78731

Sent via email: rules@txdmv.gov

Re: Proposed TAC, Chapter 215, §215.155 Amendments published in the Texas Register March 24, 2017

Dear Mr. Duncan:

The Texas Independent Automobile Dealers Association (TIADA) thanks you for the opportunity to submit the following comment with regard to buyer's temporary tags.

The association supports the rule amendments as proposed, and applauds the efforts of the agency to codify the existing practice for remitting buyer's temporary tag fees when a vehicle is sold to an out-of-state buyer.

TIADA looks forward to working with the agency in the future. Please feel free to contact me directly with any questions or concerns you may have.

Sincerely,

Amber Hackett Crosby
TIADA Director of Dealer Compliance and Education

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING ADOPTION OF AN AMENDMENT TO
43 TAC SECTION 215.155, BUYER'S TEMPORARY TAGS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 215, Motor Vehicle Distribution, Subchapter E, General Distinguishing Numbers, §215.155, Buyer's Temporary Tags.

The preamble and the amendment are attached to this resolution as Exhibits A-B, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rule is adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

Jeremiah Kuntz, Director
Vehicle Titles and Registration

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts an
3 amendment to Chapter 215, Motor Vehicle Distribution, Subchapter
4 E, General Distinguishing Numbers, §215.155, Buyer's Temporary
5 Tags without changes to the proposed text as published in the
6 March 24, 2017, issue of the *Texas Register* (42 TexReg 1392).
7 The rule will not be republished.

8

9 EXPLANATION OF ADOPTED AMENDMENT

10 Transportation Code, §503.063(g) requires a dealer to charge the
11 buyer a fee of not more than \$5 as prescribed by the department
12 for each buyer's temporary tag issued. The statute directs this
13 fee to be sent to the comptroller for deposit to the credit of
14 the Texas Department of Motor Vehicles fund.

15

16 The amendment adds subsection (f) to §215.155, Buyer's Temporary
17 Tags. Subsection (f) establishes the \$5 fee and clarifies that
18 if the vehicle is sold to an out-of-state buyer and the dealer
19 is making payment through the department's electronic title
20 system, the entire fee shall be remitted to the department for
21 deposit to the credit of the Texas Department of Motor Vehicles
22 fund. All other buyer's temporary tag fees shall be remitted to
23 the county for deposit to the credit of the Texas Department of

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 Motor Vehicles fund. The amendment also clarifies that the
2 buyer's temporary tag fee shall not be charged if the vehicle is
3 exempt from payment of certain registration fees (exempt
4 registration, all-terrain vehicle or recreational off-highway
5 vehicle or off-highway motorcycle).

6

7 COMMENTS

8 The department received a comment from Amber Hackett Crosby on
9 behalf of the Texas Independent Automobile Dealers Association
10 (TIADA). TIADA is in support of the department's proposed
11 amendments to codify the existing practice for remitting buyer's
12 temporary tag fees when a vehicle is sold to an out-of-state
13 buyer.

14

15 STATUTORY AUTHORITY

16 The amendment is adopted under Transportation Code, §1002.001,
17 which provides the board of the Texas Department of Motor
18 Vehicles with the authority to adopt rules that are necessary
19 and appropriate to implement the powers and the duties of the
20 department; and more specifically, Transportation Code,
21 §503.002, which authorizes the board to adopt rules to
22 administer Chapter 503, Dealer's and Manufacturer's Vehicle
23 License Plates and Transportation Code, §503.063, which

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

- 1 authorizes the department to establish the buyer's temporary tag
- 2 fee by rule.
- 3
- 4 CROSS REFERENCE TO STATUTE
- 5 Transportation Code, §503.0631 and §503.068.

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 SUBCHAPTER E. GENERAL DISTINGUISHING NUMBERS

2 §215.155. Buyer's Temporary Tags.

3 (a) A buyer's temporary tag may be displayed only on a
4 vehicle that can be legally operated on the public streets and
5 highways and for which a sale has been consummated.

6 (b) A buyer's temporary tag may be displayed only a vehicle
7 that has a valid inspection in accordance with Transportation
8 Code, Chapter 548.

9 (c) For a wholesale transaction, the purchasing dealer
10 places on the motor vehicle its own:

11 (1) dealer's temporary tag; or

12 (2) metal dealer's license plate.

13 (d) A buyer's temporary tag is valid until the earlier of:

14 (1) the date on which the vehicle is registered; or

15 (2) the 60th day after the date of purchase.

16 (e) The dealer must ensure that the following information
17 is placed on a buyer's temporary tag that the dealer issues:

18 (1) the vehicle-specific number obtained from the
19 temporary tag database;

20 (2) the year and make of the vehicle;

21 (3) the VIN of the vehicle;

22 (4) the month, day, and year of the expiration of the
23 buyer's temporary tag; and

Texas Department of Motor Vehicles
Chapter 215, Motor Vehicle Distribution

1 (5) the name of the dealer.

2 (f) A dealer shall charge a buyer a fee of \$5 for the
3 buyer's temporary tag or Internet-down buyer's temporary tag
4 issued, unless the vehicle is exempt from payment of
5 registration fees under Transportation Code, §502.453 or
6 §502.456 or an all-terrain vehicle or recreational off-highway
7 vehicle under Transportation Code, §502.140 or Transportation
8 Code, Chapter 663. The fee shall be remitted to the county in
9 conjunction with the title transfer for deposit to the credit of
10 the Texas Department of Motor Vehicles fund, unless the vehicle
11 is sold to an out-of-state resident, in which case:

12 (1) the dealer shall remit the entire fee to the
13 department for deposit to the credit of the Texas Department of
14 Motor Vehicles fund if payment is made through the department's
15 electronic title system; or

16 (2) the dealer shall remit the fee to the county for
17 deposit to the credit of the Texas Department of Motor Vehicles
18 fund.



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Jimmy Archer, Director, Motor Carrier Division
Agenda Item: 14
Subject: Adoption of Rule under Title 43, Texas Administrative Code, Chapter 217, Vehicle Titles and Registration Amendments, §217.56, Registration Reciprocity Agreements

RECOMMENDATION

Approve adoption of amendments for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of the amendments is to update §217.56 to be consistent with the International Registration Plan (IRP) and Transportation Code, Chapter 502.

FINANCIAL IMPACT

There will be no fiscal implications related to the amendments.

BACKGROUND AND DISCUSSION

The purpose of these amendments is to adopt by reference the current versions of the IRP and the IRP Audit Procedures Manual. Amendments also correct language that is inconsistent with the IRP, and list the sources of the department's authority to cancel or revoke registration under §217.56.

The proposed amendments were published in the *Texas Register* for public comment on March 24, 2017. The comment period closed on April 24, 2017. No comments were received.

If the board adopts the amendments during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*; and
- an effective date of July 2, 2017.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTION 217.56, REGISTRATION RECIPROCITY AGREEMENTS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 217, Vehicle Titles and Registration, Subchapter B, Motor Vehicle Registration, §217.56, Registration Reciprocity Agreements.

The preamble and the amendments are attached to this resolution as Exhibits A-B, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rule is adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

Jimmy Archer, Director
Motor Carrier Division

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to Chapter 217, Vehicle Titles and Registration,
4 Subchapter B, Motor Vehicle Registration, §217.56, Registration
5 Reciprocity Agreements without changes to the proposed text as
6 published in the March 24, 2017, issue of the *Texas Register* (42
7 TexReg 1393). The rule will not be republished.

8

9 EXPLANATION OF ADOPTED AMENDMENTS

10 Amendments to §217.56 adopt by reference the current versions of
11 the International Registration Plan (IRP) and the IRP Audit
12 Procedures Manual. Amendments also correct language that is
13 inconsistent with the IRP, and list the sources of the
14 department's authority to cancel or revoke registration under
15 §217.56.

16

17 COMMENTS

18 No comments on the proposed amendments were received.

19

20 STATUTORY AUTHORITY

21 The amendments are adopted under Transportation Code, §1002.001,
22 which provides the board of the Texas Department of Motor
23 Vehicles with the authority to adopt rules that are necessary

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 and appropriate to implement the powers and the duties of the
2 department; and more specifically, Transportation Code,
3 §502.091(b), which authorizes the department to adopt rules to
4 carry out the IRP.

5

6 CROSS REFERENCE TO STATUTE

7 Transportation Code, §502.091.

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 SUBCHAPTER B. MOTOR VEHICLE REGISTRATION

2 §217.56. Registration Reciprocity Agreements.

3 (a) Purpose. To promote and encourage the fullest possible
4 use of the highway system and contribute to the economic
5 development and growth of the State of Texas and its residents,
6 the department is authorized by Transportation Code, §502.091 to
7 enter into agreements with duly authorized officials of other
8 jurisdictions, including any state of the United States, the
9 District of Columbia, a foreign country, a state or province of
10 a foreign country, or a territory or possession of either the
11 United States or of a foreign country, and to provide for the
12 registration of vehicles by Texas residents and nonresidents on
13 an allocation or distance apportionment basis, and to grant
14 exemptions from the payment of registration fees by nonresidents
15 if the grants are reciprocal to Texas residents.

16 (b) Definitions. The following words and terms, when used
17 in this section, shall have the following meanings, unless the
18 context clearly indicates otherwise:

19 (1) Cab card--The apportioned vehicle registration
20 receipt that contains, but is not limited to, the vehicle
21 description and the registered weight at which the vehicle may
22 operate in each jurisdiction.

23 (2) Department--The Texas Department of Motor

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 Vehicles.

2 (3) Director--The director of the Motor Carrier

3 Division, Texas Department of Motor Vehicles.

4 (4) Executive director--The chief executive officer of
5 the department.

6 (5) Regional Service Center--A department office which
7 provides specific services to the public, including replacement
8 titles, bonded title rejection letters, and apportioned
9 registration under the International Registration Plan (IRP).

10 (6) Temporary cab card--A temporary registration
11 permit authorized by the department that allows the operation of
12 a vehicle for 30 days subject to all rights and privileges
13 afforded to a vehicle displaying apportioned registration.

14 (c) Multilateral agreements.

15 (1) Authority. The executive director may on behalf of
16 the department enter into a multilateral agreement with the duly
17 authorized officials of two or more other jurisdictions to carry
18 out the purpose of this section.

19 (2) International Registration Plan.

20 (A) Applicability. The IRP is a registration
21 reciprocity agreement among states of the United States and
22 other jurisdictions providing for payment of registration fees
23 on the basis of fleet distance operated in various

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 jurisdictions. Its purpose is to promote and encourage the
2 fullest possible use of the highway system by authorizing
3 apportioned registration for commercial motor vehicles and
4 payment of appropriate vehicle registration fees and thus
5 contributing to the economic development and growth of the
6 member jurisdictions.

7 (B) Adoption. The department adopts by reference
8 the January 1, 2017, [~~2015,~~] edition of the IRP. [~~Effective~~
9 ~~January 1, 2016, the department adopts by reference the~~
10 ~~amendments to the IRP with an effective date of January 1, 2016.~~
11 ~~Effective July 1, 2016, the department adopts by reference the~~
12 ~~amendment to the IRP with an effective date of July 1, 2016.]~~
13 The department also [~~further~~] adopts by reference the January 1,
14 2016, [~~July 1, 2013,~~] edition of the IRP Audit Procedures
15 Manual. In the event of a conflict between this section and the
16 IRP or the IRP Audit Procedures Manual, the IRP and the IRP
17 Audit Procedures Manual control. Copies of the documents are
18 available for review in the Motor Carrier Division, Texas
19 Department of Motor Vehicles. Copies are also available on
20 request. The following words and terms, when used in the IRP or
21 in paragraph (2) of this subsection, shall have the following
22 meanings, unless the context clearly indicates otherwise.

23 (i) Apportionable vehicle--Any vehicle -

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 except recreational vehicles, vehicles displaying restricted
2 plates, city pickup and delivery vehicles, and government-owned
3 vehicles - used or intended for use in two or more member
4 jurisdictions that allocate or proportionally register vehicles
5 and used either for the transportation of persons for hire or
6 designed, used, or maintained primarily for the transportation
7 of property and:

8 (I) is a power unit having two axles
9 and a gross vehicle weight or registered gross vehicle weight in
10 excess of 26,000 pounds (11,793.401 kilograms);

11 (II) is a power unit having three or
12 more axles, regardless of weight;

13 (III) is used in combination, when the
14 weight of such combination exceeds 26,000 pounds (11,793.401
15 kilograms) gross vehicle weight; or

16 (IV) at the option of the registrant, a
17 power unit, or the power unit in a combination of vehicles
18 having a gross vehicle weight of 26,000 pounds (11,793.401
19 kilograms) or less.

20 (ii) Commercial vehicle--A vehicle or
21 combination of vehicles designed and used for the transportation
22 of persons or property in furtherance of any commercial
23 enterprise, for hire or not for hire.

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 (iii) Erroneous issuance--Apportioned
2 registration issued based on erroneous information provided to
3 the department.

4 (iv) Established place of business--A
5 physical structure owned or leased within the state of Texas by
6 the applicant or fleet registrant and maintained in accordance
7 with the provisions of the IRP.

8 (v) Fleet distance--All distance operated by
9 an apportionable vehicle or vehicles used to calculate
10 registration fees for the various jurisdictions.

11 (C) Application.

12 (i) An applicant must submit an application
13 to the department on a form prescribed by the director, along
14 with additional documentation as required by the director.

15 (ii) Upon approval of the application, the
16 department will compute the appropriate registration fees and
17 notify the registrant.

18 (D) Fees. Upon receipt of the applicable fees in
19 the form as provided by §209.23 of this title (relating to
20 Methods of Payment), the department will issue one or two
21 license plates and a cab card for each vehicle registered.

22 (E) Display.

23 (i) The department will issue one license

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 plate for a tractor, truck tractor, trailer, and semitrailer.

2 The license plate issued to a tractor or a truck tractor shall
3 be installed on the front of the tractor or truck tractor, and
4 the license plate issued for a trailer or semitrailer shall be
5 installed on the rear of the trailer or semitrailer.

6 (ii) The department will issue two license
7 plates for all other vehicles that are eligible to receive
8 license plates under the IRP. Once the department issues two
9 license plates for a vehicle listed in this clause, one plate
10 shall be installed on the front of the vehicle, and one plate
11 shall be installed on the rear of the vehicle.

12 (iii) The cab card shall be carried at all
13 times in the vehicle in accordance with the IRP.

14 (F) Audit. An audit of the registrant's vehicle
15 operational records may be conducted by the department according
16 to the IRP provisions and the IRP Audit Procedures Manual. Upon
17 request, the registrant shall provide the operational records of
18 each vehicle for audit in unit number order, in sequence by
19 date, and including, but not limited to, a summary of distance
20 traveled by each individual vehicle on a monthly, quarterly, and
21 annual basis with distance totaled separately for each
22 jurisdiction in which the vehicle traveled.

23 (G) Assessment. The department may assess

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 additional registration fees of up to 100% of the apportionable
2 fees paid by the registrant for the registration of its fleet in
3 the registration year to which the records pertain, as
4 authorized by the IRP, if an audit conducted under subparagraph
5 (F) of this paragraph reveals that:

6 (i) the operational records indicate that
7 the vehicle did not generate interstate distance in two or more
8 member jurisdictions for the distance reporting period
9 supporting the application being audited, plus the six-month
10 period immediately following that distance reporting period;

11 (ii) the registrant failed to provide
12 complete operational records; or

13 (iii) the distance must be adjusted, and the
14 adjustment results in a shortage of registration fees due Texas
15 or any other IRP jurisdiction.

16 (H) Refunds. If an audit conducted under
17 subparagraph (F) of this paragraph reveals an overpayment of
18 fees to Texas or any other IRP jurisdiction, the department will
19 refund the overpayment of registration fees in accordance with
20 Transportation Code, §502.195 and the IRP. Any registration fees
21 refunded to a carrier for another jurisdiction will be deducted
22 from registration fees collected and transmitted to that
23 jurisdiction.

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 (I) Cancellation or revocation. The director or
2 the director's designee may cancel or revoke a registrant's
3 apportioned registration and all privileges provided by the
4 IRP as authorized by the following:

5 (i) the IRP; or

6 (ii) Transportation Code, Chapter 502. [~~if~~
7 ~~the registrant:~~]

8 [~~(i) submits payment in the form of a check~~
9 ~~that is dishonored;~~]

10 [~~(ii) files or provides erroneous~~
11 ~~information to the department; or]~~

12 [~~(iii) fails to:~~]

13 [~~(I) remit appropriate fees due each~~
14 ~~jurisdiction in which the registrant is authorized to operate;~~]

15 [~~(II) meet the requirements of the IRP~~
16 ~~concerning established place of business;~~]

17 [~~(III) provide operational records in~~
18 ~~accordance with subparagraph (F) of this paragraph;~~]

19 [~~(IV) provide an acceptable source~~
20 ~~document as specified in the IRP; or]~~

21 [~~(V) pay an assessment pursuant to~~
22 ~~subparagraph (G) of this paragraph.]~~

23 (J) Enforcement of cancelled or revoked

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 registration.

2 (i) Notice. If a registrant is assessed
3 additional registration fees, as provided in subparagraph (G) of
4 this paragraph, and the additional fees are not paid by the due
5 date provided in the notice or it is determined that a
6 registrant's apportioned license plates and privileges should be
7 canceled or revoked, as provided in subparagraph (I) of this
8 paragraph, the director or the director's designee will mail a
9 notice by certified mail to the last known address of the
10 registrant. The notice will state the facts underlying the
11 assessment, ~~[or]~~ cancellation, or revocation; the effective date
12 of the assessment, ~~[or]~~ cancellation, or revocation; and the
13 right of the registrant to request a conference as provided in
14 clause (ii) of this subparagraph.

15 (ii) Conference. A registrant may request a
16 conference upon receipt of a notice issued as provided by clause
17 (i) of this subparagraph. The request must be made in writing to
18 the director or the director's designee within 30 days of the
19 date of the notice. If timely requested, the conference will be
20 scheduled and conducted by the director or the director's
21 designee at division headquarters in Austin and will serve to
22 abate the assessment, ~~[or]~~ cancellation, or revocation unless
23 and until that assessment, ~~[or]~~ cancellation, or revocation is

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 affirmed or disaffirmed by the director or the director's
2 designee. In the event matters are resolved in the registrant's
3 favor, the director or the director's designee will mail the
4 registrant a notice of withdrawal, notifying the registrant that
5 the assessment, ~~[or]~~ cancellation, or revocation is withdrawn,
6 and stating the basis for that action. In the event matters are
7 not resolved in the registrant's favor, the director or the
8 director's designee will issue a ruling reaffirming the
9 department's assessment of additional registration fees or
10 cancellation or revocation of apportioned license plates and
11 privileges. The registrant has the right to appeal in accordance
12 with clause (iii) of this subparagraph.

13 (iii) Appeal. If a conference held in
14 accordance with clause (ii) of this subparagraph fails to
15 resolve matters in the registrant's favor, the registrant may
16 request an administrative hearing. The request must be in
17 writing and must be received by the director no later than the
18 20th day following the date of the ruling issued under clause
19 (ii) of this subparagraph. If requested within the designated
20 period, the hearing will be initiated by the department and will
21 be conducted in accordance with Chapter 206, Subchapter D of
22 this title (relating to Procedures in Contested Cases).
23 Assessment, ~~[or]~~ cancellation, or revocation is abated unless

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 and until affirmed or disaffirmed by order of the Board of the
2 Texas Department of Motor Vehicles.

3 (K) Reinstatement.

4 (i) The director or the director's designee
5 will reinstate apportioned registration to a previously canceled
6 or revoked registrant if all applicable fees and assessments due
7 on the previously canceled or revoked apportioned account have
8 been paid and the applicant provides proof of an acceptable
9 recordkeeping system for a period of no less than 60 days.

10 (ii) The application for the following
11 registration year will be processed in accordance with the
12 provisions of the IRP.

13 (L) Denial of apportioned registration for safety
14 reasons. The department will comply with the requirements of the
15 Performance and Registration Information Systems Management
16 program (PRISM) administered by the Federal Motor Carrier Safety
17 Administration (FMCSA).

18 (i) Denial or suspension of apportioned
19 registration. Upon notification from the FMCSA that a carrier
20 has been placed out of service for safety violations, the
21 department will:

22 (I) deny initial issuance of
23 apportioned registration;

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 (II) deny authorization for a temporary
2 cab card, as provided for in subparagraph (M) of this paragraph;

3 (III) deny renewal of apportioned
4 registration; or

5 (IV) suspend current apportioned
6 registration.

7 (ii) Issuance after denial of registration
8 or reinstatement of suspended registration. The director or the
9 director's designee will reinstate or accept an initial or
10 renewal application for apportioned registration from a
11 registrant who was suspended or denied registration under clause
12 (i) of this subparagraph upon presentation of a Certificate of
13 Compliance from FMCSA, in addition to all other required
14 documentation and payment of fees.

15 (M) Temporary cab card.

16 (i) Application. The department may
17 authorize issuance of a temporary cab card to a motor carrier
18 with an established Texas apportioned account for a vehicle upon
19 proper submission of all required documentation, a completed
20 application, and all fees for either:

21 (I) Texas title as prescribed by
22 Transportation Code, Chapter 501 and Subchapter A of this
23 chapter (relating to Motor Vehicle Titles); or

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 (II) registration receipt to evidence
2 title for registration purposes only (Registration Purposes
3 Only) as provided for in Transportation Code, §501.029 and
4 §217.24 of this title (relating to Vehicle Last Registered in
5 Another Jurisdiction).

6 (ii) Title application. A registrant who is
7 applying for a Texas title as provided for in clause (i)(I) of
8 this subparagraph and is requesting authorization for a
9 temporary cab card, must submit to a Regional Service Center by
10 email, fax, overnight mail, or in person a photocopy of the
11 title application receipt issued by the county tax assessor-
12 collector's office.

13 (iii) Registration Purposes Only. A
14 registrant who is applying for Registration Purposes Only under
15 clause (i)(II) of this subparagraph and is requesting
16 authorization for a temporary cab card, must submit an
17 application and all additional original documents or copies of
18 original documents required by the director to a Regional
19 Service Center by email, fax, or overnight mail or in person.

20 (iv) Department approval. On department
21 approval of the submitted documents, the department will send
22 notice to the registrant to finalize the transaction and make
23 payment of applicable registration fees.

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

1 (v) Finalization and payment of fees. To
2 finalize the transaction and print the temporary cab card, the
3 registrant may compute the registration fees through the
4 department's apportioned registration software application,
5 TxIRP system, and:

6 (I) make payment of the applicable
7 registration fees to the department as provided by §209.23 of
8 this title (related to Methods of Payment); and

9 (II) afterwards, mail or deliver
10 payment of the title application fee in the form of a check,
11 certified cashier's check, or money order payable to the county
12 tax assessor-collector in the registrant's county of residency
13 and originals of all copied documents previously submitted.

14 (vi) Deadline. The original documents and
15 payment must be received by the Regional Service Center within
16 72-hours after the time that the office notified the registrant
17 of the approval to print a temporary cab card as provided in
18 clause (iv) of this subparagraph.

19 (vii) Failure to meet deadline. If the
20 registrant fails to submit the original documents and required
21 payment within the time prescribed by clause (vi) of this
22 subparagraph, the registrant's privilege to use this expedited
23 process to obtain a temporary cab card will be denied by the

Texas Department of Motor Vehicles
Chapter 217, Vehicle Titles and Registration

- 1 department for a period of six months from the date of approval
- 2 to print the temporary cab card.



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Jimmy Archer, Director, Motor Carrier Division; and Bill. Harbeson, Director, Enforcement Division
Agenda Item: 15
Subject: Adoption of Rules under Title 43, Texas Administrative Code, Chapter 218, Motor Carriers Amendments, §§218.13, 218.17, 218.56, 218.57, 218.65, and 218.73
 New, §218.75, Cost of Preparing Agency Record
 Repeal, §218.74, Settlement Agreements

RECOMMENDATION

Approve adoption of amendments, new section, and repeal for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of the amendments is to protect consumers, improve public safety, incorporate the latest edition of the Unified Carrier Registration (UCR) Agreement, and allow shippers and household goods carriers to use electronic documents and signatures on certain documents.

The purpose of new §218.75 is to require the party who appeals a final decision to pay the costs of preparing the record the department is required to file with the reviewing court.

The purpose of repealing §218.74 is to consolidate the language with the language in §218.73 regarding administrative proceedings.

FINANCIAL IMPACT

There will be minor fiscal implications related to the amendments and new rule because: 1) applicants will be required to provide the department with additional documents; and 2) parties who appeal final decisions may have to pay the costs to create the record that must be filed with the reviewing court.

BACKGROUND AND DISCUSSION

Most of the amendments resulted from over 16 meetings of the department's Motor Carrier Credentialing System (MCCS) Working Group. Most of the amendments improve the credentialing process to protect the consumer by requiring an applicant for motor carrier registration to provide the information and documents the department needs to identify the motor carrier in order to enforce Transportation Code, Chapter 643 and Chapter 218 regarding motor carriers. The amendments also help the department to identify chameleon carriers, which are motor carriers that attempt to reinvent themselves in order to avoid the consequences of prior violations of the laws, rules, and/or regulations.

An amendment requires motor carriers that obtain a certificate of registration to review certain information in MCCS every six months and to update the information that is no longer correct. Another amendment requires household goods carriers to certify that they have procedures that comply with a provision of the Code of Criminal Procedure, which prohibits certain people who are required to register as a sex offender from providing moving services in the residence of another person without supervision.

Other amendments update the rules to be consistent with current practice and to correct grammatical errors.



The proposal was published in the *Texas Register* on April 7, 2017. The comment period closed on May 8, 2017. No comments were received.

If the board adopts the amendments, new section, and repeal during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*; and
- an effective date of July 2, 2017.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTIONS 218.13, 218.17, 218.56, 218.57, 218.65, AND 218.73;
NEW SECTION 218.75, AND REPEAL OF SECTION 218.74
RELATING TO MOTOR CARRIERS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 218, Motor Carriers, Subchapter B, Motor Carrier Registration, §218.13, Application for Motor Carrier Registration and §218.17, Unified Carrier Registration System; Subchapter E, Consumer Protection, §218.56, Proposals and Estimates for Moving Services, §218.57, Moving Services Contract, and §218.65, Tariff Registration; and Subchapter F, §218.73, Administrative Proceedings; new §218.75, Cost of Preparing Agency Record; and repeal of §218.74, Settlement Agreements.

The preamble and the amendments, new section, and repeal are attached to this resolution as Exhibits A-F, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rules are adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

Jimmy Archer, Director
Motor Carrier Division

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to Chapter 218, Motor Carriers, Subchapter B:
4 §218.17, Unified Carrier Registration System; Subchapter E:
5 §218.56, Proposals and Estimates for Moving Services; §218.57,
6 Moving Services Contract; and §218.65, Tariff Registration; and
7 Subchapter F: §218.73, Administrative Proceedings without
8 changes to the proposed text as published in the April 7, 2017,
9 issue of the *Texas Register* (42 TexReg 1876). The department
10 also adopts Subchapter F: new §218.75, Cost of Preparing Agency
11 Record and the repeal of §218.74, Settlement Agreements without
12 changes to the proposed text as published in the April 7, 2017,
13 issue of the *Texas Register* (42 TexReg 1876). The rules will
14 not be republished. The amendments to Subchapter B: §218.13,
15 Application for Motor Carrier Registration are adopted with
16 changes to the proposed text and will be republished. The
17 changes make terminology in §218.13 consistent with terminology
18 in this chapter and change certain words into the possessive
19 form.

20

21 EXPLANATION OF ADOPTED AMENDMENTS, NEW SECTION, AND REPEAL

22 Most of the amendments resulted from over 16 meetings of
23 department staff who are members of the Motor Carrier

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 Credentialing System (MCCS) Working Group. The mission of the
2 MCCS Working Group is to expand the web-enabling capabilities of
3 MCCS and to facilitate certain enhancements to MCCS through an
4 orderly and reasoned process. The overriding purposes of the
5 MCCS Working Group meetings to date were to: 1) improve the
6 credentialing process to protect the consumers who use the
7 services of motor carriers; and 2) automate the credentialing
8 process to ultimately enable all motor carriers to apply online
9 through MCCS to obtain operating authority.

10

11 The amendments to §218.13 require the motor carrier applicants
12 to provide additional information and documents, which will
13 protect the consumers and improve safety by helping the
14 department and law enforcement to identify the motor carrier.
15 For example, applicants who are individuals will be required to
16 provide information from a list of identification documents, so
17 the department can verify the identity of the individual.
18 Applicants who are entities will be required to provide their
19 Texas Comptroller's Taxpayer Number or their Federal Employer
20 Identification Number, which will help the department identify
21 the applicant and verify whether the applicant is a valid legal
22 entity by using databases from other state agencies, such as the
23 Texas Secretary of State's Office.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1

2 The amendments also help the department administer and enforce
3 Chapter 218 and Transportation Code, Chapter 643. For example,
4 the amendments help the department determine whether the
5 applicant is a chameleon carrier or reincarnated carrier, which
6 is a carrier that attempts to reinvent itself or to operate
7 affiliated companies to avoid the consequences of prior
8 violations of the laws, rules, and/or regulations. The people
9 who operate chameleon carriers will create a new business entity
10 or operate affiliated companies because they would not qualify
11 for a certificate of registration because of a prior revocation
12 or unpaid penalties for prior violations. See Transportation
13 Code, §§643.054(a-1) and 643.2525(k) and (l). One of the
14 amendments requires all applicants to complete the New Applicant
15 Questionnaire, which helps the department comply with
16 Transportation Code, §643.054. Section 643.054 authorizes the
17 department to deny registration if the applicant is a chameleon
18 carrier.

19

20 The Federal Motor Carrier Safety Administration (FMCSA) passed
21 regulations to deal with chameleon carriers and cited to a fatal
22 bus crash in Sherman, Texas in 2008, in which at least 17 people
23 died and dozens of people were injured. The motor carrier

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 involved in the bus crash was a reincarnation of another bus
2 company that FMCSA had recently placed out of service. See 77
3 Fed.Reg. 24865 (April 26, 2012).

4

5 The amendments help the department comply with Family Code,
6 §231.302, which requires state agencies to require license
7 applicants to provide their social security number if they are
8 an individual. The department is required to provide any social
9 security numbers to the Texas Office of the Attorney General
10 upon request. One amendment requires entities to provide either
11 their Texas Comptroller's Taxpayer Number or their Federal
12 Employer Identification Number, which will help the department
13 verify whether an applicant is really a legal entity or an
14 individual. If the applicant is an individual, the department
15 requires the individual to provide a social security number, as
16 required by Family Code, §231.302.

17

18 The amendments also require the motor carriers that obtain a
19 certificate of registration to review certain information, such
20 as their physical address, in MCCA every six months and to
21 update the information if it is no longer correct. The
22 department's Enforcement Division, as well as law enforcement,
23 need certain current information to contact motor carriers to

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 investigate, inspect records, and take any necessary enforcement
2 action. Some motor carriers have had the same active
3 certificate of registration for tens of years, and they may
4 forget to update their contact information. The department's
5 Enforcement Division has attempted to investigate certain motor
6 carriers by going to the address on file with the department,
7 only to find an empty parking lot at the address.

8

9 The amendments require household goods carriers and passenger
10 carriers to provide a copy of the lease and certain information
11 about the lessor, so the department can link a vehicle to the
12 motor carrier that is leasing the vehicle and so the department
13 can verify that the vehicle is registered under Transportation
14 Code, Chapter 643. Household goods carriers and passenger
15 carriers have more opportunity to cause harm to their customers,
16 so the department needs more information from these carriers to
17 protect the customers, as well as the traveling public. For
18 example, if a household goods carrier leases a U-Haul truck that
19 is used to steal a consumer's household goods, the lease
20 information will help the department, as well as law
21 enforcement, link the leased vehicle to the motor carrier.

22

23 An amendment requires household goods carriers to certify that

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 they have procedures that comply with Code of Criminal
2 Procedure, Article 62.063(b)(3), which prohibits certain people
3 who are required to register as a sex offender from providing
4 moving services in the residence of another person without
5 supervision. This requirement helps to protect the consumers
6 who use the services of a household goods carrier.

7
8 An amendment denies a seven-day or 90-day certificate of
9 registration to a passenger carrier, unless approved by the
10 director of the Motor Carrier Division, because of the time and
11 resources involved in processing applications for passenger
12 carriers. The department spends more time reviewing
13 applications for passenger carriers because of the potential
14 harm to a large number of people. The bus crash in Sherman,
15 Texas in 2008 is just one example of a fatal passenger carrier
16 accident. In response to several fatal passenger carrier
17 accidents, the Texas Legislature amended Transportation Code,
18 §643.252 in 2009 to require the department to deny registration
19 to a for-hire passenger carrier if the carrier is required to
20 register with FMCSA, and the federal registration is denied,
21 revoked, suspended, or otherwise terminated.

22

23 An amendment to §218.17 incorporates the latest version of the

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 Unified Carrier Registration Agreement (Agreement). The Unified
2 Carrier Registration System plan and agreement is a federal
3 motor carrier registration program authorized by 49 USC §14504a
4 and 49 CFR Part 367. The participating states signed the
5 Agreement, which implements the federal law and regulations.

6

7 Amendments to §§218.56 and 218.57 authorize the household goods
8 carriers and the consumers to use electronic documents and
9 electronic signatures, so the parties can benefit from the
10 convenience of modern technology.

11

12 Amendments to §218.65 delete language that conflicts with
13 statute and update language because a new applicant might not
14 have a certificate of registration.

15

16 Amendments to §218.73 allow more flexibility regarding
17 settlement agreements and include language from §218.74.

18 Section 218.74 is repealed in order to consolidate the language
19 regarding administrative proceedings into §218.73. Amendments
20 to §218.73 also inform motor carriers of the current law and
21 rules which govern any proceedings under Chapter 218 and
22 Transportation Code, Chapter 643 at the State Office of
23 Administrative Hearings.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1

2 New §218.75 requires the party who appeals a final decision to
3 pay the costs of preparing the record the department is required
4 to file with the reviewing court, unless the department grants a
5 waiver. It is equitable to make the party who appeals the
6 decision pay the costs to prepare the record.

7

8 Other amendments update the rules to be consistent with current
9 practice and to correct grammatical errors.

10

11 COMMENTS

12 No comments on the proposed amendments, new section, or repeal
13 were received.

14

15 STATUTORY AUTHORITY

16 The amendments, new section, and repeal are adopted under
17 Transportation Code, §1002.001, which provides the board of the
18 Texas Department of Motor Vehicles with the authority to adopt
19 rules that are necessary and appropriate to implement the powers
20 and the duties of the department under the Transportation Code
21 and other laws of this state; Government Code, §2001.004(1),
22 which requires state agencies to adopt rules of practice stating
23 the nature and requirements of all available formal and informal

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 procedures; and more specifically, Transportation Code,
2 §643.003, which authorizes the department to adopt rules to
3 administer Transportation Code, Chapter 643; Transportation
4 Code, §643.052(8), which authorizes the department by rule to
5 require an application to include any information the department
6 determines is necessary for the safe operation of a motor
7 carrier under Chapter 218; Transportation Code, §643.061(a),
8 which authorizes the department to adopt rules that provide for
9 an optional temporary registration that is valid for less than
10 one year; Transportation Code, §643.153, which requires the
11 department to adopt rules to protect a consumer using the
12 service of a motor carrier transporting household goods for
13 compensation; and Government Code, §2001.177, which authorizes a
14 state agency by rule to require a party who appeals a final
15 decision in a contested case to pay all or a part of the cost of
16 preparing the original or a certified copy of the record.

17

18 CROSS REFERENCE TO STATUTE

19 Business and Commerce Code, §506.001; Family Code, §231.302; and
20 Transportation Code, Chapters 643 and 645, and §1003.004.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 SUBCHAPTER B. MOTOR CARRIER REGISTRATION

2 §218.13. Application for Motor Carrier Registration.

3 (a) Form of application. An application for motor carrier
4 registration must be filed with the department's Motor Carrier
5 Division and must be in the form prescribed by the director and
6 must contain, at a minimum, the following information.

7 (1) USDOT number. A valid USDOT number.

8 (2) Business or trade name. The applicant must
9 designate the business or trade name of the motor carrier.

10 (3) Owner name. If the motor carrier is a sole
11 proprietorship, the owner must indicate the name and social
12 security number of the owner. A partnership must indicate the
13 partners' names, and a corporation or other entity must indicate
14 principal officers and titles.

15 (4) Physical address of principal [~~Principal~~] place of
16 business. A motor carrier must disclose the motor carrier's
17 principal business address. If the mailing address is different
18 from the principal business address, the mailing address must
19 also be disclosed.

20 (5) Legal agent.

21 (A) A Texas-domiciled motor carrier must provide
22 the name, telephone number, and address of a legal agent for
23 service of process if the agent is different from the motor

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 carrier.

2 (B) A motor carrier domiciled outside Texas must
3 provide the name, telephone number, and Texas address of the
4 legal agent for service of process.

5 (C) A legal agent for service of process shall be
6 a Texas resident, a domestic corporation, or a foreign
7 corporation authorized to transact business in Texas with a
8 Texas physical address, rather than a post office box, for
9 service of process.

10 (6) Description of vehicles. An application must
11 include a motor carrier equipment report identifying each
12 commercial motor vehicle that requires registration and that the
13 carrier proposes to operate. Each commercial motor vehicle must
14 be identified by its motor vehicle identification number, make,
15 model year, and type of cargo and by the unit number assigned to
16 the commercial motor vehicle by the motor carrier. Any
17 subsequent registration of vehicles must be made under
18 subsection (e) of this section.

19 (7) Type of motor carrier operations. An applicant
20 must state if the applicant:

21 (A) proposes to transport passengers, household
22 goods, or hazardous materials; or

23 (B) is domiciled in a foreign country.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (8) Insurance coverage. An applicant must indicate
2 insurance coverage as required by §218.16 of this title
3 (relating to Insurance Requirements).

4 (9) Safety certification [~~affidavit~~]. Each motor
5 carrier must complete, as part of the application, a
6 certification [~~an affidavit~~] stating that the motor carrier
7 knows and will conduct operations in accordance with all federal
8 and state safety regulations.

9 (10) Drug-testing certification. Each motor carrier
10 must certify, as part of the application, that the motor carrier
11 is in compliance with the drug-testing requirements of 49 C.F.R.
12 Part 382. If the motor carrier belongs to a consortium, as
13 defined by 49 C.F.R. Part 382, the applicant must provide the
14 names of the persons operating the consortium.

15 (11) Duration of registration.

16 (A) An applicant must indicate the duration of
17 the desired registration. Except as provided otherwise in this
18 section, registration [~~Registration~~] may be for seven calendar
19 days, [~~or for~~] 90 calendar days, one year, or two years. The
20 duration of registration chosen by the applicant will be applied
21 to all vehicles.

22 (i) Household goods carriers may not obtain
23 seven-day [~~seven-day~~] or 90-day [~~90-day~~] certificates of

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 registration.

2 (ii) Motor carriers that transport
3 passengers in a commercial motor vehicle as defined by
4 §218.2(8)(A)(ii) of this title (relating to Definitions) may not
5 obtain seven-day or 90-day certificates of registration, unless
6 approved by the director.

7 (B) Interstate motor carriers that operate in
8 intrastate commerce and meet the requirements under §218.14(c)
9 of this title (relating to Expiration and Renewal of Commercial
10 Motor Vehicles Registration) are not required to renew a
11 certificate of registration issued under this section.

12 (12) Additional requirements. The following fees,
13 documents, and information must be submitted with all
14 applications.

15 (A) An application must be accompanied by an
16 application fee of:

17 (i) \$100 for annual and biennial
18 registrations;

19 (ii) \$25 for 90-day [~~90-day~~] registrations;

20 or

21 (iii) \$5 for seven-day [~~seven-day~~]
22 registrations.

23 (B) An application must be accompanied by a

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 vehicle registration fee of:

2 (i) \$10 for each vehicle that the motor
3 carrier proposes to operate under a seven-day [~~seven-day~~], 90-
4 day [~~90-day~~], or annual registration; or

5 (ii) \$20 for each vehicle that the motor
6 carrier proposes to operate under a biennial registration.

7 (C) An application must be accompanied by proof
8 of insurance or financial responsibility and insurance filing
9 fee as required by §218.16.

10 (D) An application must include the applicant's
11 business telephone number, email address, and any cell phone
12 number. [~~An application for registration by a household goods~~
13 ~~carrier must include a tariff that sets out the maximum charges~~
14 ~~for transportation of household goods between two or more~~
15 ~~municipalities, or a copy of the tariff governing interstate~~
16 ~~transportation services on a highway between two or more~~
17 ~~municipalities.]~~

18 (E) An application must include the completed New
19 Applicant Questionnaire.

20 (F) An application submitted by an individual
21 must include the number from one of the following forms of
22 identification:

23 (i) an unexpired driver's license issued by

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 a state or territory of the United States. If the driver's
2 license was issued by the Department of Public Safety, the
3 application must also include the audit number listed on the
4 driver's license;

5 (ii) an unexpired identification certificate
6 issued by a state or territory of the United States; or

7 (iii) an unexpired concealed handgun license
8 or license to carry a handgun issued by the Department of Public
9 Safety under Government Code, Chapter 411, Subchapter H.

10 (G) An application submitted by an individual or
11 entity with an assumed name must be accompanied by supporting
12 documents regarding the assumed name, such as an assumed name
13 filing in the county of proposed operation.

14 (H) An application submitted by an entity, such
15 as a corporation, general partnership, limited liability
16 company, limited liability corporation, limited partnership, or
17 partnership, must include the entity's Texas Comptroller's
18 Taxpayer Number or the entity's Federal Employer Identification
19 Number.

20 (I) An application must be accompanied by any
21 other information required by law.

22 (13) Additional requirements for household goods
23 carriers. The following information, documents, and

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 certification must be submitted with all applications by
2 household goods carriers:

3 (A) A copy of the tariff that sets out the
4 maximum charges for transportation of household goods between
5 two or more municipalities, or a copy of the tariff governing
6 interstate transportation services on a highway between two or
7 more municipalities. If an applicant is governed by a tariff
8 that its association has already filed with the department under
9 §218.65 of this title (relating to Tariff Registration), the
10 applicant complies with the requirement in this subparagraph by
11 checking the applicable box on the application to identify the
12 association's tariff.

13 (B) If the motor vehicle is not titled in the
14 name of the household goods carrier, the following lease
15 information and documentation, notwithstanding §218.18(a) of
16 this title (relating to Short-term Lease and Substitute
17 Vehicles):

18 (i) a copy of a valid lease agreement for
19 each motor vehicle that the household goods carrier will
20 operate; and

21 (ii) the name of the lessor and their USDOT
22 number for each motor vehicle leased to the household goods
23 carrier under a short-term lease.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (C) A certification that the household goods
2 carrier has procedures that comply with Code of Criminal
3 Procedure, Article 62.063(b)(3), which prohibits certain people
4 who are required to register as a sex offender from providing
5 moving services in the residence of another person without
6 supervision.

7 (14) Additional requirements for passenger carriers.
8 The following information and documents must be submitted with
9 all applications for motor carriers that transport passengers in
10 a commercial motor vehicle as defined by §218.2(8)(A)(ii) of
11 this title:

12 (A) If the commercial motor vehicle is titled in
13 the name of the motor carrier, a copy of the International
14 Registration Plan registration receipt or a copy of the front
15 and back of the title for each commercial motor vehicle; or

16 (B) If the commercial motor vehicle is not titled
17 in the name of the motor carrier, the following lease
18 information and documentation, notwithstanding §218.18(a) of
19 this title:

20 (i) A copy of a valid lease agreement for
21 each commercial motor vehicle; and

22 (ii) The name of the lessor and their USDOT
23 number for each commercial motor vehicles leased to the motor

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 carrier under a short-term lease.

2 (b) Conditional acceptance of application. If an
3 application has been conditionally accepted by the director
4 pursuant to Transportation Code, §643.055, the applicant may not
5 operate the following until the department has issued a
6 certificate under Transportation Code, §643.054:

7 (1) a commercial motor vehicle or any other motor
8 vehicle to transport household goods for compensation, or

9 (2) a commercial motor vehicle to transport persons or
10 cargo.

11 (c) Approved application. An applicant meeting the
12 requirements of this section and whose registration is approved
13 will be issued the following documents:

14 (1) Certificate of registration. The department will
15 issue a certificate of registration. The certificate of
16 registration will contain the name and address of the motor
17 carrier and a single registration number, regardless of the
18 number of vehicles requiring registration that the carrier
19 operates.

20 (2) Insurance cab card. The department will issue an
21 insurance cab card listing all vehicles to be operated under the
22 carrier's certificate of registration. The insurance cab card
23 shall be continuously maintained at the registrant's principal

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 place of business. The insurance cab card will be valid for the
2 same period as the motor carrier's certificate of registration
3 and will contain information regarding each vehicle registered
4 by the motor carrier.

5 (A) A current copy of the page of the insurance
6 cab card on which the vehicle is shown shall be maintained in
7 each vehicle listed, unless the motor carrier chooses to
8 maintain a legible and accurate image of the insurance cab card
9 on a wireless communication device in the vehicle or chooses to
10 display such information on a wireless communication device by
11 accessing the department's online system from the vehicle. The
12 appropriate information concerning that vehicle shall be
13 highlighted if the motor carrier chooses to maintain a hard copy
14 of the insurance cab card or chooses to display an image of the
15 insurance cab card on a wireless communication device in the
16 vehicle. The insurance cab card or the display of such
17 information on a wireless communications device will serve as
18 proof of insurance as long as the motor carrier has continuous
19 insurance or financial responsibility on file with the
20 department.

21 (B) On demand by a department investigator or any
22 other authorized government personnel, the driver shall present
23 the highlighted page of the insurance cab card that is

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 maintained in the vehicle or that is displayed on a wireless
2 communication device in the vehicle. If the motor carrier
3 chooses to display the information on a wireless communication
4 device by accessing the department's online system, the driver
5 must locate the vehicle in the department's online system upon
6 request by the department-certified inspector or other
7 authorized government personnel.

8 (C) The motor carrier shall notify the department
9 in writing if it discontinues use of a registered commercial
10 motor vehicle before the expiration of its insurance cab card.

11 (D) Any erasure or alteration of an insurance cab
12 card that the department printed out for the motor carrier
13 renders it void.

14 (E) If an insurance cab card is lost, stolen,
15 destroyed, or mutilated; if it becomes illegible; or if it
16 otherwise needs to be replaced, the department will print out a
17 new insurance cab card at the request of the motor carrier.
18 Motor carriers are authorized to print out a copy of a new
19 insurance cab card using the department's online system.

20 (F) The department is not responsible for a motor
21 carrier's inability to access the insurance information using
22 the department's online system.

23 (G) The display of an image of the insurance cab

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 card or the display of insurance information from the
2 department's online system via a wireless communication device
3 by the motor carrier does not constitute effective consent for a
4 law enforcement officer, the department investigator, or any
5 other person to access any other content of the wireless
6 communication device.

7 (d) Additional and replacement vehicles. A motor carrier
8 required to obtain a certificate of registration under this
9 section shall not operate additional vehicles unless the carrier
10 identifies the vehicles on a form prescribed by the director and
11 pays applicable fees as described in this subsection.

12 (1) Additional vehicles. To add a vehicle, a motor
13 carrier must pay a fee of \$10 for each additional vehicle that
14 the motor carrier proposes to operate under a seven-day, 90-day
15 [~~seven-day, 90-day~~], or annual registration. To add a vehicle
16 during the first year of a biennial registration, a motor
17 carrier must pay a fee of \$20 for each vehicle. To add a vehicle
18 during the second year of a biennial registration, a motor
19 carrier must pay a fee of \$10 for each vehicle.

20 (2) Replacement vehicles. No fee is required for a
21 vehicle that is replacing a vehicle for which the fee was
22 previously paid. Before the replacement vehicle is put into
23 operation, the motor carrier shall notify the department,

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 identify the vehicle being taken out of service, and identify
2 the replacement vehicle on a form prescribed by the department.

3 A motor carrier registered under seven-day [~~seven-day~~]
4 registration may not replace vehicles.

5 (e) Supplement to original application. A motor carrier
6 required to register under this section shall submit a
7 supplemental application under the following circumstances.

8 (1) Change of cargo. A registered motor carrier may
9 not begin transporting household goods or hazardous materials
10 unless the carrier submits a supplemental application to the
11 department and shows the department evidence of insurance or
12 financial responsibility in the amounts specified by §218.16.

13 (2) Change of name. A motor carrier that changes its
14 name shall file a supplemental application for registration no
15 later than the effective date of the change. The motor carrier
16 shall include evidence of insurance or financial responsibility
17 in the new name and in the amounts specified by §218.16. A motor
18 carrier that is a corporation must have its name change approved
19 by the Texas Secretary of State before filing a supplemental
20 application. A motor carrier incorporated outside the state of
21 Texas must complete the name change under the law of its state
22 of incorporation before filing a supplemental application.

23 (3) Change of address or legal agent for service of

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 process. A motor carrier shall file a supplemental application
2 for any change of address or any change of its legal agent for
3 service of process no later than the effective date of the
4 change. The address most recently filed will be presumed
5 conclusively to be the current address.

6 (4) Change in principal officers and titles. A motor
7 carrier that is a corporation shall file a supplemental
8 application for any change in the principal officers and titles
9 no later than the effective date of the change.

10 (5) Conversion of corporate structure. A motor carrier
11 that has successfully completed a corporate conversion involving
12 a change in the name of the corporation shall file a
13 supplemental application for registration and evidence of
14 insurance or financial responsibility reflecting the new company
15 name. The conversion must be approved by the Office of the
16 Secretary of State before the supplemental application is filed.

17 (6) Change in drug-testing consortium status. A motor
18 carrier that changes consortium status shall file a supplemental
19 application that includes the names of the persons operating the
20 consortium.

21 (7) Retaining a revoked or suspended certificate of
22 registration number. A motor carrier may retain a prior
23 certificate of registration number by:

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (A) filing a supplemental application to re-
2 register instead of filing an original application; and

3 (B) providing adequate evidence that the carrier
4 has satisfactorily resolved the facts that gave rise to the
5 suspension or revocation.

6 (f) Change of ownership. A motor carrier must file an
7 original application for registration when there is a corporate
8 merger or a change in the ownership of a sole proprietorship or
9 of a partnership.

10 (g) Alternative vehicle registration for household goods
11 agents. To avoid multiple registrations of a commercial motor
12 vehicle, a household goods agent's vehicles may be registered
13 under the motor carrier's certificate of registration under this
14 subsection.

15 (1) The carrier must notify the department on a form
16 approved by the director of its intent to register its agent's
17 vehicles under this subsection.

18 (2) When a carrier registers vehicles under this
19 subsection, the carrier's certificate will include all vehicles
20 registered under its agent's certificates of registration. The
21 carrier must register under its certificate of registration all
22 vehicles operated on its behalf that do not appear on its
23 agent's certificate of registration.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (3) The department may send the carrier a copy of any
2 notification sent to the agent concerning circumstances that
3 could lead to denial, suspension, or revocation of the agent's
4 certificate.

5 (h) Substitute vehicles leased from leasing businesses. A
6 registered motor carrier is not required to comply with the
7 provisions of subsection (e) of this section for a substitute
8 vehicle leased from a business registered under §218.18 of this
9 title (relating to Short-term Lease and Substitute Vehicles). A
10 motor carrier is not required to carry proof of registration as
11 described in subsection (d) of this section if a copy of the
12 lease agreement for the originally leased vehicle is carried in
13 the cab of the temporary replacement vehicle.

14 (i) Once the motor carrier obtains a certificate of
15 registration, the motor carrier must review its principal
16 business address, mailing address, and email address in the
17 department's online system every six months and shall update
18 such information if it is no longer correct.

19

20 §218.17. Unified Carrier Registration System.

21 (a) The State of Texas, through the department, shall
22 participate in the federal motor carrier registration program
23 under the Unified Carrier Registration System plan and

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 agreement.

2 (b) An interstate motor carrier operating in Texas, as well
3 as a broker, freight forwarder, motor private carrier of
4 property, and leasing company, must register and comply with the
5 provisions of the Unified Carrier Registration System as
6 required by 49 U.S.C. §14504a and the UCR plan and agreement.

7 (c) The department adopts by reference the July 14, 2016
8 [~~May 20, 2010~~], version of the Unified Carrier Registration
9 Agreement. A copy of the agreement is available for review in
10 the Motor Carrier Division, Texas Department of Motor Vehicles.

11 (d) An application for UCR must be filed online as
12 prescribed by the department, or an application must be filed
13 with the department on a form prescribed by the department.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 SUBCHAPTER E. CONSUMER PROTECTION

2 §218.56. Proposals and Estimates for Moving Services.

3 (a) Written proposals. Prior to loading, a household goods
4 carrier shall provide a written proposal, such as a bid or
5 quote, to the shipper. A proposal shall state the maximum amount
6 the shipper could be required to pay for the listed
7 transportation and listed related services. This section does
8 not apply if a pre-existing transportation contract sets out the
9 maximum amount the shipper could be required to pay for the
10 transportation services. Pre-existing transportation contracts
11 include, but are not limited to, corporate contracts for the
12 relocation of multiple employees.

13 (1) A proposal must contain the name and registration
14 number of the household goods carrier as they appear on the
15 motor carrier certificate of registration. If a proposal is
16 prepared by the household goods carrier's agent, it shall
17 include the name of the agent as listed on the carrier's agent
18 filing with the department. A proposal shall also include the
19 street address of the household goods carrier or its agent.

20 (2) A proposal must clearly and conspicuously state
21 whether it is a binding or not-to-exceed proposal.

22 (3) A proposal must completely describe the shipment
23 and all services to be provided. A proposal must state, "This

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 proposal is for listed items and services only. Additional items
2 and services may result in additional costs."

3 (4) A proposal must specifically state when the
4 shipper will be required to pay the transportation charges, such
5 as if payment must be made before unloading at the final
6 destination. A proposal must also state what form of payment is
7 acceptable, such as a cashier's check.

8 (5) A proposal must conspicuously state that a
9 household goods carrier's liability for loss or damage to cargo
10 is limited to \$.60 per pound per article unless the household
11 goods carrier and shipper agree, in writing, to a higher limit
12 of carrier liability.

13 (b) Hourly rates. If a proposal is based on an hourly rate,
14 then it is not required to provide the number of hours necessary
15 to perform the transportation and related services. However, if
16 the number of hours is not included in a proposal, then the
17 carrier must secure a written acknowledgment from the shipper
18 indicating the proposal is complete without the number of hours.
19 Also, the proposal shall state the maximum amount the shipper
20 could be required to pay for the listed transportation and
21 listed related services.

22 (c) Proposal as addendum. If a proposal is accepted by the
23 shipper and the carrier transports the shipment, then the

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 proposal is considered an addendum to the moving services
2 contract.

3 (d) Additional items and services. If the household goods
4 carrier determines additional items are to be transported and/or
5 additional services are required to load, transport, or deliver
6 the shipment, then before the carrier transports the additional
7 items or performs the additional services the carrier and
8 shipper must agree, in writing, to:

9 (1) allow the original proposal to remain in effect;

10 (2) amend the original proposal or moving services
11 contract; or

12 (3) substitute a new proposal for the original.

13 (e) Amendments and storage.

14 (1) An amendment to an original proposal or moving
15 services contract, as allowed in subsection (d) of this section,
16 must:

17 (A) be signed and dated by the household goods
18 carrier and shipper; and

19 (B) clearly and specifically state the amended
20 maximum price for the transportation of the household goods.

21 (2) If the household goods carrier fails to amend or
22 substitute an original proposal as required by this subsection
23 and subsection (d) of this section, only the charges stated on

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 the original proposal for moving services may be assessed on the
2 moving services contract. The carrier shall not attempt to amend
3 or substitute the proposal to add items or services after the
4 items or services have been provided or performed.

5 (3) If through no fault of the carrier, the shipment
6 cannot be delivered during the agreed delivery period, then the
7 household goods carrier may place the shipment in storage and
8 assess fees relating to storage according to the terms in
9 §218.58 of this title (relating to Moving Services Contract -
10 Options for Carrier Limitation of Liability), without a written
11 agreement with the shipper to amend or substitute the original
12 proposal.

13 (f) Combination document. A proposal required by subsection
14 (a) of this section may be combined with other shipping
15 documents, such as the moving services contract, into a single
16 document. If a proposal is combined with other shipping
17 documents, the purpose of each signature line on the combination
18 document must be clearly indicated. Each signature is
19 independent and shall not be construed as an agreement to all
20 portions and terms of the combination document.

21 (g) Telephone estimates. A household goods carrier may
22 provide an estimate for the transportation services by
23 telephone. If the household goods carrier provides the estimate

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 by telephone, then the carrier must also furnish a written
2 proposal for the transportation services to the shipper prior to
3 loading the shipment.

4 (h) Written document. To the extent this section requires a
5 document or communication to be in writing, the document or
6 communication may be in a printed or electronic format.

7 (i) Signatures. The signatures of the shipper and household
8 goods carrier, as required by this section, may be transmitted
9 by facsimile or other electronic means.

10

11 §218.57. Moving Services Contract.

12 (a) Requirements. A household goods carrier must give a
13 copy of the moving services contract to the shipper prior to the
14 loading of the shipment. This copy must include:

15 (1) the name and motor carrier registration number of
16 the household goods carrier as they appear on the motor carrier
17 certificate of registration, and the address and telephone
18 number of the household goods carrier or the household goods
19 agent that prepared the moving services contract;

20 (2) the date the shipment is loaded and a description
21 of the shipment as household goods;

22 (3) the name and address of the shipper;

23 (4) the addresses of the:

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (A) origin;

2 (B) destination, if known; and

3 (C) any stops in transit, if known;

4 (5) the moving services to be performed;

5 (6) the conspicuous statement, "A household goods

6 carrier's liability for loss or damage to any shipment is \$.60

7 per pound per article, unless the carrier and shipper agree, in

8 writing, to a greater level of liability.";

9 (7) a conspicuous explanation of any agreement for

10 increased carrier liability limit, the amount of increased

11 carrier liability, the cost of the increased limit, any

12 deductible above the carrier's \$.60 per pound per article

13 liability, and the statement, "This is not insurance.";

14 (8) a clear notice of the amount of any insurance for

15 property that is transported or stored, the amount of insurance

16 premiums, and the insurance policy number, if insurance for the

17 shipment was purchased from or through the household goods

18 carrier;

19 (9) the conspicuous statement, "This is a contract for

20 moving services and is subject to the terms and conditions on

21 the front and back of this document and any addendum.";

22 (10) a description of whether the proposal is a

23 binding or not-to-exceed proposal, and the maximum price the

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 shipper could be required to pay for the services listed;

2 (11) a statement authorizing performance of the listed
3 services, signed and dated by the household goods carrier and
4 the shipper; and

5 (12) a statement signed and dated by the shipper
6 authorizing delivery of household goods at a destination where
7 the shipper is not present if the shipper intends for the
8 household goods carrier to deliver to a site where the shipper
9 will not be present.

10 (b) Delivery. A household goods carrier must give a
11 completed copy of the moving services contract to the shipper
12 upon delivery of the shipment. The household goods carrier must
13 release the household goods to the shipper at destination if the
14 shipper pays the maximum price listed on the moving services
15 contract. Except as provided by subsection (c) of this section,
16 the moving services contract shall be signed and dated by the
17 household goods carrier and the shipper confirming the shipment
18 has been delivered. This signature only confirms delivery of the
19 shipment. Except as provided in subsection (e) of this section,
20 this copy must include the information listed in subsection (a)
21 of this section and:

22 (1) the total charges for the shipment and the
23 specific nature of each charge, including the method used to

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 calculate the minimum and total charges if the shipment was not
2 transported based on a binding proposal;

3 (2) an explanation of all additional moving services
4 provided in accordance with §218.56(d) of this title (relating
5 to Proposals and Estimates for Moving Services); and

6 (3) the addresses of the origin, destination, and any
7 stops in transit if not previously provided on the moving
8 services contract at the origin.

9 (c) Delivery to a destination where the shipper is not
10 present. If a shipper authorizes the household goods carrier to
11 deliver household goods to a destination where the shipper is
12 not present, as allowed in subsection (a)(12) of this section,
13 the moving services contract need not be signed and dated by the
14 shipper at the time of delivery.

15 (d) Pre-existing transportation contracts. A household
16 goods carrier is not required to comply with subsection (b)(1)
17 and (2) of this section if a pre-existing transportation
18 contract sets out the maximum amount the shipper could be
19 required to pay for the transportation services. Pre-existing
20 transportation contracts include, but are not limited to,
21 corporate contracts for the relocation of multiple employees.

22 (e) Copies. To the extent this section requires a copy of a
23 document or a written document, the document may be in a printed

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 or electronic format.

2 (f) [(e)] Signatures. The signatures of the shipper and the
3 household goods carrier, as required by [~~subsections (a)(11) and~~
4 ~~(b) of~~] this section, may be transmitted by facsimile or other
5 electronic means. These signatures must be separate from any
6 signatures required by the household goods carrier such as the
7 acknowledgment of the statement of value of the shipment.

8

9 §218.65. Tariff Registration.

10 (a) Submission. In accordance with Transportation Code,
11 §643.153, a household goods carrier and/or its household goods
12 agent shall file a tariff with the department. [~~The tariff shall~~
13 ~~establish maximum rates and charges for transportation services~~
14 ~~when a highway between two or more incorporated cities, towns or~~
15 ~~villages is traversed.~~] A household goods carrier who is not a
16 member of an approved association under §218.64 of this title
17 (relating to Rates) shall file a tariff individually. In lieu of
18 filing individually, a household goods carrier or its household
19 goods agent, that is a member of an approved association in
20 accordance with §218.64, may designate a collective association
21 as its ratemaking association. The association may file a
22 tariff, as required by this subsection, for member carriers.

23 (1) Contents. The tariff:

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (A) shall set out all rates, charges, rules,
2 regulations, or other provisions, in clear and concise terms,
3 used to determine total transportation charges;

4 (B) may provide for the offering, selling, or
5 procuring of insurance as provided in §218.54 of this title
6 (relating to Selling Insurance to Shippers);

7 (C) may provide for the base transportation
8 charge to include assumption by the household goods carrier for
9 the full value of the shipment in the event a policy or other
10 appropriate evidence of the insurance purchased by the shipper
11 from the household goods carrier is not issued to the shipper at
12 the time of purchase;

13 (D) shall describe the procedure for determining
14 charges that are below the maximum rate for each service
15 performed; and

16 (E) shall reference a specific mileage guide or
17 source, if information on rates and charges based on mileage is
18 included in the tariff (The referenced mileage guide shall be
19 filed with the department as an addendum to the tariff. If the
20 household goods carrier utilizes a computer database as a
21 mileage guide, the household goods carrier shall allow
22 department personnel free access to the system when conducting
23 an inquiry regarding a specific movement performed by the

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 household goods carrier).

2 (2) Interstate tariff. In accordance with
3 Transportation Code, §643.153, a household goods carrier may
4 satisfy the requirements of this subsection by filing a copy of
5 its tariff governing interstate household goods transportation
6 services.

7 (3) Transmittal letter. A transmittal letter shall
8 accompany a tariff being filed. The transmittal letter shall
9 provide:

10 (A) the name of the household goods carrier;

11 (B) the Texas mailing address and street address
12 of the household goods carrier's principal office;

13 (C) the household goods carrier's registration
14 number, if any;

15 (D) the name and title of the household goods
16 carrier's representative authorizing the tariff filing; and

17 (E) whether the tariff is being filed on behalf
18 of a member carrier.

19 (4) Format. Tariffs shall be filed:

20 (A) on 8 1/2" x 11" paper;

21 (B) with a cover sheet showing:

22 (i) the name of the issuing household goods
23 carrier or collective ratemaking association;

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

- 1 (ii) the Texas mailing and street address;
2 (iii) the issuance date of the tariff;
3 (iv) the effective date of the tariff; and
4 (v) the tariff number; and

5 (C) separated into the following sections:

- 6 (i) general rules;
7 (ii) accessorial services; and
8 (iii) rates.

9 (5) Item numbers. Individual items shall be titled and
10 designated by item number.

11 (6) Amendments. Any amendment to a tariff shall be
12 filed with the department not less than 10 days prior to the
13 effective date of the amendment. The household goods carrier or
14 collective ratemaking association filing on behalf of its member
15 may either file an amended tariff in total or an amendment
16 referencing the specific sections and items which are being
17 amended. The amendment format shall be the same as required by
18 paragraph (4) of this subsection. A transmittal letter providing
19 the same information as required by paragraph (3) of this
20 subsection shall accompany the amendment filing.

21 (7) Rejection. The department will reject a tariff or
22 amendment filing if it is determined the tariff:

23 (A) fails to meet the requirements of this

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 section; or

2 (B) fails to fully disclose, in clear and concise
3 terms, all rates, charges, and rules.

4 (8) Electronic filings. A household goods carrier may
5 file an electronic copy of its tariff provided that the document
6 is consistent with the provision of this subsection and is
7 formatted in Microsoft Word or other format approved by the
8 director.

9 (b) Operations. The department will accept a tariff which
10 is in substantial compliance with this section if the tariff was
11 submitted prior to November 1, 1995.

12 (c) Access. In accordance with Transportation Code,
13 §643.153, tariffs filed in accordance with this section will be
14 made available for public inspection at the TxDMV Enforcement
15 Division or by calling the department's toll-free consumer
16 helpline as listed on the department's website.

17 (d) Conflicts. All provisions of household goods carriers'
18 tariffs are superseded to the extent they may conflict with the
19 provisions of this chapter.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 SUBCHAPTER F. ENFORCEMENT

2 §218.73. Administrative Proceedings.

3 (a) If the department decides to take an enforcement action
4 under §218.71 of this title (relating to Administrative
5 Penalties) or §218.72 of this title (relating to Administrative
6 Sanctions), the department shall give written notice to the
7 motor carrier by first class mail to the carrier's address as
8 shown in the records of the department.

9 (b) The notice required by subsection (a) of this section
10 must include:

11 (1) a brief summary of the alleged violation;

12 (2) a statement of each sanction and/or penalty;

13 (3) the effective date of each sanction and/or penalty;

14 (4) a statement informing the carrier of the carrier's
15 right to request a hearing;

16 (5) a statement as to the procedure for requesting a
17 hearing, including the period during which a request must be
18 made; and

19 (6) a statement that the proposed penalties and sanctions
20 will take effect on the date specified in the letter if the
21 motor carrier fails to request a hearing.

22 (c) The motor carrier must submit a written request for a
23 hearing to the address provided in the notice not later than the

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 26th day after the date the notice is mailed.

2 (d) On receipt of the written request for a hearing the
3 department will refer the matter to the State Office of
4 Administrative Hearings. When the hearing is set, the department
5 will give notice of the time and place of the hearing to the
6 carrier.

7 (e) If the motor carrier does not make a written request
8 for a hearing or enter into a settlement agreement [~~under~~
9 ~~§218.74 of this title (relating to Settlement Agreements)~~]
10 before the 27th day after the date the notice is mailed, the
11 department's decision becomes final.

12 (f) Except as provided by Transportation Code, Chapter 643
13 and this chapter, any proceeding at the State Office of
14 Administrative Hearings is governed by Government Code, Chapter
15 2001 and 1 TAC Chapter 155, including the authority to
16 informally dispose of the contested case by stipulation, agreed
17 settlement, consent order, or default.

18 (g) The department and the motor carrier may informally
19 dispose of the enforcement action by entering into a settlement
20 agreement or agreeing to stipulations at any time before the
21 director issues a final order. However, the motor carrier must
22 pay any penalty in full prior to the execution of a settlement
23 agreement.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 SUBCHAPTER F. ENFORCEMENT

2 §218.75. Cost of Preparing Agency Record.

3 In the event that a final decision is appealed and the
4 department is required to transmit to the court the original or
5 a certified copy of the record, or any part thereof, the
6 appealing party shall pay the costs of preparation of such
7 record, unless waived by the department in whole or in part.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 SUBCHAPTER F. ENFORCEMENT

2 §218.74. Settlement Agreements.

3 (a) The department and the alleged violator may enter into
4 a compromise settlement agreement at any time before the
5 issuance of a final decision. The compromise settlement
6 agreement must provide that the alleged violator consents to the
7 assessment of a specified administrative penalty or to other
8 specified action by the department against the violator and must
9 be signed by the alleged violator and the director. A compromise
10 agreement is not an admission of the alleged violation.

11 (b) If the settlement agreement requires the payment of a
12 penalty to the department, the alleged violator must submit a
13 cashier's check or money order to the department in the agreed
14 amount before the agreement may be executed.

15 (c) Upon the execution by the director of a settlement
16 agreement, the administrative proceeding ends. The settlement is
17 a department order that is final.



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: Jimmy Archer, Director, Motor Carrier Division; and Bill Harbeson, Director, Enforcement Division
Agenda Item: 16
Subject: Adoption of Rules under Title 43, Texas Administrative Code, Chapter 219, Oversize and Overweight Vehicles and Loads
 Amendments, §§219.2, 219.3, and 219.124
 New, §219.127, Cost of Preparing Agency Record
 Repeal, §219.125, Settlement Agreements

RECOMMENDATION

Approve adoption of amendments, new section, and repeal for publication in the *Texas Register*.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of the amendments and the repeal is to update, clarify, and streamline the rules. The purpose of new §219.127 is to require the party who appeals a final decision in an administrative enforcement action to pay any costs of preparing the record the department is required to file with the reviewing court.

FINANCIAL IMPACT

There will be minor fiscal implications related to the new §219.127 because a party that appeals a final decision may have to pay the costs to create the record that must be filed with the reviewing court.

BACKGROUND AND DISCUSSION

Amendments to §219.2 improve the terminology, correct errors, modify the language for consistency with other rules in Chapter 219, add definitions for undefined terms in Chapter 219, clarify that the definitions in Transportation Code, Chapters 621, 622, and 623 apply to Chapter 219, and delete definitions that are already contained in statute.

Amendments to §219.3 remove unnecessary language, clarify requirements and procedures, and reorganize the language for greater clarity.

The purpose of repealing §219.125 is to consolidate the language with the language in §219.124 regarding administrative proceedings. Amendments to §219.124 also inform the industry of the current laws and rules which govern any proceedings under Chapter 219 and Transportation Code, Chapters 621, 622, and 623 at the State Office of Administrative Hearings.

New §219.127 requires the party who appeals a final decision to pay any costs of preparing the record the department is required to file with the reviewing court, unless the department grants a waiver. It is equitable to make the appellant pay the costs to prepare the record.

The proposal was published in the *Texas Register* for public comment on April 7, 2017. The comment period closed on May 8, 2017. No comments were received.

If the board adopts the amendments, new section, and repeal during its June 1, 2017, open meeting, staff anticipates:

- publication of the adoption in the June 23, 2017 issue of the *Texas Register*; and
- an effective date of July 2, 2017.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES
RESOLUTION APPROVING ADOPTION OF AMENDMENTS TO
43 TAC SECTIONS 219.2, 219.3, AND 219.124;
NEW SECTION 219.127; AND REPEAL OF SECTION 219.125
RELATING TO OVERSIZE AND OVERWEIGHT VEHICLES AND LOADS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to adopt amendments to Chapter 219, Oversize and Overweight Vehicles and Loads, Subchapter A, General Provisions, §219.2, Definitions and §219.3, Surety Bonds for Vehicles Transporting Recyclable Materials or Solid Waste; and Subchapter H, Enforcement, §219.124, Administrative Proceedings; new §219.127, Cost of Preparing Agency Record; and repeal of §219.125, Settlement Agreements.

The preamble and the amendments, new section, and repeal are attached to this resolution as Exhibits A-D and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rules are adopted.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

Jimmy Archer, Director
Motor Carrier Division

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 Adoption Preamble

2 The Texas Department of Motor Vehicles (department) adopts
3 amendments to Chapter 219, Oversize and Overweight Vehicles and
4 Loads, Subchapter A: §219.2, Definitions; and §219.3, Surety
5 Bonds for Vehicles Transporting Recyclable Materials or Solid
6 Waste; and Subchapter H: Enforcement, §219.124, Administrative
7 Proceedings. The department also adopts new Subchapter H,
8 §219.127, Cost of Preparing Agency Record. In addition, the
9 department adopts the repeal of Subchapter H, §219.125,
10 Settlement Agreements without changes to the proposed text as
11 published in the April 7, 2017, issue of the *Texas Register* (42
12 TexReg 1885). The rules will not be republished.

13

14 EXPLANATION OF ADOPTED AMENDMENTS, NEW SECTION, AND REPEAL

15 Amendments to §219.2 improve the terminology, correct errors,
16 modify the language for consistency with other rules in Chapter
17 219, add definitions for undefined terms in Chapter 219, clarify
18 that the definitions in Transportation Code, Chapters 621, 622,
19 and 623 apply to Chapter 219, and delete definitions that are
20 already contained in statute.

21

22 Amendments to §219.3 remove unnecessary language, clarify
23 requirements and procedures, and reorganize the language for

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 greater clarity. For example, the amendments remove the form
2 numbers because it is not necessary to reference the form
3 numbers in the rule. Also, the form numbers could change in the
4 future.

5

6 Amendments to §219.124 include language from §219.125, which is
7 being repealed in order to consolidate the language regarding
8 administrative proceedings into §219.124. Amendments to
9 §219.124 also inform the industry of the current laws and rules
10 which govern any proceedings under Chapter 219 and
11 Transportation Code, Chapters 621, 622, and 623 at the State
12 Office of Administrative Hearings.

13

14 New §219.127 requires the party who appeals a final decision to
15 pay the costs of preparing the record the department is required
16 to file with the reviewing court, unless the department grants a
17 waiver. It is equitable to make the appellant pay the costs to
18 prepare the record.

19

20 COMMENTS

21 No comments on the proposed amendments, new section, or repeal
22 were received.

23

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 STATUTORY AUTHORITY

2 The amendments, new section, and repeal are adopted under
3 Transportation Code, §1002.001, which provides the board of the
4 Texas Department of Motor Vehicles (board) with the authority to
5 adopt rules that are necessary and appropriate to implement the
6 powers and the duties of the department; and more specifically,
7 Transportation Code, §§621.008, 622.002, and 623.002 which
8 authorize the board to adopt rules that are necessary to
9 implement and enforce Chapters 621, 622, and 623; and Government
10 Code §2001.177, which authorizes a state agency by rule to
11 require a party who appeals a final decision in a contested case
12 to pay all or a part of the cost of preparing the original or a
13 certified copy of the record.

14

15 CROSS REFERENCE TO STATUTE

16 Transportation Code, Chapters 621, 622, and 623.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 SUBCHAPTER A. GENERAL PROVISIONS

2 §219.2. Definitions.

3 (a) The definitions contained in Transportation Code,
4 Chapters 621, 622, and 623 apply to this chapter. In the event
5 of a conflict with this chapter, the definitions contained in
6 Transportation Code, Chapters 621, 622, and 623 control.

7 (b) [~~a~~] The following words and terms, when used in this
8 chapter, will have the following meanings, unless the context
9 clearly indicates otherwise.

10 (1) Annual permit--A permit that authorizes movement
11 of an oversize and/or overweight load for one year commencing
12 with the effective date.

13 (2) Applicant--Any person, firm, or corporation
14 requesting a permit.

15 (3) Axle--The common axis of rotation of one or more
16 wheels whether power-driven or freely rotating, and whether in
17 one or more segments.

18 (4) Axle group--An assemblage of two or more
19 consecutive axles, with two or more wheels per axle, spaced at
20 least 40 inches from center of axle to center of axle, equipped
21 with a weight-equalizing suspension system that will not allow
22 more than a 10% weight difference between any two axles in the
23 group.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 (5) Board--The Board of the Texas Department of Motor
2 Vehicles.

3 (6) Closeout--The procedure used by the department to
4 terminate a permit, issued under Transportation Code, §623.142
5 or §623.192 that will not be renewed by the applicant.

6 (7) Complete identification number--A unique and
7 distinguishing number assigned to equipment or a commodity for
8 purposes of identification.

9 (8) Concrete pump truck--A self-propelled vehicle
10 designed to pump the concrete product from a ready mix truck to
11 the point of construction.

12 (9) Crane--Any unladen lift equipment motor vehicle
13 designed for the sole purpose of raising, shifting, or lowering
14 heavy weights by means of a projecting, swinging mast with an
15 engine for power on a chassis permanently constructed or
16 assembled for such purpose.

17 (10) Credit card--A credit card approved by the
18 department [~~and a permit account card~~].

19 (11) Daylight--The period beginning one-half hour
20 before sunrise and ending one-half hour after sunset.

21 (12) Department--The Texas Department of Motor
22 Vehicles.

23 (13) Digital signature--An electronic identifier

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 intended by the person using it to have the same force and
2 effect as a manual signature. The digital signature shall be
3 unique to the person using it.

4 (14) Director--The Executive Director of the Texas
5 Department of Motor Vehicles or a designee not below the level
6 of division director.

7 (15) District--One of the 25 geographical areas,
8 managed by a district engineer of the Texas Department of
9 Transportation, in which the Texas Department of Transportation
10 conducts its primary work activities.

11 (16) District engineer--The chief executive officer in
12 charge of a district of the Texas Department of Transportation.

13 (17) Electronic identifier--A unique identifier which
14 is distinctive to the person using it, is independently
15 verifiable, is under the sole control of the person using it,
16 and is transmitted in a manner that makes it infeasible to
17 change the data in the communication or digital signature
18 without invalidating the digital signature.

19 (18) Escort vehicle--A motor vehicle used to warn
20 traffic of the presence of an oversize and/or overweight [a
21 ~~permitted~~] vehicle.

22 (19) Four-axle group--Any four consecutive axles,
23 having at least 40 inches from center of axle to center of axle,

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 whose extreme centers are not more than 192 inches apart and are
2 individually attached to or articulated from, or both, to the
3 vehicle by a weight equalizing suspension system.

4 (20) Gauge--The transverse spacing distance between
5 tires on an axle, expressed in feet and measured to the nearest
6 inch, from center-of-tire to center-of-tire on an axle equipped
7 with only two tires, or measured to the nearest inch from the
8 center of the dual wheels on one side of the axle to the center
9 of the dual wheels on the opposite side of the axle.

10 (21) Gross weight--The unladen weight of a vehicle or
11 combination of vehicles plus the weight of the load being
12 transported.

13 (22) Height pole--A device made of a non-conductive
14 material, used to measure the height of overhead obstructions.

15 (23) Highway maintenance fee--A fee established by
16 Transportation Code, §623.077, based on gross weight, and paid
17 by the permittee when the permit is issued.

18 (24) Highway use factor--A mileage reduction figure
19 used in the calculation of a permit fee for a permit issued
20 under Transportation Code, §623.142 and §623.192.

21 (25) Hubometer--A mechanical device attached to an
22 axle on a unit or a crane for recording mileage traveled.

23 (26) HUD number--A unique number assigned to a

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 manufactured home by the U.S. Department of Housing and Urban
2 Development.

3 (27) Indirect cost share--A prorated share of
4 administering department activities, other than the direct cost
5 of the activities, including the cost of providing statewide
6 support services.

7 (28) Load-restricted bridge--A bridge that is
8 restricted by the Texas Department of Transportation, under the
9 provisions of Transportation Code, §621.102, to a weight limit
10 less than the maximum amount allowed by Transportation Code,
11 §621.101.

12 (29) Load-restricted road--A road that is restricted
13 by the Texas Department of Transportation, under the provisions
14 of Transportation Code, §621.102, to a weight limit less than
15 the maximum amount allowed by Transportation Code, §621.101.

16 (30) Machinery plate--A license plate issued under
17 Transportation Code, §502.146.

18 (31) Manufactured home--Manufactured housing, as
19 defined in Occupations Code, Chapter 1201, and industrialized
20 housing and buildings, as defined in Occupations Code,
21 §1202.002, and temporary chassis systems, and returnable
22 undercarriages used for the transportation of manufactured
23 housing and industrialized housing and buildings, and a

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 transportable section which is transported on a chassis system
2 or returnable undercarriage that is constructed so that it
3 cannot, without dismantling or destruction, be transported
4 within legal size limits for motor vehicles.

5 (32) Motor carrier--A person that controls, operates,
6 or directs the operation of one or more vehicles that transport
7 persons or cargo over a public highway in this state, as defined
8 in Chapter 218 of this title (relating to Motor Carriers).

9 (33) Motor carrier registration (MCR)--The
10 registration issued by the department to motor carriers moving
11 intrastate, under authority of Transportation Code, Chapter 643
12 as amended.

13 (34) Nighttime--The period beginning one-half hour
14 after sunset and ending one-half hour before sunrise, as defined
15 by Transportation Code, §541.401.

16 (35) Nondivisible load or vehicle--

17 (A) Any load or vehicle exceeding applicable
18 length or weight limits which, if separated into smaller loads
19 or vehicles, would:

20 (i) compromise the intended use of the
21 vehicle, i.e., make it unable to perform the function for which
22 it was intended;

23 (ii) destroy the value of the load or

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 vehicle, i.e., make it unusable for its intended purpose; or

2 (iii) require more than eight workhours to
3 dismantle using appropriate equipment. The applicant for a
4 nondivisible load permit has the burden of proof as to the
5 number of workhours required to dismantle the load.

6 (B) Emergency response vehicles, including those
7 loaded with salt, sand, chemicals or a combination thereof, with
8 or without a plow or blade attached in front, and being used for
9 the purpose of spreading the material on highways that are or
10 may become slick or icy.

11 (C) Casks designed for the transport of spent
12 nuclear materials.

13 (D) Military vehicles transporting marked
14 military equipment or materiel.

15 (36) Oil field rig-up truck--An unladen vehicle with
16 an overweight single steering axle, equipped with a winch and
17 set of gin poles used for lifting, erecting, and moving oil well
18 equipment and machinery.

19 (37) Oil well servicing unit--An oil well clean-out
20 unit, oil well drilling unit, or oil well swabbing unit, which
21 is mobile equipment, either self-propelled or trailer-mounted,
22 constructed as a machine used solely for cleaning-out, drilling,
23 servicing, or swabbing oil wells, and consisting in general of,

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 but not limited to, a mast, an engine for power, a draw works,
2 and a chassis permanently constructed or assembled for this
3 purpose.

4 (38) One trip registration--Temporary vehicle
5 registration issued under Transportation Code, §502.095.

6 (39) Overdimension load--A vehicle, combination of
7 vehicles, or vehicle and its load that exceeds maximum legal
8 width, height, length, overhang, or weight as set forth by
9 Transportation Code, Chapter 621, Subchapters B and C.

10 (40) Overhang--The portion of a load extending beyond
11 the front or rear of a vehicle or combination of vehicles.

12 (41) Overheight--A vehicle or [~~An overdimension~~] load
13 that exceeds the maximum height specified in Transportation
14 Code, §621.207.

15 (42) Overlength--A vehicle, combination of vehicles,
16 or a vehicle or vehicle combination and its [~~An overdimension~~]
17 load that exceed(s) [~~exceeds~~] the maximum length specified in
18 Transportation Code, §§621.203, 621.204, 621.205, and 621.206.

19 (43) Oversize load--A vehicle, combination of
20 vehicles, or a vehicle or vehicle combination and its load that
21 exceed(s) maximum legal width, height, length, or overhang, as
22 set forth by Transportation Code, Chapter 621, Subchapter C.

23 (44)[~~(43)~~] Overweight--A vehicle, combination of

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 vehicles, or a vehicle or vehicle combination and its [An
2 overdimension] load that exceed(s) [~~exceeds~~] the maximum weight
3 specified in Transportation Code, §621.101.

4 (45) [(44)] Overwidth--A vehicle or [An overdimension]
5 load that exceeds the maximum width specified in Transportation
6 Code, §621.201.

7 (46) [(45)] Permit--Authority for the movement of an
8 oversize and/or overweight vehicle, combination of vehicles, or
9 a vehicle or vehicle combination and its [overdimension] load,
10 issued by the department under Transportation Code, Chapter 623.

11 (47) [(46)] Permit account card (PAC)--A debit card
12 that can only be used to purchase a permit and which is issued
13 by a financial institution that is under contract to the
14 department and the Comptroller of Public Accounts.

15 (48) [(47)] Permit officer--An employee of the
16 department who is authorized to issue an oversize/overweight
17 permit.

18 (49) [(48)] Permit plate--A license plate issued under
19 Transportation Code, §502.146, to a crane or an oil well
20 servicing vehicle.

21 (50) [(49)] Permitted vehicle--A vehicle, combination
22 of vehicles, or vehicle and its load operating under the
23 provisions of a permit.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 (51) [~~(50)~~] Permittee--Any person, firm, or
2 corporation that is issued an oversize/overweight permit by the
3 department.

4 (52) [~~(51)~~] Pipe box--A container specifically
5 constructed to safely transport and handle oil field drill pipe
6 and drill collars.

7 (53) [~~(52)~~] Portable building compatible cargo--Cargo,
8 other than a portable building unit, that is manufactured,
9 assembled, or distributed by a portable building unit
10 manufacturer and is transported in combination with a portable
11 building unit.

12 (54) [~~(53)~~] Portable building unit--The pre-fabricated
13 structural and other components incorporated and delivered by
14 the manufacturer as a complete inspected unit with a distinct
15 serial number whether in fully assembled, partially assembled,
16 or kit (unassembled) configuration when loaded for transport.

17 (55) [~~(54)~~] Principal--The person, firm, or
18 corporation that is insured by a surety bond company.

19 ~~[(55) Recyclable materials Material that has been~~
20 ~~recovered or diverted from the solid waste stream for purposes~~
21 ~~of reuse, recycling, or reclamation, a substantial portion of~~
22 ~~which is consistently used in the manufacture of products which~~
23 ~~may otherwise be produced using raw or virgin materials.~~

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 ~~Recycled material is not solid waste unless the material is~~
2 ~~deemed to be hazardous solid waste by the Administrator of the~~
3 ~~United States Environmental Protection Agency, whereupon it~~
4 ~~shall be regulated accordingly unless it is otherwise exempted~~
5 ~~in whole or in part from regulation under the federal Solid~~
6 ~~Waste Disposal Act, as amended by the Resource Conservation and~~
7 ~~Recovery Act of 1976 (42 U.S.C. Section 6901, et seq.), by~~
8 ~~Environmental Protection Agency regulation. However, recyclable~~
9 ~~material may become solid waste at such time, if any, as it is~~
10 ~~abandoned or disposed of rather than recycled, whereupon it will~~
11 ~~be solid waste with respect only to the party actually~~
12 ~~abandoning or disposing of the material.]~~

13 ~~(56) Shipper--Person who consigns the movement of a~~
14 ~~shipment.]~~

15 (56) [(57)] Shipper's certificate of weight--A form
16 approved by the department in which the shipper certifies to the
17 maximum weight of the shipment being transported.

18 (57) [(58)] Single axle--An assembly of two or more
19 wheels whose centers are in one transverse vertical plane or may
20 be included between two parallel transverse planes 40 inches
21 apart extending across the full width of the vehicle.

22 (58) [(59)] Single-trip permit--A permit issued for an
23 overdimension load for a single continuous movement over a

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 specific route for an amount of time necessary to make the
2 movement.

3 (59) [~~(60)~~] State highway--A highway or road under the
4 jurisdiction of the Texas Department of Transportation.

5 (60) [~~(61)~~] State highway system--A network of roads
6 and highways as defined by Transportation Code, §221.001.

7 (61) [~~(62)~~] Surety bond--An agreement issued by a
8 surety bond company to a principal that pledges to compensate
9 the Texas Department of Transportation for any damage that might
10 be sustained to the highways and bridges by virtue of the
11 operation of the equipment for which a permit was issued. A
12 surety bond is effective the day it is issued and expires at the
13 end of the state fiscal year, which is August 31st. For example,
14 if you obtain a surety bond on August 30th, it will expire the
15 next day at midnight.

16 (62) [~~(63)~~] Tare weight--The empty weight of any
17 vehicle transporting an overdimension load.

18 (63) [~~(64)~~] Temporary vehicle registration--A 72-hour
19 temporary vehicle registration, 144-hour temporary vehicle
20 registration, or one-trip registration, as defined by
21 Transportation Code, §502.094.

22 (64) [~~(65)~~] Three-axle group--Any three consecutive
23 axles, having at least 40 inches from center of axle to center

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 of axle, whose extreme centers are not more than 144 inches
2 apart, and are individually attached to or articulated from, or
3 both, to the vehicle by a weight equalizing suspension system.

4 (65) [~~(66)~~] Time permit--A permit issued for a
5 specified period of time under §219.13 of this title (relating
6 to Time Permits).

7 (66) Tire size--The inches of lateral tread width.

8 (67) Traffic control device--All traffic signals,
9 signs, and markings, including their supports, used to regulate,
10 warn, or control traffic.

11 (68) Trailer mounted unit--An oil well clean-out,
12 drilling, servicing, or swabbing unit mounted on a trailer,
13 constructed as a machine used for cleaning out, drilling,
14 servicing, or swabbing oil wells, and consisting in general of,
15 but not limited to, a mast, an engine for power, a draw works,
16 and a chassis permanently constructed or assembled for this
17 purpose.

18 (69) Truck--A motor vehicle designed, used, or
19 maintained primarily for the transportation of property.

20 [~~(70) Truck tractor--A motor vehicle designed or used~~
21 ~~primarily for drawing another vehicle.~~]

22 [~~(A) that is not constructed to carry a load~~
23 ~~other than a part of the weight of the vehicle and load being~~

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 ~~drawn; or]~~

2 [~~(B) that is engaged with a semitrailer in the~~
3 ~~transportation of automobiles or boats and that transports the~~
4 ~~automobiles or boats on part of the truck tractor.]~~

5 (70) [~~(71)~~] Trunnion axle--Two individual axles
6 mounted in the same transverse plane, with four tires on each
7 axle, that are connected to a pivoting wrist pin that allows
8 each individual axle to oscillate in a vertical plane to provide
9 for constant and equal weight distribution on each individual
10 axle at all times during movement.

11 (71) [~~(72)~~] Trunnion axle group--Two or more
12 consecutive trunnion axles whose centers are at least 40 inches
13 apart and which are individually attached to or articulated
14 from, or both, to the vehicle by a weight equalizing suspension
15 system.

16 (72) [~~(73)~~] Two-axle group--Any two consecutive axles
17 whose centers are at least 40 inches but not more than 96 inches
18 apart and are individually attached to or articulated from, or
19 both, to the vehicle by a weight equalizing suspension system.

20 (73) [~~(74)~~] TxDOT--Texas Department of Transportation.

21 (74) [~~(75)~~] Unit--Oil well clean-out unit, oil well
22 drilling unit, oil well servicing unit, and/or oil well swabbing
23 unit.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 (75) [~~(76)~~] Unladen lift equipment motor vehicle--A
2 motor vehicle designed for use as lift equipment used solely to
3 raise, shift, or lower heavy weights by means of a projecting,
4 swinging mast with an engine for power on a chassis permanently
5 constructed or assembled for such purpose.

6 (76) [~~(77)~~] USDOT Number--The United States Department
7 of Transportation number.

8 (77) [~~(78)~~] Variable load suspension axles--Axles,
9 whose controls must be located outside of and be inaccessible
10 from the driver's compartment, that can be regulated, through
11 the use of hydraulic and air suspension systems, mechanical
12 systems, or a combination of these systems, for the purpose of
13 adding or decreasing the amount of weight to be carried by each
14 axle during the movement of the vehicle.

15 [~~(79) Vehicle--Every device in or by which any person~~
16 ~~or property is or may be transported or drawn upon a public~~
17 ~~highway, except devices used exclusively upon stationary rails~~
18 ~~or tracks.]~~

19 (78) [~~(80)~~] Vehicle identification number--A unique
20 and distinguishing number assigned to a vehicle by the
21 manufacturer or by the department in accordance with
22 Transportation Code, §501.032 and §501.033.

23 [~~(81) Vehicle supervision fee--A fee required by~~

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 ~~Transportation Code, §623.078, paid by the permittee to the~~
2 ~~department, designed to recover the direct cost of providing~~
3 ~~safe transportation of a permit load exceeding 200,000 pounds~~
4 ~~gross weight over a state highway, including the cost for bridge~~
5 ~~structural analysis, monitoring the progress of the trip, and~~
6 ~~moving and replacing traffic control devices.]~~

7 (79) [~~+82+~~] Water Well Drilling Machinery--Machinery
8 used exclusively for the purpose of drilling water wells,
9 including machinery that is a unit or a unit mounted on a
10 conventional vehicle or chassis.

11 (80) [~~+83+~~] Weight-equalizing suspension system--An
12 arrangement of parts designed to attach two or more consecutive
13 axles to the frame of a vehicle in a manner that will equalize
14 the load between the axles.

15 (81) [~~+84+~~] Windshield sticker--Identifying insignia
16 indicating that a a [~~an over axle/over gross weight tolerance~~]
17 permit has been issued in accordance with Subchapter C of this
18 chapter [~~and Transportation Code, §623.011~~].

19 (82) [~~+85+~~] Year--A time period consisting of 12
20 consecutive months that commences with the effective date stated
21 in the permit.

22 (83) [~~+86+~~] 72-hour temporary vehicle registration--
23 Temporary vehicle registration issued by the department

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 authorizing a vehicle to operate at maximum legal weight on a
2 state highway for a period not longer than 72 consecutive hours,
3 as prescribed by Transportation Code, §502.094.

4 (84) [~~(87)~~] 144-hour temporary vehicle registration--
5 Temporary vehicle registration issued by the department
6 authorizing a vehicle to operate at maximum legal weight on a
7 state highway for a period not longer than 144 consecutive
8 hours, as prescribed by Transportation Code, §502.094.

9

10 §219.3. Surety Bonds for Vehicles Transporting Recyclable
11 Materials or Solid Waste.

12 (a) Surety bond required. A surety bond is required for:

13 (1) vehicles used exclusively to transport recyclable
14 materials operated under the provisions of Transportation Code,
15 §622.134; and

16 (2) vehicles used exclusively to transport solid waste
17 under the provisions of Transportation Code, §623.163.

18 (b) Surety bonds.

19 (1) Surety bonds filed under this section must:

20 (A) be in the amount of \$1,000 per vehicle [~~for~~
21 ~~example, if 10 trucks are covered by the surety bond then the~~
22 ~~total amount of the surety bond would be \$10,000)];~~

23 (B) indicate the total amount of coverage; and

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 (C) be filed on a form and in a manner prescribed
2 by [~~submitted in duplicate to~~] the department [~~on Form 1575~~].

3 (2) A surety bond is effective the day it is issued
4 and expires at the end of the state fiscal year[~~, which is~~
5 ~~August 31st. For example, if you obtain a surety bond on August~~
6 ~~30th, it will expire the next day at midnight~~].

7 (3) The original bond certificate form must be carried
8 in the cab of the bonded vehicle.

9 [~~(3) Form 1576 must be completed in duplicate and~~
10 ~~submitted to the department for certification of each vehicle~~
11 ~~bonded under Form 1575.~~]

12 [~~(A) The department will certify and return to~~
13 ~~the principal, one copy of Form 1575 and one copy of Form 1576.~~]

14 [~~(B) The original Form 1576 must be carried in~~
15 ~~the cab of the bonded vehicle.~~]

16 [~~(4) Form 1577 must be used to add or delete a vehicle~~
17 ~~covered by Form 1575 and must be completed in duplicate and~~
18 ~~submitted to the department for certification.~~]

19 [~~(A) The department will certify and return to~~
20 ~~the principal, one copy of Form 1577 when a new vehicle is added~~
21 ~~to the surety bond. When a vehicle is dropped from the surety~~
22 ~~bond the department will make the necessary revision to the~~
23 ~~principal's file.~~]

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 [~~(B) Form 1577 must be carried in the cab of the~~
2 ~~bonded vehicle.~~]

3 [~~(5) A facsimile copy of Forms 1575, 1576 or 1577 is not~~
4 ~~acceptable in lieu of the original surety bond.~~]

5 (c) Bond certification.

6 (1) For each vehicle, a bond certificate must:

7 (A) be on a form prescribed by the department;

8 and

9 (B) be completed in duplicate and submitted to

10 the department in a manner prescribed by the department for

11 certification.

12 (2) The department will certify and return one copy of

13 the bond certificate form to the principal.

14 (d) Bond amendment.

15 (1) A bond amendment form must be submitted to the

16 department to add or delete a vehicle covered by a certified

17 surety bond. A bond amendment must be completed in duplicate on

18 a form and in a manner prescribed by the department.

19 (2) The department will certify and return to the

20 principal one copy of the bond amendment form when a new vehicle

21 is added to the surety bond.

22 (3) When a vehicle is removed from the surety bond,

23 the department will make the necessary revision to the

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 principal's file.

2 (4) The certified bond amendment form must be carried

3 in the cab of the bonded vehicle.

4 (e) Acceptable bond documents. An electronic copy or

5 facsimile copy of a surety bond form, bond certification form,

6 or bond amendment form is not acceptable in lieu of the original

7 surety bond.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 SUBCHAPTER H. ENFORCEMENT

2 §219.124. Administrative Proceedings.

3 (a) If the department decides to take an enforcement action
4 under §219.121 of this title (relating to Administrative
5 Penalties) or §219.122 of this title (relating to Administrative
6 Sanctions), the department shall give written notice to the
7 person against whom the action is being taken by first class
8 mail to the person's address as shown in the records of the
9 department.

10 (b) The notice required by subsection (a) of this section
11 must include:

12 (1) a brief summary of the alleged violation;

13 (2) a statement of each enforcement action being
14 taken;

15 (3) the effective date of each enforcement action;

16 (4) a statement informing the person of the person's
17 right to request a hearing;

18 (5) a statement describing the procedure for
19 requesting a hearing, including the period during which a
20 hearing request must be made; and

21 (6) a statement that the proposed penalties and
22 sanctions will take effect on the date specified in the letter
23 if the person fails to request a hearing.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 (c) The person must submit a written request for a hearing
2 to the address provided in the notice not later than the 26th
3 day after the date the notice required by subsection (a) of this
4 section is mailed.

5 (d) On receipt of the written request for a hearing, the
6 department will refer the matter to the State Office of
7 Administrative Hearings. When the hearing is set, the department
8 will give notice of the time and place of the hearing to the
9 person.

10 (e) If the person does not make a written request for a
11 hearing or enter into a settlement agreement [~~under §219.125 of~~
12 ~~this title (relating to Settlement Agreements)] before the 27th
13 day after the date that the notice is mailed, the department's
14 decision becomes final [~~on that date~~].~~

15 (f) Except as provided by this chapter and Transportation
16 Code, Chapters 621, 622, and 623, any proceeding at the State
17 Office of Administrative Hearings is governed by Government
18 Code, Chapter 2001 and 1 TAC Chapter 155, including the
19 authority to informally dispose of the contested case by
20 stipulation, agreed settlement, consent order, or default.

21 (g) The department and the person may informally dispose of
22 the enforcement action by entering into a settlement agreement
23 or agreeing to stipulations at any time before the director

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 issues a final order. However, the person must pay any penalty
2 in full prior to the execution of a settlement agreement.

3

4 §219.127. Cost of Preparing Agency Record.

5 In the event that a final decision is appealed and the
6 department is required to transmit to the court the original or
7 a certified copy of the record, or any part thereof, the
8 appealing party shall pay the costs of preparation of such
9 record, unless waived by the department in whole or in part.

Texas Department of Motor Vehicles
Chapter 219, Oversize and Overweight Vehicles and Loads

1 SUBCHAPTER H. ENFORCEMENT

2 §219.125. Settlement Agreements.

3 (a) The department and the alleged violator may enter into
4 a compromise settlement agreement at any time before the
5 issuance of a final decision. The compromise settlement
6 agreement must provide that the alleged violator consents to the
7 assessment of a specified administrative penalty or to the
8 imposition of the specified administrative sanction by the
9 department against the alleged violator and must be signed by
10 the alleged violator and the director.

11 (b) If the settlement agreement requires the payment of a
12 penalty to the department, the alleged violator must submit the
13 payment to the department in the agreed amount before the
14 agreement may be finalized.

15 (c) Upon the execution by the director of a settlement
16 agreement, the administrative proceeding ends. The settlement
17 agreement is a department order that is final.



Date: June 1, 2017

Action Requested: Decision

To: The Texas Department of Motor Vehicles (TxDMV) Board
From: William P. Harbeson, Director, Enforcement Division
Agenda Item: 17
Subject: Proposal of Rule under Title 43, Texas Administrative Code, Chapter 218, Motor Carriers, Amendments, §218.61, Claims

RECOMMENDATION

Approval to publish the proposed amendments in the *Texas Register* for public comment.

PURPOSE AND EXECUTIVE SUMMARY

The purpose of these amendments is to increase the protection for consumers, and to modify the language for consistency and clarity.

An amendment proposes to eliminate the exception to the requirement for a household goods carrier to issue an acknowledgment letter to its consumer who files a claim, if the claim has not been resolved within 20 days after the household goods carrier or its agent receives the claim. The current exception allows a household goods carrier to initiate communication with the claimant regarding the claim in lieu of sending the acknowledgment letter. Some household goods carriers are “initiating communication” by sending an email to the consumer regarding the claim, without including the important information that must be included in an acknowledgment letter. The acknowledgment letter contains important information to educate the consumer about the consumer’s rights, the department’s toll-free consumer helpline, the claims process, and deadlines regarding the claims process.

FINANCIAL IMPACT

There will be no fiscal implications related to the proposed amendments.

BACKGROUND AND DISCUSSION

If the proposed amendments are approved by the board, staff anticipates publication of the proposed amendments in the *Texas Register* on or about June 23, 2017. Comments on the proposed amendments will be accepted until 5:00 p.m. on July 24, 2017.

BOARD OF THE TEXAS DEPARTMENT OF MOTOR VEHICLES

RESOLUTION APPROVING PUBLICATION OF PROPOSED AMENDMENTS TO
43 TAC SECTION 218.61, CLAIMS

The Board of the Texas Department of Motor Vehicles (board) finds it necessary to amend Chapter 218, Motor Carriers, Subchapter E, Consumer Protection, §218.61, Claims.

The preamble and the proposed amendments are attached to this resolution as Exhibits A-B, and are incorporated by reference as though set forth verbatim in this resolution, except that they are subject to technical corrections and revisions, approved by the General Counsel, necessary for compliance with state or federal law or for acceptance by the Secretary of State for filing and publication in the *Texas Register*.

IT IS THEREFORE ORDERED by the board that the attached rule is authorized for publication in the *Texas Register* for the purpose of receiving public comment.

The department is directed to take the necessary steps to implement the actions authorized in this order pursuant to the requirements of the Administrative Procedure Act, Government Code, Chapter 2001.

Raymond Palacios, Jr., Chairman
Board of the Texas Department of Motor Vehicles

Recommended by:

William P. Harbeson, Director
Enforcement Division

Order Number: _____

Date Passed: June 1, 2017

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 Proposed Preamble

2 The Texas Department of Motor Vehicles (department) proposes
3 amendments to Chapter 218, Motor Carriers, Subchapter E,
4 Consumer Protection, §218.61, Claims.

5

6 EXPLANATION OF PROPOSED AMENDMENTS

7 Proposed amendments to §218.61 increase the protection for
8 consumers and modify the language for consistency and clarity.

9

10 An amendment proposes to eliminate the exception to the
11 requirement for a household goods carrier to issue an
12 acknowledgment letter to its consumer who files a claim, if the
13 claim has not been resolved within 20 days after the household
14 goods carrier or its agent receives the claim. The current
15 exception allows a household goods carrier to initiate
16 communication with the claimant regarding the claim in lieu of
17 sending the acknowledgment letter. Some household goods
18 carriers are "initiating communication" by sending an email to
19 the consumer regarding the claim, without including the
20 important information that must be included in an acknowledgment
21 letter. The acknowledgment letter contains important
22 information to educate the consumer about the consumer's rights,
23 the department's toll-free consumer helpline, the claims

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 process, and deadlines regarding the claims process.

2

3 FISCAL NOTE

4 Linda M. Flores, Chief Financial Officer, has determined that
5 for each of the first five years the amendments as proposed are
6 in effect, there will be no fiscal implications for state or
7 local governments as a result of enforcing or administering the
8 proposed amendments.

9

10 William P. Harbeson, Director of the Enforcement Division, has
11 determined that there will be no anticipated impact on local
12 economies or overall employment as a result of enforcing or
13 administering the proposed amendments.

14

15 PUBLIC BENEFIT AND COST

16 Mr. Harbeson has also determined that for each year of the first
17 five years the amendments are in effect, the public benefit
18 anticipated as a result of enforcing or administering the
19 amendments will be greater protection for consumers who use the
20 services of household goods carriers. There are no anticipated
21 economic costs for persons required to comply with the
22 amendments as proposed. There will be no adverse economic
23 effect on small businesses or micro-businesses.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1

2 TAKINGS IMPACT ASSESSMENT

3 The department has determined that this proposal affects no
4 private real property interests and that this proposal does not
5 restrict or limit an owner's right to property that would
6 otherwise exist in the absence of government action, and so does
7 not constitute a taking or require a takings impact assessment
8 under Government Code, §2007.043.

9

10 SUBMITTAL OF COMMENTS

11 Written comments on the proposed amendments may be submitted to
12 David D. Duncan, General Counsel, Texas Department of Motor
13 Vehicles, 4000 Jackson Avenue, Austin, Texas 78731 or by email
14 to *rules@txdmv.gov*. The deadline for receipt of comments is
15 5:00 p.m. on July 24, 2017.

16

17 STATUTORY AUTHORITY

18 The amendments are proposed under Transportation Code,
19 §1002.001, which provides the board of the Texas Department of
20 Motor Vehicles with the authority to adopt rules that are
21 necessary and appropriate to implement the powers and the duties
22 of the department under the Transportation Code; Transportation
23 Code, §643.003, which authorizes the department to adopt rules

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 to administer Transportation Code, Chapter 643; and more
2 specifically, Transportation Code, §643.153(a), which requires
3 the department to adopt rules to protect a consumer using the
4 service of a motor carrier who is transporting household goods
5 for compensation.

6

7 CROSS REFERENCE TO STATUTE

8 Transportation Code, Chapter 643.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 SUBCHAPTER E. CONSUMER PROTECTION

2 218.61. Claims.

3 (a) Filing of claims. A household goods carrier must act on
4 all claims filed by a shipper on shipments of household goods
5 according to this section.

6 (1) A claim must be filed in writing or by electronic
7 format with the household goods carrier or the household goods
8 carrier's agent whose name appears on the moving services
9 contract. A claim is considered filed on the date the claim is
10 received by the household goods carrier or its agent. A shipper
11 must file a claim either in writing or by electronic format
12 within 90 days:

13 (A) of delivery of the shipment to the final
14 destination; or

15 (B) after a reasonable time for delivery has
16 elapsed in the case of failure to make delivery.

17 (2) The claim must include enough facts to identify
18 the shipment. The claim must also describe the type of claim and
19 request a specific type of remedy.

20 (3) Shipping documents may be used as evidence to
21 support a claim, but cannot be substituted for a written claim.

22 (4) A claim submitted by someone other than the owner
23 of the household goods must be accompanied by a written

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 explanation of the claimant's interest in the claim.

2 (b) Acknowledgment and disposition of filed claims.

3 (1) A household goods carrier shall send an
4 acknowledgment of the claim either in writing or by electronic
5 format to the claimant within 20 days (excluding Sundays and
6 nationally recognized holidays) after receipt of the claim by
7 the carrier or its [~~his~~] agent.

8 (A) The claim acknowledgment shall include the
9 statement, "Household goods carriers have 90 days from receipt
10 of a claim to pay, decline to pay, or make a firm settlement
11 offer, in writing, to a claimant. Questions or complaints
12 concerning the household goods carrier's claims handling should
13 be directed to the Texas Department of Motor Vehicles (TxDMV),
14 Enforcement Division, via the toll-free consumer helpline as
15 listed on the department's website. Additionally, a claimant has
16 the right to request mediation from TxDMV within 30 days
17 (excluding Sundays and nationally recognized holidays) after any
18 portion of the claim is denied by the carrier, the carrier makes
19 a firm settlement offer that is not acceptable to the claimant,
20 or 90 days has elapsed since the carrier received the claim and
21 the claim has not been resolved."

22 (B) The household goods carrier is not required
23 to issue the acknowledgment letter prescribed in this subsection

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 if the claim has been resolved [~~or the household goods carrier~~
2 ~~has initiated communication regarding the claim with the~~
3 ~~claimant~~] within 20 days (excluding Sundays and nationally
4 recognized holidays) after receipt of the claim. However, the
5 household goods carrier has the burden of proof regarding the
6 resolution of the claim [~~resolution or communication with the~~
7 ~~claimant is the responsibility of the household goods carrier~~].

8 (2) After a thorough investigation of the facts, the
9 household goods carrier shall pay, decline to pay, or make a
10 firm settlement offer in writing to the claimant within 90 days
11 after receipt of the claim by the household goods carrier or its
12 household goods agent. The settlement offer or denial shall
13 state, "A claimant has the right to seek mediation through the
14 Texas Department of Motor Vehicles (TxDMV) within 30 days
15 (excluding Sundays and nationally recognized holidays) after any
16 portion of the claim is denied by the carrier, the carrier makes
17 a firm settlement offer that is not acceptable to the claimant,
18 or 90 days has elapsed since the carrier received the claim and
19 the claim has not been resolved."

20 (3) A household goods carrier must provide a copy of
21 the shipping documents to the shipper's insurance company upon
22 request. The carrier may assess a reasonable fee for this
23 service.

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

1 (c) Documenting loss or damage to household goods.

2 (1) Inspection. If a loss or damage claim is filed and
3 the household goods carrier wishes to inspect the items, the
4 carrier must complete any inspection as soon as possible, but no
5 later than 30 calendar days, after receipt of the claim.

6 (2) Payment of shipping charges. Payment of shipping
7 charges and payment of claims shall be handled separately, and
8 one shall not be used to offset the other unless otherwise
9 agreed upon by both the household goods carrier and claimant.

10 (d) Claim records. A household goods carrier shall maintain
11 a record of every claim filed. Claim records shall be retained
12 for two years as required by §218.32 of this title (relating to
13 Motor Carrier Records). At a minimum, the following information
14 on each claim shall be maintained in a systematic, orderly and
15 easily retrievable manner:

16 (1) claim number (if assigned), date received, and
17 amount of money or the requested remedy;

18 (2) number (if assigned) and date of the moving
19 services contract;

20 (3) name of the claimant;

21 (4) date the carrier issued its claim acknowledgment
22 letter;

23 (5) date and total amount paid on the claim or date

Texas Department of Motor Vehicles
Chapter 218, Motor Carriers

- 1 and reasons for disallowing the claim; and
- 2 (6) dates, time, and results of any mediation
- 3 coordinated by the department.



Board Policy Documents

[Governance Process](#) (10/13/11)

[Strategic Planning](#) (10/13/11)

[Board Vision](#) (4/7/16)

[Agency Boundaries](#) (9/13/12)

[KPIs](#) (9/12/14)

Texas Department of Motor Vehicles TxDMV Board Governance Policy

1. PURPOSE

The directives presented in this policy address board governance of the Texas Department of Motor Vehicles (TxDMV).

2. SCOPE

The directives presented in this policy apply to the TxDMV Board and TxDMV agency personnel who interact with the Board. The TxDMV Board Governance Policy shall be one that is comprehensive and pioneering in its scope.

3. POLICY

3.1. TxDMV Board Governing Style

The Board shall govern according to the following general principles: (a) a vision for the agency, (b) diversity in points of view, (c) strategic leadership, providing day-to-day detail as necessary to achieve the agency vision, (d) clear distinction of Board and Executive Director roles, (e) collective decision making, (f) react proactively rather than reactively and with a strategic approach. Accordingly:

- 3.1.1. The Board shall provide strategic leadership to TxDMV. In order to do this, the Board shall:
 - 3.1.1.1. Be proactive and visionary in its thinking.
 - 3.1.1.2. Encourage thoughtful deliberation, incorporating a diversity of viewpoints.
 - 3.1.1.3. Work together as colleagues, encouraging mutual support and good humor.
 - 3.1.1.4. Have the courage to lead and make difficult decisions.
 - 3.1.1.5. Listen to the customers and stakeholders needs and objectives.
 - 3.1.1.6. Anticipate the future, keeping informed of issues and trends that may affect the mission and organizational health of the TxDMV.
 - 3.1.1.7. Make decisions based on an understanding that is developed by appropriate and complete stakeholder participation in the process of identifying the needs of the motoring public, motor vehicle industries,

and best practices in accordance with the mission and vision of the agency.

- 3.1.1.8. Commit to excellence in governance, including periodic monitoring, assessing and improving its own performance.
- 3.1.2. The Board shall create the linkage between the Board and the operations of the agency, via the Executive Director when policy or a directive is in order.
- 3.1.3. The Board shall cultivate a sense of group responsibility, accepting responsibility for excellence in governance. The Board shall be the initiator of policy, not merely respond to staff initiatives. The Board shall not use the expertise of individual members to substitute for the judgment of the board, although the expertise of individual members may be used to enhance the understanding of the Board as a body.
- 3.1.4. The Board shall govern the agency through the careful establishment of policies reflecting the board's values and perspectives, always focusing on the goals to be achieved and not the day-to-day administrative functions.
- 3.1.5. Continual Board development shall include orientation of new Board members in the board's governance process and periodic board discussion of how to improve its governance process.
- 3.1.6. The Board members shall fulfill group obligations, encouraging member involvement.
- 3.1.7. The Board shall evaluate its processes and performances periodically and make improvements as necessary to achieve premier governance standards.
- 3.1.8. Members shall respect confidentiality as is appropriate to issues of a sensitive nature.

3.2. TxDMV Board Primary Functions/Characteristics

TxDMV Board Governance can be seen as evolving over time. The system must be flexible and evolutionary. The functions and characteristics of the TxDMV governance system are:

- 3.2.1. Outreach
 - 3.2.1.1. Monitoring emerging trends, needs, expectations, and problems from the motoring public and the motor vehicle industries.
 - 3.2.1.2. Soliciting input from a broad base of stakeholders.



3.2.2. Stewardship

- 3.2.2.1. Challenging the framework and vision of the agency.
- 3.2.2.2. Maintaining a forward looking perspective.
- 3.2.2.3. Ensuring the evolution, capacity and robustness of the agency so it remains flexible and nimble.

3.2.3. Oversight of Operational Structure and Operations

- 3.2.3.1. Accountability functions.
- 3.2.3.2. Fiduciary responsibility.
- 3.2.3.3. Checks and balances on operations from a policy perspective.
- 3.2.3.4. Protecting the integrity of the agency.

3.2.4. Ambassadorial and Legitimizing

- 3.2.4.1. Promotion of the organization to the external stakeholders, including the Texas Legislature, based on the vision of the agency.
- 3.2.4.2. Ensuring the interests of a broad network of stakeholders are represented.
- 3.2.4.3. Board members lend their positional, professional and personal credibility to the organization through their position on the board.

3.2.5. Self-reflection and Assessment

- 3.2.5.1. Regular reviews of the functions and effectiveness of the Board itself.
- 3.2.5.2. Assessing the level of trust within the Board and the effectiveness of the group processes.

3.3. Board Governance Investment

Because poor governance costs more than learning to govern well, the Board shall invest in its governance capacity. Accordingly:

- 3.3.1. Board skills, methods, and supports shall be sufficient to ensure governing with excellence.

- 3.3.1.1. Training and retraining shall be used liberally to orient new members, as well as maintain and increase existing member skills and understanding.
 - 3.3.1.2. Outside monitoring assistance shall be arranged so that the board can exercise confident control over agency performance. This includes, but is not limited to, financial audits.
 - 3.3.1.3. Outreach mechanisms shall be used as needed to ensure the Board's ability to listen to stakeholder viewpoints and values.
 - 3.3.1.4. Other activities as needed to ensure the Board's ability to fulfill its ethical and legal obligations and to represent and link to the motoring public and the various motor vehicle industries.
- 3.3.2. The Board shall establish its cost of governance and it will be integrated into strategic planning and the agency's annual budgeting process.

3.4. Practice Discipline and Assess Performance

The Board shall ensure the integrity of the board's process by practicing discipline in Board behavior and continuously working to improve its performance. Accordingly:

- 3.4.1. The assigned result is that the Board operates consistently with its own rules and those legitimately imposed on it from outside the organization.
 - 3.4.1.1. Meeting discussion content shall consist solely of issues that clearly belong to the Board to decide or to monitor according to policy, rule and law. Meeting discussion shall be focused on performance targets, performance boundaries, action on items of Board authority such as conduct of administrative hearings, proposal, discussion and approval of administrative rule-making and discussion and approval of all strategic planning and fiscal matters of the agency.
 - 3.4.1.2. Board discussion during meetings shall be limited to topics posted on the agenda.
 - 3.4.1.3. Adequate time shall be given for deliberation which shall be respectful, brief, and to the point.
- 3.4.2. The Board shall strengthen its governing capacity by periodically assessing its own performance with respect to its governance model. Possible areas of assessment include, but are not limited to, the following:
 - 3.4.2.1. Are we clear and in agreement about mission and purpose?

- 3.4.2.2. Are values shared?
- 3.4.2.3. Do we have a strong orientation for our new members?
- 3.4.2.4. What goals have we set and how well are we accomplishing them?
- 3.4.2.5. What can we do as a board to improve our performance in these areas?
- 3.4.2.6. Are we providing clear and relevant direction to the Executive Director, stakeholders and partners of the TxDMV?
- 3.4.3. The Board Chair shall periodically promote regular evaluation and feedback to the whole Board on the level of its effectiveness.

Texas Department of Motor Vehicles Strategic Planning Policy

1. PURPOSE

The directives presented in this policy address the annual Strategic Planning process at the Texas Department of Motor Vehicles (TxDMV).

2. SCOPE

The directives presented in this policy apply to the TxDMV Board and TxDMV agency personnel who interact with the Board. TxDMV Strategic Planning Policy attempts to develop, document and expand its policy that is comprehensive in its scope in regards to the strategic planning process of the Board and the Department beyond that of the state strategic planning process.

3. POLICY

3.1. TxDMV Board Strategic Planning

This policy describes the context for strategic planning at TxDMV and the way in which the strategic plan shall be developed and communicated.

- 3.1.1. The Board is responsible for the strategic direction of the organization, which includes the vision, mission, values, strategic goals, and strategic objectives.
- 3.1.2. TxDMV shall use a 5-year strategic planning cycle, which shall be reviewed and updated annually, or as needed.
- 3.1.3. The 5-year strategic plan shall be informed by but not confined by requirements and directions of state and other funding bodies.
- 3.1.4. In developing strategic directions, the Board shall seek input from stakeholders, the industries served, and the public.
- 3.1.5. The Board shall:
 - 3.1.5.1. Ensure that it reviews the identification of and communication with its stakeholders at least annually.
 - 3.1.5.2. Discuss with agency staff, representatives of the industries served, and the public before determining or substantially changing strategic directions.

- 3.1.5.3. Ensure it receives continuous input about strategic directions and agency performance through periodic reporting processes.
- 3.1.6. The Board is responsible for a 5-year strategic plan that shall identify the key priorities and objectives of the organization, including but not limited to:
 - 3.1.6.1. The creation of meaningful vision, mission, and values statements.
 - 3.1.6.2. The establishment of a Customer Value Proposition that clearly articulates essential customer expectations.
 - 3.1.6.3. A Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis, to be updated annually.
 - 3.1.6.4. An assessment of external factors or trends (i.e., customer needs, political factors, economic factors, industry trends, technology factors, uncertainties, etc.)
 - 3.1.6.5. Development of the specific goals and objectives the Department must achieve and a timeline for action.
 - 3.1.6.6. Identification of the key performance indicators to measure success and the initiatives that shall drive results.
 - 3.1.6.7. Engage staff at all levels of the organization, through the executive director, in the development of the strategic plan through surveys, interviews, focus groups, and regular communication.
 - 3.1.6.8. Ensure the strategic planning process produces the data necessary for LBB/GOBPP state required compliance while expanding and enhancing the strategic plan to support the needs of the TxDMV. The overall strategic plan shall be used as a tool for strategic management.
- 3.1.7. The Board delegates to the Executive Director the responsibility for **implementing** the agency's strategic direction through the development of agency wide and divisional operational plans.

Texas Department of Motor Vehicles TxDMV Goals and Objectives

1. PURPOSE

The information presented in this policy addresses the goals and key objectives of the Board of the Texas Department of Motor Vehicles (TxDMV) as they relate to the mission, vision, and values of the TxDMV.

2. SCOPE

The scope of this policy is to define the desired state the TxDMV Board is working to achieve. This policy is designed to be inspirational in outlining the desired state of the agency that supports the TxDMV Board vision and meeting agency goals.

3. TxDMV MISSION

To serve, protect and advance the citizens and industries in the state with quality motor vehicle related services.

4. TxDMV VISION

The Texas Department of Motor Vehicles sets the standard as the premier provider of customer service in the nation.

5. TxDMV VALUES

To earn the trust and faith of all citizens of Texas with transparency, efficiency, excellence, accountability, and putting stakeholders first.

5.1. Transparency – Being open and inclusive in all we do.

5.2. Efficiency – Being good stewards of state resources by providing products and services in the most cost-effective manner possible.

5.3. Excellence – Working diligently to achieve the highest standards.

5.4. Accountability – Accepting responsibility for all we do, collectively and as individuals.

5.5. Stakeholders – Putting customers and stakeholders first, always.

6. TxDMV GOALS

6.1. GOAL 1 – Performance Driven

The TxDMV shall be a performance driven agency in its operations whether it is in customer service, licensing, permitting, enforcement or rule-making. At all times the TxDMV shall mirror in its performance the expectations of its customers and stakeholder by effective, efficient, customer-focused, on-time, fair, predictable and thorough service or decisions.

6.1.1. Key Objective 1

The TxDMV shall be an agency that is retail-oriented in its approach. To accomplish this orientation TxDMV shall concentrate the focus of the agency on:

- 6.1.1.1. Delivering its products and services to all of its customers and stakeholders in a manner that recognizes that their needs come first. These needs must be positively and proactively met. TxDMV works for and with its customers and stakeholders, not the other way around.
- 6.1.1.2. Operating the agency's licensing and registration functions in a manner akin to how a private, for-profit business. As a private, for-profit business, TxDMV would have to listen to its customers and stakeholders and implement best practices to meet their needs or its services would no longer be profitable or necessary. Act and react in a manner that understands how to perform without a government safety net and going out of business.
- 6.1.1.3. Simplify the production and distribution processes and ease of doing business with the TxDMV. Adapting and maintaining a business value of continuous improvement is central to TxDMV operations and processes.
- 6.1.1.4. All operations of the TxDMV shall stand on their own merits operationally and financially. If a current process does not make sense then TxDMV shall work within legislative and legal constraints to redesign or discard it. If a current process does not make or save money for the state and/or its customers or stakeholders then TxDMV shall work within legislative and legal constraints to redesign or discard it. TxDMV shall operate as efficiently and effective as possible in terms of financial and personnel needs. Divisions should focus on cost savings without sacrificing performance. Division directors are accountable for meeting these needs and applicable measures. All division directors are collectively responsible for the performance of TxDMV as a whole.
- 6.1.1.5. Focus on revenue generation for transportation needs as well as the needs of its customers.
- 6.1.1.6. Decisions regarding the TxDMV divisions should be based on the overriding business need of each division to meet or provide a specific service demand, with the understanding and coordination of overarching agency-wide needs.

- 6.1.1.7. Developing and regularly updating a long-range Statewide Plan describing total system needs, establishing overarching statewide goals, and ensuring progress toward those goals.
- 6.1.1.8. The TxDMV shall establish a transparent, well-defined, and understandable system of project management within the TxDMV that integrates project milestones, forecasts, and priorities.
- 6.1.1.9. The TxDMV shall develop detailed work programs driven by milestones for major projects and other statewide goals for all TxDMV divisions.
- 6.1.1.10. The TxDMV, with input from stakeholders and policymakers, shall measure and report on progress in meeting goals and milestones for major projects and other statewide goals.

6.2. GOAL 2 – Optimized Services and Innovation

The TxDMV shall be an innovative, forward thinking agency that looks for ways to promote the economic well-being and development of the industries it serves as well as the State of Texas within the legislative boundaries that have been established for the agency.

6.2.1. Key Objective 1

The TxDMV shall achieve operational, cultural, structural and financial independence from other state agencies.

- 6.2.1.1. Build the TxDMV identity. This means that TxDMV shall make customers aware of what services we offer and how they can take advantage of those services.
- 6.2.1.2. Build the TxDMV brand. This means that TxDMV shall reach out to the stakeholders, industries we serve and the public, being proactive in addressing and anticipating their needs.
- 6.2.1.3. Determine immediate, future, and long term facility and capital needs. TxDMV needs its own stand-alone facility and IT system as soon as possible. In connection with these needs, TxDMV shall identify efficient and effective ways to pay for them without unduly burdening either the state, its customers or stakeholders.
- 6.2.1.4. All regulations, enforcement actions and decision at TxDMV shall be made in a timely, fair and predictable manner.

6.2.2. Key Objective 2

Provide continuous education training on business trends in the industry with a particular emphasis on activities in Texas.

6.2.3. Key Objective 3

Provide continuous outreach services to all customers and stakeholders to access their respective needs and wants. This includes helping frame legislative or regulatory issues for consideration by other bodies including the legislature.

6.2.4. Key Objective 4

Examine all fees to determine their individual worth and reasonableness of amount. No fee shall be charged that cannot be defended financially and operationally.

6.3. GOAL 3 – Customer-centric

The TxDMV shall be a customer-centric agency that delivers today's services and decisions in a positive, solution-seeking manner while ensuring continuous, consistent and meaningful public and stakeholder involvement in shaping the TxDMV of tomorrow.

6.3.1. Key Objective 1

The TxDMV shall seek to serve its customer base through a creative and retail oriented approach to support the needs of its industries and customers.

6.3.2. Key Objective 2

The TxDMV shall develop and implement a public involvement policy that guides and encourages meaningful public involvement efforts agency-wide.

6.3.3. Key Objective 3

The TxDMV shall develop standard procedures for documenting, tracking, and analyzing customer complaint data. Successful problem resolution metrics should be monitored to support continuous improvement activities that shall permanently improve customer facing processes.

6.3.4. Key Objective 4

The TxDMV shall provide a formal process for staff with similar responsibilities to share best practices information.

6.3.5. Key Objective 5

The TxDMV shall provide central coordination of the Department's outreach campaigns.

6.3.6. Key Objective 6

The TxDMV shall develop and expand user friendly, convenient, and efficient website applications.

6.3.7. Key Objective 7

TxDmv shall timely meet all legislative requests and mandates.

Agency Operational Boundaries as Defined by Department Policies of the TxDMV Board (Board)

The Board is responsible for the policy direction of the agency. The Board's official connection to the day-to-day operation of the Texas Department of Motor Vehicles (TxDMV) and the conduct of its business is through the Executive Director of the TxDMV (ED) who is appointed by the Board and serves at its pleasure. The authority and accountability for the day-to-day operations of the agency and all members of the staff, except those members who report directly to the Board, is the sole responsibility of the ED.

In accordance with its policy-making authority the Board has established the following policy boundaries for the agency. The intent of the boundaries is not to limit the ability of the ED and agency staff to manage the day-to-day operations of the agency. To the contrary, the intent of the boundaries is to more clearly define the roles and responsibilities of the Board and the ED so as to liberate the staff from any uncertainty as to limitations on their authority to act in the best interest of the agency. The ED and staff should have certainty that they can operate on a daily basis as they see fit without having to worry about prior Board consultation or subsequent Board reversal of their acts.

The ED and all agency employees shall act at all times in an exemplary manner consistent with the responsibilities and expectations vested in their positions. The ED and all agency employees shall act in a manner consistent with Board policies as well as with those practices, activities, decisions, and organizational circumstances that are legal, prudent, and ethical. It is the responsibility of the ED to ensure that all agency employees adhere to these boundaries.

Accordingly, the TxDMV boundaries are as follows:

1. The day-to-day operations of the agency should be conducted in a manner consistent with the vision, mission, values, strategic framework, and performance metrics as established by the Board. These elements must not be disregarded or jeopardized in any way.
2. A team-oriented approach must be followed on all enterprise-wide decisions to ensure openness and transparency both internally and externally.
3. The agency must guard against allowing any financial conditions and decision which risk adverse fiscal consequences, compromise Board financial priorities, or fail to

show an acceptable level of foresight as related to the needs and benefits of agency initiatives.

4. The agency must provide timely, accurate, and honest information that will afford the Board, public, stakeholders, executive branch and the legislature the best ability to evaluate all sides of an issue or opportunity before forming an opinion or taking action on it. Any information provided that is intentionally untimely, inaccurate, misleading or one-sided will not be tolerated.
5. The agency must take all reasonable care to avoid or identify in a timely manner all conflicts of interest or even the appearance of impropriety in awarding purchases, negotiating contracts or in hiring employees.
6. The agency must maintain adequate administrative policies and procedures that are understandable and aid in staff recruitment, development and retention.
7. The agency must maintain an organizational structure that develops and promotes the program areas from an enterprise-wide perspective. No organizational silos or sub-agencies will be allowed. We are the TxDMV.
8. The agency must empower its entire staff to deliver a positive customer experience to every TxDMV customer, stakeholder or vendor to reduce their effort and make it easier for them to do business with the TxDMV.
9. The agency must at all times look to flattening its organizational structure to reduce cost as technology advances allow.
10. Agency staff shall anticipate and resolve all issues timely.
11. The agency must maximize the deployment and utilization of all of its assets – people, processes and capital equipment – in order to fully succeed.
12. The agency must not waste the goodwill and respect of our customers, stakeholders, executive branch and legislature. All communication shall be proper, honest, and transparent with timely follow-up when appropriate.
13. The agency should focus its work efforts to create value, make sure that processes, programs, or projects are properly designed, budgeted and vetted as appropriate with outside stakeholders to ensure our assumptions are correct so positive value continues to be created by the actions of the TxDMV.
14. The ED through his or her staff is responsible for the ongoing monitoring of all program and fiscal activities and providing information to the Board to keep it apprised of all program progress and fiscal activities. This self-assessment must result in a product that adequately describes the accomplishment of all program

goals, objectives and outcomes as well as proposals to correct any identified problems.

15. In advance of all policy decisions that the Board is expected to make, the ED will provide pertinent information and ensure board members understand issues/matters related to the pending policy decision. Additionally, the ED or designee will develop a process for planning activities to be performed leading up to that particular policy decision and the timeframe for conducting these planning activities. It is imperative that the planning process describes not only when Board consideration will be expected but also when prior Board consultation and involvement in each planning activity will occur.
16. In seeking clarification on informational items Board members may directly approach the ED or his or her designee to obtain information to supplement, upgrade or enhance their knowledge and improve the Board's decision-making. Any Board member requests that require substantive work should come to the Board or Committee Chairs for direction.
17. The agency must seek stakeholder input as appropriate on matters that might affect them prior to public presentation of same to the Board.
18. The agency must measure results, track progress, and report out timely and consistently.
19. The ED and staff shall have the courage to admit a mistake or failure.
20. The ED and staff shall celebrate successes!

The Board expects the ED to work with agency staff to develop their written interpretation of each of the boundaries. The ED will then present this written interpretation to the Board prior to discussion between the Board and ED on the interpretation. The Board reserves the right to accept, reject or modify any interpretation. The intent is that the Board and the ED will come to a mutually agreeable interpretation of agency boundaries that will then form the basis of additional written thought on the part of the ED and staff as to how these boundaries will influence the actions of the agency.



**Key Performance Indicator Measures
Adopted by TxDMV Board 9/12/14**

GOAL	STRATEGY	#	MEASURE	Baseline	Target	Actual	OWNER
Performance Driven	Effective and efficient services	1	Average processing time for new franchise license applications	45 days	35 days		MVD
		2	Average processing time for franchise renewals	11 days	5 days		MVD
		3	Average processing time of franchise license amendments	20 days	8 days		MVD
		4	Average processing time for new Dealer's General Distinguishing Number (GDN) license applications	35 days	17 days		MVD
		5	Average processing time for GDN renewals	14 days	7 days		MVD
		6	Average processing time for GDN license amendments	19 days	7 days		MVD
		7	Average turnaround time for single-trip routed permits	33.88 mins	32 mins		MCD
		8	Average turnaround time for intrastate authority application processing	1.47 days	1.4 days		MCD
		9	Average turnaround time for apportioned registration renewal applications processing	2 days	2 days		MCD
		10	Average turnaround time to issue salvage or non-repairable vehicle titles	5 days	4 days		VTR
		11	Average time to complete motor vehicle complaints with no contested case proceeding	131 days	120 days		ENF
		12	Average time to complete motor vehicle complaints with contested case proceeding	434 days	400 days		ENF
		13	Average time to complete salvage complaints with no contested case proceeding	131 days	120 days		ENF
		14	Average time to complete salvage complaints with contested case proceeding	434 days	400 days		ENF
		15	Average time to complete motor carrier complaints with no contested case proceeding	297 days	145 days		ENF
		16	Average time to complete motor carrier complaints with contested case proceeding	133 days	120 days		ENF
		17	Average time to complete household goods complaints with no contested case proceeding	432 days	145 days		ENF
		18	Average time to complete household goods complaints with contested case proceeding	371 days	180 days		ENF
		19	Average time to complete Oversize/Overweight (OS/OW) complaints with no contested case proceeding	40 days	35 days		ENF
		20	Average time to complete OS/OW complaints with contested case proceeding	265 days	250 days		ENF
		21	Percent of lemon law cases resolved prior to referral for hearing	76%	60%		ENF
		22	Average time to complete lemon law cases where no hearing is held	147 days	65 days		ENF
		23	Average time to complete lemon law cases where hearing is held	222 days	150 days		ENF
		24	Percent of total renewals and net cost of registration renewal: A. Online B. Mail C. In Person	A. 15% B. 5% C. 80%	A. 16% B. 5% C. 79%		VTR
		25	Total dealer title applications: A. Through Webdealer B. Tax Office	Baseline in development	A. 5% B. 95%		VTR

GOAL	STRATEGY	#	MEASURE	Baseline	Target	Actual	OWNER	
Optimized Services and Innovation		26	Percent of total lien titles issued: A. Electronic Lien Title B. Standard Lien Title	A. 16% B. 84%	A. 20% B. 80%		VTR	
		27	Percent of total OS/OW permits: A. Online (self-issued) B. Online (MCD-issued) C. Phone D. Mail E. Fax	A. 57.47% B. 23.03% C. 11.33% D. 1.76% E. 6.4%	A. 58% or greater B. 25% or greater C. 10% or less D. 1.7% or less E. 5.3% or less		MCD	
		28	Average time to complete lemon law and warranty performance cases after referral	Baseline in development	25 days		OAH	
		29	Average time to issue a decision after closing the record of hearing	Baseline in development	30 days		OAH	
		Implement appropriate best practices	30	Percent of audit recommendations implemented	Baseline in development	90% annual goal for these recommendations which Internal Audit included in a follow-up audit		IAD
		Continuous business process improvement and realignment	31	Percent of projects approved by the agency's governance team that finish within originally estimated time (annual)	57%	100%		EPMO
	32		Percent of projects approved by the agency's governance team that finish within originally estimated budget (annual)	71%	100%		EPMO/ FAS	
	33		Percent of monitoring reports submitted to Texas Quality Assurance Team (TXQAT) by or before the due date	79%	100%		EPMO	
	34		Percent of project manager compliance with EPMO project management standards based upon internal quality assurance reviews	Baseline in development	100%		EPMO	
		Executive ownership and accountability for results	35	Percent of employees due a performance evaluation during the month that were completed on time by division.	Baseline in development	100%		HR
	36		Percent of goals accomplished as stated in the directors performance evaluation	Baseline in development	Measure annually at the end of the fiscal year		EXEC	
		Organizational culture of continuous improvement and creativity	37	Employees who rate job satisfaction as above average as scored by the Survey of Employee Engagement (SEE)	3.47 (SEE 2012)	3.65	3.60 (SEE 2013)	HR
	38		Increase in the overall SEE score	337 (SEE 2012)	360	351 (SEE 2013)	HR	
	ic	Focus on the internal customer	39	Percent of favorable responses from customer satisfaction surveys	Baseline in development	90%		EPMO
			40	Annual agency voluntary turnover rate	6.5% (FY 2013)	5.0%		HR
		Increase transparency with external customers	41	Number of education programs conducted and number of stakeholders/customers attending education programs	4.48/80.61	4/80		MCD
			42	Number of education programs conducted and number of stakeholders/customers attending education programs	36/335	42/390		VTR
			43	Number of eLearning training modules available online through the Learning Management System and number of modules completed by stakeholders/customers	eLearning Modules Available - 28 Completed - 735	Available - 31 Completed - 814		VTR

GOAL	STRATEGY	#	MEASURE	Baseline	Target	Actual	OWNER
Customer Center		44	Number of Shows and Exhibits attended to educate stakeholders/customers about TxDMV services and programs	6	7		MVD
		45	Number of education programs conducted and number of stakeholders/customers attending education programs	3/250	3/250		ENF
		46	Number of education programs conducted and number of stakeholders/customers attending education programs	3/150	4/300		ABTPA
		47	Percent of customers and stakeholders who express above average satisfaction with communications to and from TxDMV	Baseline in development	80%		All Divisions
	Excellent Service Delivery	48	Average hold time	9 min	9 min		CRD
		49	Abandoned call rate	22%	20%		CRD
		50	Average hold time	Baseline in development	1 min		ITS
		51	Abandoned call rate	Baseline in development	5%		ITS
		52	Average hold time	Credentialing - 1.6 minutes Permits - 2.08 minutes CFS - 54.38 seconds	Credentialing - 1.5 minutes Permits - 2 minutes CFS - 50 seconds		MCD
		53	Abandoned call rate	Credentialing - 7% Permits - 6.42% CFS - 5.63%	Credentialing - 6% Permits - 5% CFS - 5%		MCD
Key:		Critical	Off Target		On target	Not yet started	
Vision: The Texas Department of Motor Vehicles sets the standard as the premier provider of customer service in the nation.							
Mission: To serve, protect, and advance the citizens and industries in the state with quality motor vehicle related services.							
Philosophy: The Texas Department of Motor Vehicles is customer-focused and performance driven. We are dedicated to providing services in an efficient, effective and progressive manner as good stewards of state resources. With feedback from our customers, stakeholders and employees, we work to continuously improve our operations, increase customer satisfaction and provide a consumer friendly atmosphere.							
Values: We at the Texas Department of Motor Vehicles are committed to: TEXAS-Transparency, Efficiency, EXcellence, Accountability, and Stakeholders.							