

Out-of-trust dealership group can sue auditor

Eric Freedman

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A dealership group can pursue claims of negligent misrepresentation and breach of fiduciary duty against the company retained by its floorplan lender to perform monthly inventory audits, a federal judge in Philadelphia has ruled.

But the judge tossed out related claims of breach of contract and professional malpractice against DataScan Technologies, of Alpharetta, Ga.

Companies owned by Brandow Auto Group, of Warminster, Pa., and several of its principals claim that audit-related inaccuracies by DataScan left them unwittingly out of trust and cost them more than \$20 million in decreased asset value, lost profits and lost future opportunities. At the time, the group had three new-vehicle dealerships in Pennsylvania and New Jersey.

"DataScan never determined the full extent of the out-of-trust position or the actual amount of inventory that had been fraudulently and significantly overstated," the complaint alleges.

The dealerships were out of trust by an estimated \$8.2 million to \$8.4 million because Brandow's former controller is thought to have "falsified many, many records," including recording "fictitious sales" of more than 300 vehicles, Brandow's lawyer, Alan Frank, of Elkins Park, Pa., told *Automotive News*.

Facing trial

Issue: Did a data company that performed inventory audits for a dealership group that found itself out of trust with its floorplan lender breach its fiduciary duty to the group?

Where it stands: Federal judge rules the group may pursue its lawsuit. A trial could begin this fall.

Parties' positions

"DataScan simply missed the fictitious sales or, if they knew, didn't tell the owners," Frank said.

The controller was fired in 2004, is under criminal investigation and has been sued by Brandow, Frank said.

But DataScan denies liability and says its audits "were not responsible for missing autos or for the dealerships' alleged lack of knowledge that the autos were gone."

"In essence, they are blaming alleged auditing errors, as opposed to the dealerships' failure to maintain and control their own inventories, for their alleged financial harm," DataScan argues in court papers.

According to the decision, for more than 30 years, Brandow obtained floorplan financing from PNC Bank, which had used its own staff to conduct the mandatory monthly inventory corroborations. In 2001 or 2002, DataScan started performing the audits under a contract with the bank.

The lawsuit alleges that DataScan failed to properly carry out the audits, failed for eight months in 2003 and 2004 to rotate auditors as industry standards require, and failed to provide Brandow monthly reports. A different auditor whom DataScan assigned in 2004 reported "significant inaccuracies in the inventory," resulting in the group's being out of trust, the decision said.

Besides the claimed financial losses, the lawsuit said the auto group's principals were forced to personally guarantee bank financing.

The ruling

In his decision, U.S. District Judge Thomas O'Neill denied DataScan's request to toss out the entire lawsuit without trial.

He let the negligent-misrepresentation claim stand because the suit accuses DataScan of "a repeated failure to detect and report the inventory discrepancies on a monthly basis for a specified period of time."

"Such an omission," the judge wrote, "constitutes a misrepresentation where there is a duty to disclose information, such as a fiduciary duty."

The lawsuit also contends that DataScan knew Brandow would rely on the alleged misrepresentations in the flawed audits.

As for breach of fiduciary duty, O'Neill cited assertions that Brandow relied on DataScan's "pretense of expertise" to properly conduct and report the audits and said it is reasonable to infer that Brandow "reposed complete trust in DataScan to ensure compliance with its collateral requirements and was justified in trusting DataScan's specialized knowledge."

At the same time, the breach-of-contract and malpractice claims failed to survive because the audit agreement between PNC Bank and DataScan explicitly stated that their contract was not intended to benefit the bank's borrowers.

Brandow lawyer Frank said depositions and other pretrial discovery are under way with hopes of a trial this fall.

You may e-mail Eric Freedman at freedma5@msu.edu