New York Court of Appeals Rejects Sales Effectiveness Metric

On May 3, 2016, the New York Court of Appeals (New York's highest court) issued its decision in Beck Chevrolet Co., Inc. v. General Motors LLC.

The Court ruled that the “sales effectiveness” metric that General Motors LLC (“GM”) uses to evaluate its dealers’ sales performance violates the New York statute's ban on "unreasonable, arbitrary or unfair” sales performance standards. Because GM’s metric is similar to the metrics used by most motor vehicle OEMs, this ruling warrants serious attention by the entire industry. In addition, the Court addressed another recurring issue: Whether a change to a dealer’s assigned area of responsibility (“AOR”) constitutes a protestable franchise “modification” under state dealer law.

The sales effectiveness ruling

GM evaluates dealers based on a "Retail Sales Index" or "RSI," which is computed by dividing (1) the dealer's actual retail sales, wherever made, by (2) the dealer's expected sales (derived by applying state-average, segment-adjusted brand sales penetration to the competitive group registrations in the dealer's AOR). This, or a very similar, calculation is used by many OEMs, although some use regional or national average, rather than state average, as a benchmark.

The Court ruled that RSI was unreasonable and unfair because it does not take into account either "local brand popularity" or "import bias."

Potential effects of ruling

While the decision is controlling precedent only in the State of New York, its importance is likely to be more far-reaching and raises troublesome practical issues for most OEMs. As far as we are aware, there is no accepted definition of "local brand popularity" and no accepted way to determine how much of a brand's below-average performance in a particular market is the result of low "brand popularity" and how much is the result of poor dealer performance. The Court’s decision does not address, much less resolve, this difficulty.

Beck appears to be the first decision by a state high court concerning the reasonableness and fairness of a sales effectiveness metric. The likelihood that it will be followed as persuasive authority by courts and agencies in other states is, therefore, high and it is sure to be cited and relied upon by dealer attorneys in most or all performance-based termination cases in the future. It also seems likely that the case and the statutory provision upon which it is based will affect legislative action in other states. Moreover, the Beck ruling appears to preclude the use of sales effectiveness in New York for any evaluative or measurement purpose (as opposed to being limited to the termination context).

In light of the Beck decision it will be more important than ever that an OEM: (1) consider whether the benchmark used in its sales effectiveness test can fairly be applied to a particular dealer, or whether special circumstances might require adjustments to the sales effectiveness calculation; (2) look at metrics in addition to sales effectiveness to corroborate any dealer performance evaluation; and (3) cite and rely upon performance deficiencies in addition to poor sales effectiveness, wherever possible, in making a decision to terminate.

Changes to area of responsibility

The Court also ruled in Beck that a change to a dealer's AOR may be a “modification” of the dealer's “franchise” triggering statutory notice and protest rights, even if the dealer agreement gives the franchisor the right to revise the AOR in its sole discretion. The Court held that whether the AOR revision is a regulated "modification" depends on whether the change “may” substantially and adversely affect the dealer's "rights, obligations, investment or return on investment." The Court provided no guidance, however, on how to determine whether a change may have a "substantial and adverse” effect, and dealers frequently take the position that any change may substantially and adversely affect their rights, regardless of whether the AOR is being enlarged or reduced.

While Beck’s modification ruling is not likely to have as great a precedential effect as the sales effectiveness portion of the decision, it is likely to affect whether and how a franchisor provides notice of a proposed AOR change, at least under some state statutes.

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