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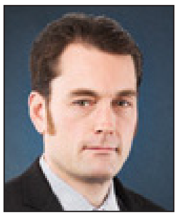
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Stop the Bleeding: Challenging The Manufacturers' Control of Dealers Through Incentives

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Audi has its "Margin and Bonus Program." BMW calls theirs the "Added Value Program." Maserati landed on the "Commercial Bonus Policy." Whatever you call it, virtually every major car manufacturer has instituted an incentive program that ties substantial profit margin on new car sales to the attainment of a litany of artificially-created standards and goals. Not true "bonuses," these programs often replace regular trading margin and holdback that dealers once enjoyed automatically. The consequences are clear: meet the manufacturer's demands or lose up to several thousand dollars of profit per car. Meeting those demands, however, may be just as costly, as manufacturers require multi-million dollar investments in new facilities, set often unobtainable sales goals, or insist upon the purchase of unneeded parts or the buyback of off-lease vehicles. Dealers face an impossible choice—lose money if you comply or lose even more money if you don't.

Thankfully, dealers have a third option—fight. These incentive programs can be (and are being) challenged in both state administrative proceedings and federal court. Particular prongs of these incentive programs violate several provisions of state dealer acts, and dealers can (and should) challenge those prongs. As a recent New York administrative decision, [*Wide World of Cars, LLC d/b/a Wide World Maserati v. Maserati North America, Inc.*, Case No. FMD 2017-03], demonstrates, dealers have begun to find success challenging the manufacturers' paradigm shift to incentive programs as the way to coerce their dealers. Many state dealer acts, such as New York's and Florida's, contain a modification provision that prevents a manufacturer from undertaking any "change or replacement of any franchise" that may "substantially and adversely affect the new motor vehicle dealer's rights, obligations, investment or return on investment," unless the manufacturer is acting in "good faith" and with "good cause." N.Y. Veh. & Traf. Law § 463(2)(ff); *see also* Fla. Stat. Ann. § 320.641. While proving that a manufacturer acted in bad faith and without good cause will be a fact-specific inquiry, the initial battle is to demonstrate that the incentive program itself is indeed a modification of the franchise. And dealers are gaining ground.

I. *Wide World* – Incentive Program Changes Are Franchise Modifications

In *Wide World* (and its companion cases), three New York Maserati dealerships challenged Maserati's rollout of its new Commercial Bonus Policy, the first incentive program that Maserati had ever instituted. Until January 2017 Maserati had a traditional relationship with its dealers, in that it wholesaled vehicles to its dealer network, and the dealers sold those cars at retail. Other than some minor housekeeping items to qualify, Maserati dealers would receive for the sale of, by example, the Ghibli, a 9% trading margin and 4% holdback (based on MSRP) that would be paid on a per new car sale basis with no strings attached.

But Maserati recently decided to implement an incentive program that would drastically change the margin structure and put onerous conditions on a substantial portion of Maserati dealers' income. Maserati took 2% away from trading margin and 2% away from holdback, and put these monies into a new incentive program worth up to a total of only 3.5% (with the remaining 0.5% being put into an "advertising fund" controlled entirely by Maserati). The incentive program has many hoops for Maserati dealers to jump through to earn back what they had been receiving (and planning to receive in connection with their business models) for the past twelve years without any costly obligations. These hoops would include, among other things, image and facility requirements, customer service targets, used car sales targets, part sales targets, and more – many requirements that the state dealer acts prohibit Maserati from imposing directly. Under the guise of an "incentive" program, it would be very expensive for the Maserati dealers to comply with the new program, in order to qualify for money that they used to enjoy (and planned to receive) automatically.

Three Maserati dealerships petitioned the New York Department of Motor Vehicles to protest the modification of their franchises by the new Commercial Bonus Policy. The dealers argued that the changes went to the fundamental heart of the relationship between dealer and manufacturer, and would adversely affect them for years to come. In granting the dealers' motion for partial summary judgment, the Administrative Law Judge (ALJ) agreed:

> Do the changes in the "holdback" and the Bonus Program have the potential to significantly impact [Wide World's] franchise agreement? [Wide World's] loss of the present assured 4% "holdback" for the 2% "holdback" and subjective Bonus Program by reducing their present long standing expected margin both as to the amount received from MNA and also due to the increased administrative cost to administer the Bonus Program, effectively and significantly impacts its return on investment and as such is a modification of its present franchise agreement.

8/1/17 Findings and Disposition, at 6.

Importantly, because the new Commercial Bonus Policy is deemed a "modification," the ALJ noted that it is subject to the automatic stay provided under the New York Dealer Act, N.Y. Veh. & Traf. Law § 463(2)(ff)(3). The fairness hearing is set for late October, to determine the remaining issues of whether Maserati had "good faith" and "good cause" in making these modifications.

II. *Beck Chevrolet* – Still Expanding Its Reach Over A Year Later

Wide World was expressly informed, in part, by the New York Court of Appeals' decision in *Beck Chevrolet*,[1] which continues to affect a sea change in the industry for manufacturers, dealers, and legislatures across the country. While the *Beck* decision is most notable for its holding that a manufacturer must use a fair sales metric in assessing its dealers (including the consideration of local market conditions that each dealer faces), the court in *Beck* also separately held in that "a modification is not limited to a change in the franchise contract because other documents may be constituent parts of the parties' written agreement." 27 N.Y.3d at 395. Moreover, under the New York Dealer Act, a manufacturer is expressly forbidden from attempting to contract its way out of those statutory restrictions; 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 effects on the dealer." *Id*. at 395-96. This rationale underpins a finding that incentive programs fall under the franchise relationship, and, accordingly, unilateral changes to those programs by a manufacturer constitute modifications to the franchise that may be challenged by the dealer, requiring the manufacturer to then prove that the change was implemented in good faith and for good cause.

The RSI portion of the *Beck* decision is also useful in challenging the manufacturers' new incentive programs, to the extent that the new incentive programs are premised upon unfair sales performance standards, such as segment-adjusted state or regional market share. For instance, in *CMS Volkswagen*,[2] the New York federal district court granted Volkswagen's motion to dismiss a price discrimination claim regarding its Variable Bonus Program, which offered bonus payouts to the dealers only if dealers they achieved their sales objectives—objectives that were created by Volkswagen and based upon segment-adjusted regional market share. Citing the *Beck* decision, the Second Circuit vacated and remanded the district court's dismissal, which relied upon the "statutory interpretation and conclusions" of the district court opinion that had been reversed in *Beck*. To the extent that segment-adjusted regional market share continues to be a part of manufacturer sales metrics for its dealers (even in the context of incentive programs), *Beck* will continue to be useful in keeping the manufacturers in check.

III. *Beck* As Statute – State Legislators Expanding Dealers' Rights

The *Beck Chevrolet* holding has also been codified in certain states over the past year.[3] For example, the Florida legislature recently enacted. Florida Statute § 320.64(41),[4] which prohibits manufacturers from establishing, implementing, or enforcing criteria "for measuring sales or service performance of any of its franchised motor vehicle dealers in this state which have a material or adverse effect on any motor vehicle dealer," and which (1) "are unfair, unreasonable, arbitrary, or inequitable," or (2) "do not include all relevant and material local and regional criteria, data, and facts." In essence, this statue codifies the prohibition against the use of segment-adjusted regional market share to measure dealer sales performance, as held in *Beck*—but it also goes further. Florida's *Beck* statute applies to service performance as well, and to any other manner in which either performance is measured—which arguably includes any measures utilized by manufacturers in administering their incentive programs.

Indeed, Maryland likewise codified the holding of *Beck*, and made the application of *Beck* to incentive programs explicit. Earlier this year, the Maryland legislature passed an amendment to its dealer act, taking effect on October 1, 2017,[5] to expand the definition of "coercion" to include the loss of incentives. The Maryland act now also requires that any assigned market area or "performance standard, sales objective, or program for measuring dealership performance that may have a material effect on a dealer, including the dealer's right to a benefit or payment under any incentive or reimbursement program, and the application of that standard" be "fair, reasonable, and equitable." They must also include "considerations of the demographic characteristics and consumer preferences of the population in the dealer's assigned market area," including car and truck preferences of consumers, and "geographic characteristics, such as natural boundaries, round conditions, and terrain, that affect car and truck shopping patterns." Maryland's *Beck* statute, therefore, expressly recognizes that manufacturer incentive programs are not "voluntary" for a dealer, and that the threatened loss of the profit margin from incentive programs can constitute "coercion."

IV. Conclusion

The dealer law battle of the 20th century was private coercion, behind closed doors, where a manufacturer would force a dealer to accept unwanted inventory, to acquiesce to an add point next door, or any other abusive aim. The dealer law battle of the 21st century is manufacturer incentive programs, where the manufacturers strong-arm their dealers in broad daylight, under the guise of standards and regulations, in an effort to accomplish what the dealer acts were designed to prohibit. Unless and until manufacturers resume treating their franchised dealers as partners, and not subordinates, these battles will continue for the foreseeable future. Considering the razor thin profit margins that many dealers face, dealers will have no choice but to fight the manufacturers with respect to their coercive incentive programs, just to remain profitable. ■

References

1. *Beck Chevrolet Co., Inc. v. Gen. Motors LLC*, 27 N.Y.3d 379 (2016), *reargument denied*, 27 N.Y.3d 1187 (2016).
2. *CMS Volkswagen Holdings, LLC v. Volkswagen Grp. of Am., Inc.*, 669 Fed. Appx. 602, 603 (2d Cir. 2016).
3. In addition to Florida and Maryland, discussed herein, Illinois, Montana, and Ohio have also enacted statutes codifying *Beck*. *See* Il. St. Ch. 815, § 710/12(d)(9); Mont. Code Ann. § 61-4-207(1)(a); Ohio Rev. Code Ann. § 4517.55(C), § 4517.01(MM), & § 4517.59(d).
4. This refers to the provision added by 2017 Fla. Sess. Law Serv. Ch. 2017-187; it appears that two separate subpart (41)s were added roughly simultaneously (*see* 2017 Fla. Sess. Law Serv. Ch. 2017-141). We believe that the numbering will be rectified in the future.
5. *See* 2017 Maryland Laws Ch. 560 (H.B. 1120).

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