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DEFENDER

The National Association of Dealer Counsel Newsletter JULY/AUGUST 2019

Best Practices When a Dealer Client Discovers a Salesperson Has Been Poached by A Competitor

By Kristen Baiardi and Bob Weller, *Abbott Nicholson*


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Weller

Introduction

One of the most unsettling but unavoidable circumstances experienced by dealer principals is the dreaded discovery that a valued salesperson has "jumped ship" to a competitor. These discoveries can be particularly disturbing for large metropolitan-area dealerships in "over-dealered" market areas where the former employee's new employer may be a bitter rival located right down the street.

To make matters even worse, as a dealer principal may be slowly coming to terms with losing a valuable member of the sales team and in the process of recruiting a replacement, there may be suspicion that the former salesperson departed with customer information and other proprietary dealership information. The dealer principal may then seek advice from dealer counsel regarding next steps to protect the business. This article will explore strategies and best practices for dealer counsel to employ in counseling a client facing this situation.

Information Gathering and Preservation

The first order of business is to understand the former employee in question–length of employment, positions held, disciplinary history, and performance. Did a single employee "jump ship" to a competitor, or did multiple employees leave around the same time? Which competitor poached the employees? (Dealer counsel should confirm that no conflict exists if the law firm also represents the competitor.) What were the circumstances of the employee's departure–sudden or planned? Was there an opportunity to conduct an exit interview? Did security escort the employee out of the building? Were dealership-owned electronic devices preserved? Did the former employee sign a confidentiality agreement and/or any other policy regarding information security? Has the dealership disabled the former employee's e-mail and access to other dealership information portals (*e.g.*, DMS system)?

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Evidence of "Stolen" Customers?

Dealer principals often have a visceral reaction to being "betrayed" by the loss of a prized employee to a competitor and assume illicit activity by the former employee. Dealer counsel plays an important role in applying reason to assess whether there is legitimate evidence of nefarious behavior by a departed employee.

Evidence that may point to improperly obtained customer information could take the form of missing physical customer information (deal jackets, credit applications), calls from customers expressing confusion at being contacted by former employee's new dealership, mass mailings by former employee's new dealership targeting customers with soon-to-expire leases, and suspicious access to the DMS or other sources of customer information prior to the employee's departure. There may also be an observable pattern in the former employee's sales numbers leading up to the end of his employment–a sharp decline in sales despite a good month for the dealership overall may indicate that the employee "held" these transactions to finalize at his new dealership to "hit the ground running."

When Does a Salesperson Cross the Line?

Of course, state law differs, but in many states, a rule of thumb is that courts will respect the right of customers to choose the salesperson with whom the customer wishes to interact. Michigan courts have long held that customer lists prepared by individual salespeople (*e.g.*, a personal "rolodex") are not protectable as trade secrets. *See Hayes-Albion v Kuberski*, 421 Mich. 170, 364 N.W.2d 609 (1984). While customer information may be protected by a confidentiality or other non-disclosure agreement, the reality is that courts are loathe to enforce agreements that bar salespeople from reasonable contacts with their own customer contacts.

If the dealer principal suspects that the former employee departed with customer information, all sources of potential corroborating evidence should be preserved. This includes the former employee's computer, e-mail account, and electronic devices. Dealer counsel may suggest retaining a forensic computer expert to image the electronic devices and extract "metadata" and other clues regarding whether illicit activity occurred. For example, a forensic expert may be able to determine if the former employee inserted a flash drive or other removable storage media around the time that s/he was preparing to leave the dealership. This could be evidence that the dealership's customer or other proprietary information was stolen.

State and federal laws prohibit the misappropriation of trade secrets. While a salesperson's own customer information likely will not be deemed a trade secret, it may be possible to argue that dealership trade secrets were misappropriated where a large "download" of data occurred, or where the type of customer data (lease end dates, etc.) is uniquely specific or in a format proprietary to the dealership.

Other Legal Concerns

One particularly concerning situation is where a salesperson walks out the door with customer information of a sensitive, financial nature. For example, a salesperson might take copies of credit applications completed by customers for deals that are in process with the hope that these deals will be finalized at his new dealership. Dealer counsel should be prepared to advise regarding the applicability of the Gramm-Leach Bliley Act, as well as other state privacy laws.

Advice for the Dealer Principal

Depending upon the results of counsel's information gathering, different courses of action may be appropriate. While the dealer principal may initially want to seek retribution through litigation against the former employee and his new employer, it is generally wise to counsel restraint as these claims are difficult to prove. Oftentimes, a stern letter to the former employee reminding him/her of applicable duties of confidentiality will be the best course of action. Sometimes, it is appropriate to pair such a letter with a similarly stern missive to the new employer. The goal of these communications is to neutralize the use of the proprietary information without the distraction, uncertainty, and cost of litigation. Many dealer principals choose to take matters into their own hands and speak directly to the new employer and deliver a warning about the use of proprietary information. Many new employers are unaware of any improperly obtained information and appalled that they could be drawn into litigation. Of course, dealer counsel should warn the dealer principal to avoid any contact with the salesperson's new employer that could give rise to a claim for tortious interference by the salesperson.

Conclusion

Salesperson turnover is an unfortunate reality of the car business. However, with appropriate planning and counselling, salesperson departures can be managed in a businesslike, rational manner with minimal disruption to the dealership business. ■

Kristen L. Baiardi is a Partner at Abbott Nicholson, P.C. and devotes a substantial percentage of her practice to representing and counseling motor vehicle dealerships in litigation, regulatory, and other matters.

Robert Y. Weller II is a shareholder and co-chair of Abbott Nicholson's Motor Vehicle Dealer Practice Group and concentrates on commercial litigation and business counseling, with an extensive background in law governing the rights and responsibilities of automobile dealers.

President's Message

Johnnie Brown
Pullin, Fowler, Flanagan, Brown & Poe LLC
NADC President

PLEASE NOTE: OUT OF OFFICE
Executive Director Erin Murphy is out on maternity leave and will return in November. Please contact Melissa Forburger, Interim Executive Director, at mforburger@dealercounsel.com or 202-495-3136 in Erin's absence.

I hope everyone is having a great summer and looking forward to our Fall conference in Chicago. The work of our Association continues to move forward. Let me first thank all the membership who participated in contacting their respective American Bar Association representatives in opposition to ABA Resolution 115G. This resolution encouraged federal and state governments to adopt laws and regulations to further limit dealer interest margins and encourage flat fees. The American Bar Association resolution also encouraged certain types of recordkeeping on credit transactions. The American Bar Association attempted to create a solution for a problem that did not exist. Through your efforts, the American Bar Association again decided to not move forward with Resolution 115G. Again, let me express the Association's appreciation to responding to this call for action. Special thanks to Andy Koblenz and Paul Metrey of National Automobile Dealers Association (NADA) for keeping the NADC apprised of the ABA's efforts and for helping mobilize our efforts.

Additionally, with the help of the NADA legal team, Eric Baker and I drafted and submitted comments to the Federal Trade Commission's proposed Safeguard Rules. These proposed rules, if adopted, would take away the present flexibility that exists within the Safeguard Rules for our dealers. The proposed rules would require expensive and burdensome arbitrary requirements to be met by every dealer regardless of individual business risk assessment. Most of these proposed new Safeguard requirements would have been simply too expensive and complex for our family-owned dealerships to ever become compliant.

In an effort to always improve and better serve its members, the NADC recently emailed a survey. Thanks to all those who participated. Your insights were very helpful and informative. The Association will certainly take all into consideration as we conduct our strategic planning initiative. NADC's last strategic planning occurred approximately five years ago. While most of NADC's goals were reached and exceeded, five years is a long time for an Association engaged in such a rapidly changing industry. The Strategic Planning Committee plans to have meetings throughout this summer and immediately prior to the Fall Conference. Our goal is to have a revised strategic plan implemented for 2020.

Please keep those article submissions coming in for the *Defender*. The *Defender* is a great asset for sharing experiences and knowledge. It is a success only because of you. Your willingness to spend your time preparing and drafting these great articles is a testament to this Association and its members. Please remember, everyone is welcome to submit articles.

So enough said, get back to enjoying what is left of the summer. I look forward to seeing everyone in Chicago. ■

NADC Member Survey
THANK YOU!

The NADC member survey closed July 15, 2019. Thank you to everyone who participated! We received an impressive number of submissions. Your feedback is critical to our strategic planning project in which we are exploring potential ways to further enhance the value of the organization and offer maximum benefits to our members.

If you have any questions or comments, please contact John Flatley (AMS President and strategic planning project lead) at: jflatley@amsamc.com.

Updated Member Contact Information

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

Updated Information:

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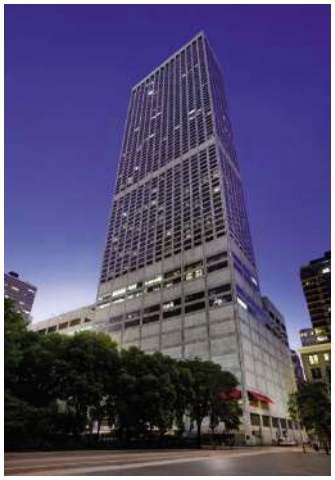
2019 NADC Fall Conference
October 27-29, 2019

The Ritz-Carlton, Chicago
Chicago, IL

Our preliminary agenda topics include:

- In-House Counsel Breakout Session: The Growing Threat of Forced Disclosure of Attorney Communications with Dealer Association Clients
- NADA Update
- The Code of Kryptonite: Ethical Limitations on Lawyers' Superpowers
- Dealer Advocacy, From Sacramento to Washington, DC: An Interview with NADA President, Peter Welch
- NIADA Update
- California Privacy Act: How Stricter Privacy Rules in California will affect Dealerships Across America
- The Habits of Highly Effective Outside Counsel
- New Technology in Fraud Detection and Prevention – a case study
- Websites and Hand Controls: Recent ADA Title III Accessibility concerns for Dealerships
- Combatting Manufacturer Constructive Termination through a Buy-Sell Turn Down and a ROFR: Lessons from an Ohio BMW – MINI Case

Agenda topics are subject to change.



Hotel Reservations

The NADC room rate at the Ritz-Carlton, Chicago is $295.00 per night plus applicable taxes. **Reservations can be made online here**. You may also call the hotel's reservations line at 1-800-542-8680. Please reference the NADC Fall Conference to get our special rate.

All reservation requests will require a credit card and a deposit for one (1) room night. Deposits will be refunded for rooms cancelled more than seventy-two (72) hours prior to arrival.

Last day to officially book is Friday, October 4, 2019
(if the hotel room block does not sell out earlier)!

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We look forward to seeing you in Chicago!
Please contact Jennifer Polo-Sherk at jpolo-sherk@dealercounsel.com.

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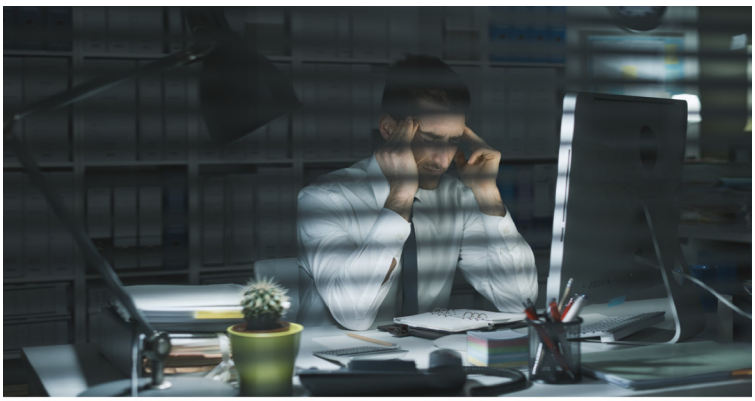

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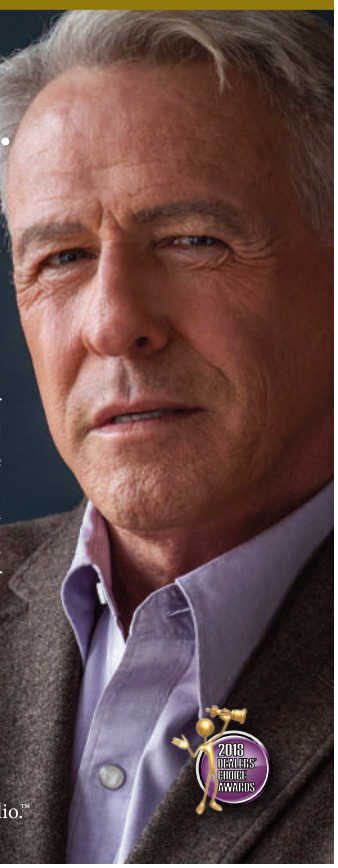

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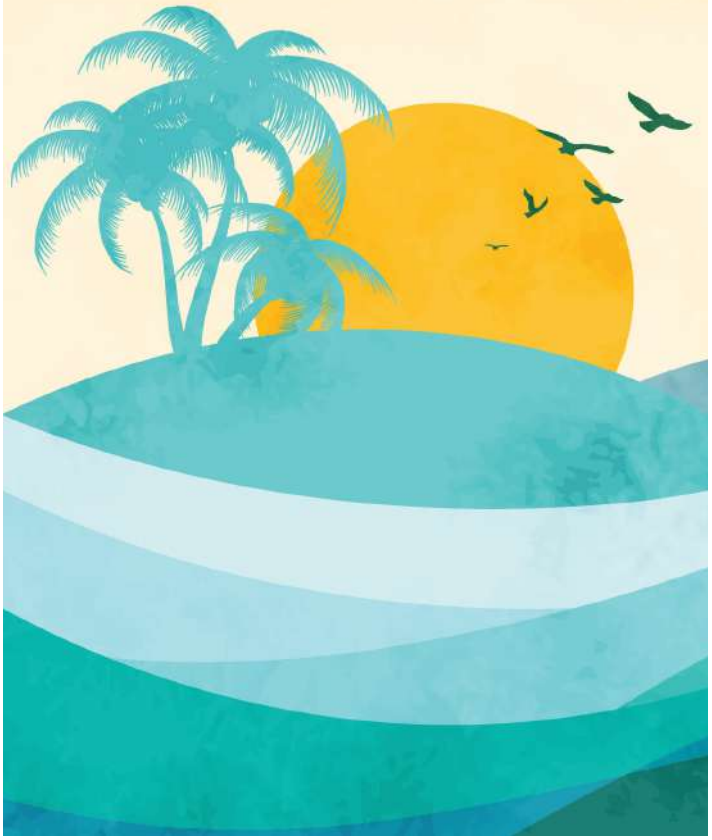

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NADC Member Announcements

Do you have an announcement or accomplishment that you would like to share with the NADC community? Please send any news that you would like to share to: jpolo-sherk@dealercounsel.com.

AI Applications and Data: What Franchise Attorneys Should Know Today

By Patrick L. Anderson
Principal and CEO, Anderson Economic Group LLC

The use of artificial intelligence once seemed like science fiction. In fact, what is now commonly called "AI" is already at work within nearly all vehicles sold in America.

What is more surprising is that automobile manufacturers and their vendors are *already* using AI methods on both automobile drivers and automobile dealers. Many dealers are also incorporating such methods into their business models. With growing legal scrutiny of AI data and methods, forward-looking industry executives need to take a close look at this topic. As we explain below, this due diligence may require asking some tough questions of vendors and manufacturers.

AI Is Much More than "Autonomous Vehicles"

Many industry participants are enamored with the prospect of autonomous vehicles. Our own research suggests the adoption of autonomous passenger vehicles is likely to be much slower than enthusiasts commonly predict.

At the same time, we observe that the adoption of AI technology within auto dealerships and manufacturers is occurring *much faster* than it is in other industries. It is this adoption *within the business*—not within the cars—that is the focus of this article.

This is probably the most important point to convey to automobile dealers: Even if you have never sold an autonomous vehicle, do not have a single robot working for you and need help getting your phone to sync with your car, *you are already in the AI business*.

AI Today Often Means Machine Learning on Customer Data

Today, we most commonly hear the term "AI" applied to describe computer science and statistical methods that are more appropriately called "machine learning." Statistical algorithms are applied in this category of techniques that include clustering, support vector machines, neural networks, and other exotic-sounding names. Machine learning typically involves putting algorithms to work on large amounts of customer and other data (a concept called "training") to arrive at a customer classification scheme. If this topic seems eerily familiar, it should. Auto dealers were among the first subjects of large-scale machine learning in the US economy.

Auto Dealers, CSI, and the Birth of Big Customer Data

By systematically tracking vehicles through VINs, matching customers to vehicles through registrations, and classifying auto buyers for targeted marketing, the auto industry was a pioneer in collecting big data on customers. Customer satisfaction surveys emerged from these practices, as did the "data portals" that some manufacturers now set up to communicate data with dealers.

With big customer data came the potential to use machine learning methods, and manufacturers began classifying customers and dealers decades ago. The data, metrics, and classification systems that produced terms like "CSI," "sales effectiveness," and "PMA" were early uses of technology now being rolled out across the entire economy. Of course, nobody called these techniques "AI" in the 1990s, but they were the forerunners of the data gathering and tracking that now occurs in many industries.

What Can Go Wrong with Machine Learning? Check Your CSI to Find Out!

Consumer sentiment indicators were a precursor to today's machine learning methods. For CSI, survey data were gathered from customers in a method originally designed to be neutral and near universal. A statistical classification scheme was applied to the response data, then an evaluation metric was applied to dealers. Based on this classified data, dealers were pronounced "good" or "bad" or "below average."

These steps—(1) gathering customer data (even if done irregularly); (2) coding data into categories that may or may not be accurate; (3) using a classification scheme based on hard-to-understand statistics; and (4) affixing labels like "good" and "bad" on these bases—are the same steps that occur in most machine learning applications.

Congratulations, auto dealers: You were the among the first to be AI test subjects! Anyone who understands how CSI scores can be tainted, biased, or bogus has a good start on understanding how fancier machine learning applications can go wrong.

Emerging AI Risk: Customer Data in the Vehicles

What is not yet widely known is that modern vehicles collect large amounts of data on customers, including their driving habits, whereabouts, and—with the Wi-Fi hotspot vehicles—potentially much more. Manufacturers use this data to more closely connect their vehicles to their customers, using everything from their customers' taste in music to their seemingly insatiable desire to communicate with others while in their cars.

Who has custody of these data-agglomerating machines? Periodically, the auto dealers do. Meanwhile, auto manufacturers and the vendors they employ gain more of that information. There will be uncomfortable questions about the use of these data. One set of such questions is discussed next.

Management Duties Regarding Data and AI Applications

Auto dealers, like managers in other firms, have a duty to understand what their workers are doing, and to ensure they are properly supervised. Part of that supervision is the establishment of policies regarding customer data and decisions involving those customers, including how they are selected for targeted marketing, whether they get different pricing or financing terms, and what services are offered to them.

Perhaps without the dealer's knowledge, some of those decisions are now being made by algorithms that operate on their customer's data. In some cases, algorithms are applied by vendors (*e.g.*, marketing consultants). In other cases, it is done by manufacturers or the vendors they select, or it may be done by lenders.

In a recent special report, Anderson Economic Group identifies laws that establish management duties regarding data and algorithms within the United States and Europe. We note that the adoption of the General Data Protection Regulation (GDPR) places Europe ahead of the US in requiring, among other things, a "meaningful explanation" of the data and algorithms used to classify or underwrite a customer. We expect tougher US laws to arrive soon—and note that existing laws already establish the basis for large damages awards against businesses that recklessly employ AI methods on customer data.

Potential Damages from Misuse of Data and Algorithms

In the special report, my colleague Kenan Cosguner and I estimate direct damages that can result from violation of current US laws. Depending on the degree of complicity, damages from management ignorance of customer data usage in these applications can easily range into the tens of millions of dollars.

With the growing legal scrutiny regarding these decisions, it is important that dealers and their attorneys start asking pointed questions regarding the use of customer data and the classification, targeting, and underwriting decisions being made with that data.

One Step You Can Take Now: An "AI Data and Algorithm Audit"

The previously mentioned special report describes an audit process to inspect these applications. Such an audit can reveal both acceptable and unacceptable data uses. The same report documents how, in some cases, other methods are superior to machine learning procedures commonly employed on customer data, and do not pose the same risks.

Dealers and their advisors should pay close attention to the issues identified here. You may wish to have a consulting firm like ours perform the steps identified in Figure 1. However, you can start by asking the five questions outlined here when you are asked to share your customer data with a vendor or a franchisor.

Remember, you are already in the AI business. Do not get caught unaware of the risks that come with it. ■

The AI Audit

One step you can take to get ahead of the risk is to commission an "AI audit" that will answer these five questions:

1	What data are collected and used by the application?
2	How are the data used? What classification, scoring, underwriting, clustering, or other machine learning algorithm is employed?
3	Can a skilled person replicate the results the algorithm produces for specific cases?
4	Has management been properly informed of the data and uses?
5	Does the use of the data conform to standards that are acceptable to management?

Figure 1: The AI Audit
Source: Anderson Economic Group, 2019 Special Report Part I - *Damages Caused by AI Errors and Omissions: Management Complicity, Malware, and Misuse of Data*

Patrick L. Anderson is the principal & CEO of Anderson Economic Group LLC, a business consulting firm specializing in the automobile industry. Founded in 1996, the company serves auto dealers, dealership groups, suppliers, and trade associations across the United States.

Mr. Anderson's article "Business strategy and firm location decisions: testing traditional and modern methods" was published in the January 2019 issue of the journal Business Economics*, and won the 2018 Mennis award for best contributed article from the National Association for Business Economics.*

This special column for the Defender contains insights from that article and from a recent special report on damages from AI errors and omissions, now available from the company's website: AndersonEconomicGroup.com.

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