RESTRUCTURING A FRANCHISE IN CRISIS: COURT DISMISSES FORMER DEALERS' CLASS ACTION AGAINST GENERAL MOTORS

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The Ontario Superior Court recently released its decision in *Trillium Motor World Ltd. v. General Motors of Canada Limited*,[1] a class action brought on behalf of approximately 200 General Motors dealers that had been eliminated in 2009 when General Motors of Canada Limited ("GMCL") downsized its dealer network in an effort to remain viable. The dealers alleged that in so doing GMCL breached its obligations to them under common law and provincial franchise legislation. The dealers also claimed that Cassels Brock & Blackwell LLP ("Cassels"), who advised some of the class members regarding the restructuring but who failed to disclose that it also acted for the Canadian Government in relation to GMCL's potential insolvency, breached its duties to them and was in a conflict of interest.

While the Court allowed the claim against Cassels (ordering it to pay $45 million in damages for breach of contract, breach of fiduciary duties and negligence), it ultimately dismissed the claim against GMCL, finding that it had not breached its common law or statutory obligations to its former dealers. This bulletin will focus on the franchise-related implications of the case. While *Trillium Motor* will likely be appealed, the decision reaffirms several previous franchise law rulings and provides some insight into how courts will assess franchisors' obligations when the franchise is in crisis.

The Facts

In 2009, GMCL's share of the Canadian auto market had been in decline for years. GMCL also had a problem with "over-dealering" – too many dealers operating in single markets – which reduced dealer profitability and made dealers reluctant to invest in their facilities and staff. The 2008 financial crisis brought these structural weaknesses at GMCL to the fore.

By the Spring of 2009, GMCL was teetering on the edge of insolvency and it was clear that the company would not survive without government assistance. In order to receive bailout funds from the Canadian and Ontario governments and avoid a *Companies Creditors' Arrangement Act* ("CCAA") filing, GMCL drastically reduced the size of its dealer network. On May 20, 2009 – eleven days before it was scheduled to file under the CCAA – GMCL informed 240 of its 705 dealers in Canada that it would not be renewing their dealership contracts (known as

the "Dealer Sales and Services Agreement", or "DSSA") in October 2010. At the same time, GMCL offered these dealers a wind-down agreement ("WDA"). As part of the WDA, GMCL offered to make a series of payments to each dealer in exchange for the dealer voluntarily terminating its DSSA and releasing GMCL from all claims. The dealers were only given six days to accept the WDA, or risk getting nothing for their businesses.

GMCL had initially indicated that the wind-down offers were conditional on all 240 dealers accepting the WDAs, although GMCL reserved the right to waive this condition. By the end of May, a total of 202 dealers had accepted the offer. GMCL waived the acceptance threshold and proceeded to pay the terminated dealers pursuant to the terms of the WDAs, and these dealers wound down their operations.

Trillium Motor World Ltd. ("Trillium"), one of the dealers that wound down, later brought a class action against GMCL on behalf of all of the Canadian dealers who had signed WDAs. Trillium claimed that GMCL had breached its obligations to these dealers under both common law and provincial franchise legislation across the country, including the *Arthur Wishart Act (Franchise Disclosure), 2000* (the "*Wishart Act*"). GMCL counterclaimed against the class members on the basis that the class members had breached their obligations under the WDA by commencing and/or failing to opt out of the class action.

The Decision And Its Implications

At the opening of the trial, plaintiffs' counsel asked, rhetorically, how could GMCL accomplish its massive dealer restructuring "in [only] six days without running afoul of the *Wishart Act*"? Following the 41-day trial, the Court's answer to this question was a dismissal of Trillium's claims against GMCL.

The Court noted that although the exceptional circumstances of this case (being the dire financial situation facing GMCL) do not negate the legal duties GMCL owe its dealers, it observed that "those duties must take their colour from that context".[2] In finding that GMCL had not breached any of its obligations owed to the dealers at common law or under the *Wishart Act*, the Court did not make much in the way of new law. Indeed, the Court was not even required to make a finding that franchise legislation applies to the relationship between automotive manufacturers and their dealers – as GMCL admitted that it did for the purposes of trial. Rather, the Court applied prior decisions on several franchise-related issues to the unique circumstances of this case. Noting that GMCL made important business decisions "very quickly during a time of instability and flux", the Court reviewed GMCL's conduct through the lens of "commercial reality".[3]

The key franchise law-related takeaways from the *Trillium Motor* decision are summarized below.

1. *Applicability of the Wishart Act to Franchisees Outside of Ontario*

The Court held that the *Wishart Act* applied to all the class members regardless of their location, including those in provinces with no franchise statutes and those in provinces having their own franchise legislation, like

Alberta and PEI. The DSSA and WDA both contained provisions stipulating that Ontario law governs. Following its earlier decision in 405341 *Ontario Limited v. Midas Canada*,[4] the Court held the relationship between GMCL and all of its dealers was therefore governed by the *Wishart Act*.[5] The Court rejected GMCL's argument that franchise legislation in other provinces effectively ousted the governing law clause.[6]

2. The Common Law Duty of Good Faith and the Statutory Duty of Fair Dealing

The Court made the following findings regarding the common law duty of good faith and the statutory duty of fair dealing (as contained in s. 3 of the *Wishart Act*):

- As a preliminary point, the Court rejected Trillium's argument that the *Wishart Act*'s duty of fair dealing is broader than the common law duty of good faith – noting that, for all practical purposes, they give rise to the same obligations in the franchise context;[7]
- Relying on *Fairview Donut Inc. v. TDL Group Corp.*,[8] the Court held that the content of the duty of good faith and fair dealing under s. 3 of the *Wishart Act* includes the following:

a. franchisors must exercise powers under the franchise agreement in good faith and with due regard to the interests of franchisees;
b. franchisors must observe standards of honesty, fairness and reasonableness;
c. franchisors must not act in a way that eviscerates or defeats the objectives of franchise agreements;
d. the parties may not substantially nullify the bargained objective or benefit contracted for by the other, contrary to the expectations of the parties; and
e. when exercising a discretionary power, the franchisor must do so reasonably and with proper motive, and may not do so arbitrarily, capriciously or in a manner not consistent with the reasonable expectations of the parties;[9]

- Notwithstanding the Supreme Court of Canada's decision in *Bhasin v. Hrynew*,[10] the Court held that the fair dealing requirement in s. 3 of the *Wishart Act* may very well give rise to an obligation requiring franchisors to disclose important and material facts in addition to the disclosure regime mandated by s. 5(1) of the legislation (but on the facts, and as noted below, the Court held GMCL did not breach any such duty);[11] and
- As noted above, the duty of fair dealing is context-specific. The Court must examine the conduct of franchisors, and assess whether they complied with the duty of good faith and fair dealing, in light of the factual circumstances at play in any given case.[12]

In the rather exceptional and unusual circumstances present in this case, the Court found that GMCL had not violated any aspect of the duty of fair dealing. In particular, the Court held that GMCL did not breach the duty

of fair dealing:

- by requiring dealers to accept the WDA on only six days' notice (the Court found, among other things, that more notice was not practical given the time pressures GMCL was facing and the fact that it was reacting to a worsening economic landscape as well as demands from the Canadian and U.S. governments);[13]
- by not disclosing to its dealers the identities of those who had been offered a WDA (viewing the circumstances objectively, the Court found that it would have been unreasonable for GMCL to have done so);[14] and
- by stating in the WDA that GMCL would not be renewing the DSSAs when their current terms expired. The plaintiffs alleged that GMCL breached its duty of fair dealing because the DSSAs were "evergreen" (auto-renewing) agreements and GMCL accordingly knew it did not have a unilateral right of non-renewal. The Court, however, noted that the DSSA Standard Provisions contain language permitting GMCL to control the number, size and location of its dealer network. The Court held that GMCL did not exercise this power arbitrarily, recognizing that GMCL was in a position where dealers had to be cut in order to obtain government funding so the company could survive.[15]

3. Does the Duty of Fair Dealing Require Disclosure of Material Facts?

The Court rejected Trillium's claim that s. 3 of the *Wishart Act* imposed a duty on GMCL to provide complete, fair and accurate information regarding its restructuring and the WDAs to its dealers when it solicited the WDAs. The Court found that the duty to disclose important and material facts as an incidence of the duty of fair dealing under s. 3 of the *Wishart Act* did not extend so far as to require GMCL to keep the dealers abreast of every development or share every detail of its restructuring plan on an ongoing basis. The duty to disclose is contextual and governed by what is reasonable in the circumstances. The Court held that, among other things, GMCL did not mislead its dealers and acted honestly and reasonably by waiting until the details of its restructuring plan had been finalized before informing the dealers.[16]

4. A Disclosure Document Is Not Required by an Agreement to Terminate a Franchise Agreement

In addition to asserting that the duty of fair dealing required GMCL to disclose material facts to dealers before asking them to sign WDAs, the plaintiffs also alleged that GMCL was required by s. 5(1) of the *Wishart Act* to deliver a disclosure document to all class members at least 14 days before they signed the WDAs. The Court disagreed for two reasons.

First, the Court held that the WDA is not a "franchise agreement or any other agreement related to the franchise" for the purposes of s. 5(1) of the *Wishart Act*. Relying on an earlier decision, the Court affirmed that a

disclosure document must be delivered under s. 5(1) before a person signs a franchise agreement or any ancillary agreements that transform the person into a franchisee. The WDA, however, did just the opposite.[17]

Second, the Court noted that the *Wishart Act* distinguishes between "prospective franchisees" and "franchisees". Only "prospective franchisees" are entitled to receive a disclosure document under s. 5(1) (so that they have sufficient information to make the decision about whether to invest in the franchise opportunity). Because the dealers who signed the WDA were already "franchisees", no disclosure document was owed to them in connection with the WDA.[18]

5. Franchisees' Right of Association Does Not Impose Positive Obligations on Franchisors

The Court rejected Trillium's claim that s. 4 of the *Wishart Act* – which grants franchisees the right to associate – imposed a positive obligation on GMCL to facilitate association between the franchisees. The Court held that s. 4 prevents franchisors from restricting, prohibiting or interfering with franchisees associating with other franchisees, but it does not require franchisors to facilitate or encourage association among their franchisees.[19] As such, GMCL was not under an obligation to, among other things, disclose to the class members the identities of the dealers that had been offered a WDA.[20]

6. A Franchisee's Rights can be Released as part of a Settlement

The WDAs included provisions that released GMCL from all claims, including any statutory rights afforded to dealers under franchise legislation. The plaintiffs alleged that the release was void and unenforceable by virtue of s. 11 of the *Wishart Act*, which makes any waiver or release by a franchisee of any rights conferred by the legislation void. The Court rejected this claim, once again by reference to earlier franchise decisions. Relying in particular on *1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC*,[21] the Court held that s. 11 of the *Wishart Act* does not apply to a release given by a franchisee with the advice of counsel in settlement of a dispute for existing and fully known breaches of the *Wishart Act*.[22]

7. Franchisors Cannot Preclude Class Actions

The WDAs also prohibited dealers from bringing any proceedings against GMCL, including class actions, relating to the released claims. GMCL counterclaimed against the class members for breaching this provision. The Court dismissed GMCL's counterclaim for two reasons. First, although the Court held that the release contained in the WDAs was generally enforceable, it concluded that the prohibition against dealers bringing a class action violated the dealers' right to associate under s. 4 of the *Wishart Act*. Second, the Court held that this provision is void for public policy reasons, due to the advantages of class proceedings and their importance in Canadian society. The Court therefore held that the Release was void to the extent that it denied former dealers the right to bring an action against GMCL collectively.[23]

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[1] 2015 ONSC 3824 ("*Trillium Motor*"), decision released on July 8, 2015.

[2] *Trillium Motor, supra*, at para. 116.

[3] *Ibid.*, at para. 163.

[4] (2009), 64 B.L.R. (4th) 251 (Ont. S.C.), aff'd by 2010 (ONCA) 478 (Ont. C.A.).

[5] *Trillium Motor, supra*, at paras. 127-130.

[6] *Ibid.*, at paras. 134-139.

[7] *Ibid.*, at paras. 145-153.

[8] 2012 ONSC 1252, aff'd by 2012 ONCA 867.

[9] *Trillium Motor, supra*, at paras. 154-157 and 163.

[10] *2014 SCC 71* (in which the Supreme Court of Canada held that the common law duty of good faith does not give rise to a positive duty to disclose).

[11] *Trillium Motor, supra*, at paras. 158-162.

[12] *Ibid.*, at para. 163.

[13] *Ibid.*, at paras. 164-196.

[14] *Ibid.*, at paras. 197-204.

[15] *Ibid.*, at paras. 205-214.

[16] *Ibid.*, at paras. 236-269.

[17] *Ibid.*, at paras. 329-338.

[18] *Ibid.*, at paras. 339-342.

[19] *Ibid.*, at paras. 270-292.

[20] *Ibid.*, at para. 284.

[21] 2006 CanLII 25276 (Ont. S.C.).

[22] *Trillium Motor, supra*, at paras. 293-328.

[23] *Ibid.*, at paras. 351-355.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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