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The International Scene

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Canadian Court Rules in Favor of GM Canada over Dealers

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The recent case of *Trillium Motor World v. General Motors of Canada, et al.*[2] provides a cautionary tale about the perils of an insolvent company reaching settlements with its key stakeholders outside a court-supervised insolvency proceeding. General Motors Corp. (GM) reorganized its business through a chapter 11 filing on June 1, 2009, and a § 363 sale of its assets to a new entity (New GM) shortly thereafter. It was intended that New GM would emerge without the financial burdens that plagued the previous GM. Although New GM has been successful since its acquisition of the GM assets, it has not been able to ignore tort- and recall-related claims for the period prior to GM's bankruptcy filing. Well after implementation of the court-approved restructuring plan, battles have been fought on many fronts and in various jurisdictions.

GM's subsidiaries were not all cleansed by the chapter 11 filing. For example, the strategy adopted by GM Canada Ltd. was to effect an out-of-court restructuring with the same ultimate objective as GM: address the major obligations, and pave a path toward profitability. Like GM, at the time that the restructuring was completed, GM Canada was hopeful that it would be able to focus solely on its future. However, that has not been the case for either entity.

Shortly after completing an out-of-court restructuring with its three main stakeholders (the union, bondholders and its dealers), GM Canada faced a class-action lawsuit from the dealers that were eliminated from its network and with whom it had reached wind-down agreements. Under the terms of these agreements, the terminated dealers agreed to wind down their operations and provide GM Canada releases from all claims in return for payments meant to compensate them in part for the loss of their dealerships.

Recently, Mr. Justice McEwen of the Ontario Superior Court of Justice rendered a decision in favor of GM Canada. In his decision, Mr. Justice McEwen recognized that GM Canada was required to restructure its operations, including by reducing the size of its dealer network, as a condition of obtaining government financing. He put the matter into context with the following introduction:

> At the height of the global financial crisis, an imperilled [GM Canada] executed a plan devised to reduce its large dealership network. Dangerously close to the edge of insolvency, [GM Canada] hoped that the plan, together with other measures, would satisfy the demands of the Federal and Provincial Governments (the "Canadian Governments"), secure long-term government funding, and allow the company to avoid seeking creditor protection under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("CCAA").[3]

Over a 41-day trial, Mr. Justice McEwen heard from five separate law firms and 25 witnesses, including eight expert witnesses, on contract, franchise and insolvency law with respect to issues raised by the terminated dealers.

Background

GM Canada was a wholly owned subsidiary of GM (and is now a wholly owned subsidiary of New GM). Its operations were inextricably intertwined with GM. GM Canada had manufacturing facilities in Canada. Approximately 90 percent of its production was sold into the U.S. through GM,

1 Mr. Harlang was engaged by GM Canada as an expert witness and testified at the trial. The authors acknowledge Sean Campbell of Davies Ward Phillips & Vineberg LLP for his contributions to this article.

2 *Trillium Motor World Ltd. v. General Motors of Canada Ltd.*, 2015 ONSC 3824 (CanLII), *available at* canlii.ca/t/gk0p7.

3 *Id.*

and approximately 90 percent of GM vehicles sold in Canada were procured from GM.

Similar to GM, in 2009, GM Canada's survival was dependent on government funding. Permanent government funding was conditioned on, among other things, GM and GM Canada developing a restructuring plan that would ensure the future viability of GM's business. The restructuring plans developed by GM and GM Canada evolved during the first half of 2009. In late April 2009, the restructuring plans for both GM and GM Canada was acceptable to the U.S. and Canadian governments and included (1) lowering labor costs, (2) compromising the claims of bondholders and (3) reducing the numbers of dealers in its dealer network.

Unlike GM, which effected its restructuring through a chapter 11 filing (and a § 363 sale) with the support of the U.S. government, GM Canada reached agreements with its key stakeholders, including its dealers, outside of a formal insolvency proceeding. GM Canada had until June 1, 2009 (the date of GM's chapter 11 filing), to finalize settlements with its labor force, bondholders and terminated dealers. Although GM Canada made extensive preparations for an insolvency filing in the period leading up to June 1, 2009, its preference and the preference of the federal and provincial governments was to effect the restructuring through negotiated, out-of-court agreements in order to avoid the risks and costs associated with an insolvency filing.

GM Canada determined that it would terminate 240 dealership agreements (approximately 34 percent) as part of its restructuring plan. As compensation for the termination of the dealerships and to prevent a disorderly liquidation of the terminated dealers' new vehicle inventory, GM Canada entered into a wind-down agreement (WDA) with each terminated dealer. The WDA's essential elements included that each terminated dealer would (1) cease being a GM Canada dealership by Dec. 31, 2009, (2) wind down its business in an orderly fashion, (3) receive compensation for the orderly wind down of its business, and (4) provide a broad release with respect to any claim that it might have against GM Canada. Given the pace of the restructuring, the dealers had six days to consider the WDAs.

Out of the 240 dealerships that GM Canada sought to terminate, 202 accepted the terms pursuant to the WDA and shared approximately $125 million in wind-down payments. In the event that it had not reached an agreement with the terminated dealers, GM Canada advised that it would have commenced an insolvency proceeding and attempted to strand the claims of the terminated dealers for the loss of their dealerships in the old GM Canada entity. By the early morning of June 1, 2009, GM Canada had finalized settlements with its labor force, the bondholders and a sufficient number of terminated dealers to avert a formal insolvency proceeding.

Class-Action Lawsuit Against GM Canada

Despite having signed the WDAs, which included the release, the terminated dealers launched a class-action lawsuit against GM Canada to set aside the WDAs, including the release, and for damages of $575 million. In addition to their claim against GM Canada, the terminated dealers also sued a law firm, alleging that it, among other things, acted negligently. This article deals only with the GM Canada portion of the lawsuit. The basis for the lawsuit included the following:

1. The terminated dealers were not bound by the WDA, including the release, because GM Canada breached its obligations under franchise legislation;
2. If the terminated dealers were properly advised by the defendant law firm, they could have acted collectively to negotiate higher wind-down payments that GM Canada could have agreed to pay to avoid a bankruptcy filing; and
3. The terminated dealers were not given sufficient time to decide whether to accept the WDA.

The lawsuit hinged to a great extent on franchise legislation and whether, under the legislation, GM Canada breached its duties of fair dealing and good faith toward the terminated dealers. A key element to understanding the content of those duties was the financial circumstances that GM and GM Canada found themselves in during 2009 and the global financial crisis of 2008 and 2009. Among the facts that were established at the trial were the following:

1. GM Canada was insolvent;
2. GM Canada's future was dependent on the financing provided by the Canadian governments;
3. In order to obtain additional financing from the Canadian governments, GM Canada had to reduce its dealership network to a size commensurate with its market share, as well as obtain labor concessions and compromise the amount due to its bondholders; and
4. In the event that GM Canada restructured under a filing (in a manner similar to GM's chapter 11 filing and § 363 sale), the terminated dealers would have received little or no recovery on their claims and would have had no recourse against the new GM Canada entity that would have emerged from an insolvency proceeding.

Decision

Following the trial, Mr. Justice McEwen determined that GM Canada did not breach its obligations under the relevant franchise legislation. Therefore, the WDAs, including the releases, were valid and enforceable. In arriving at his decision, Mr. Justice McEwen found, among other things, that

(1) The six (6) day period afforded the Non-Retained Dealers to decide whether to accept the WDA was "reasonable, given the commercial reality of the circumstances" and that not extending the deadline by a few days did not constitute a breach of GM Canada's obligation of fair dealing;

(2) Though it may not have been ideal, "given the exceptional beggars-of-government-cannot-be-choosers circumstances facing GM Canada and the dealers, the opportunity they had to make a decision was fair enough" with respect to the plaintiff's assertion that the dealers were denied a fair opportunity to protect their interests;

(3) Despite the preference of GM Canada and the Canadian government to complete an informal restructuring, a CCAA filing was a real possibility throughout April and May 2009; and

(4) GM Canada was ready, willing and able to make a CCAA filing and it was considered probable in the latter part of May 2009, unless it could resolve its financial challenges in a cost-effective way.[4]

The terminated dealers have appealed the decision.

Conclusion

With the global recession behind us, it is easy to forget how close the world came to economic collapse just seven years ago. GM and GM Canada developed similar operational and financial restructuring plans (reduced labor costs, rationalized dealer network and product lines and compromised bondholder claims), albeit with GM implementing its restructuring plan through a court-supervised process and GM Canada implementing its restructuring plan through out-of-court settlements. Interestingly, one of the primary considerations for selecting an in-court vs. out-of-court route is the certainty and finality of the process. In this instance, both routes yielded some uncertainty.

Had GM Canada known that the terminated dealers would seek to unwind the WDAs, including the releases that they had provided to GM Canada, GM Canada would likely have made an insolvency filing. Such a filing would have brought finality to GM Canada's restructuring efforts in a way that the out-of-court agreements with its dealers did not.

At the time, with the support of the U.S. and Canadian governments, the entities likely thought that they left behind their past sins and only needed to focus on operating profitably. For the time being, GM Canada can drive forward without looking in its rear-view mirror. abi

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4 *Id.*