

# Keep your distance!

## NAVIGATING NEW DEALER POINTS AND RELOCATED DEALERSHIPS

As automotive dealers know all too well, the cost of establishing a new dealership is substantial. The showroom and service area must be constructed, the land must be developed, costly tools and machinery must be purchased, and an initial inventory of vehicles must be acquired. This is in addition to a host of additional costs associated with start-up, including conducting business due diligence, hiring professional advisors, and advertising expenses.

At the same time, manufacturers are under constant pressure to remain relevant in a hyper-competitive automotive market environment. In order to ensure that customers are adequately serviced, manufacturers are constantly re-evaluating key markets to ensure that an adequate number of image-compliant dealerships are available to meet customer needs and expectations. This constant tension between providing the best available standard of service to customers, while ensuring that individual dealerships are able to recoup their substantial investment, is an ongoing concern for dealers and manufacturers alike. Understanding whether the establishment of new dealer points or the relocation of existing dealerships is within the powers of the manufacturer, or otherwise an encroachment on the market area of a dealership, requires a careful consideration of the unique circumstances facing the existing dealership.

### What is encroachment?

Put simply, encroachment occurs when a new automotive dealer point is established or an existing dealership is relocated in closer proximity to another existing dealership. This may occur in response to demographic or socioeconomic changes in a market area which has made the establishment of a new dealership point viable, or when an existing dealer has found better premises within its market area to relocate its dealership. Not surprisingly, the establishment of new or relocated nearby dealerships can quickly put existing dealers and their manufacturer into conflict.

Manufacturers will almost always include broad provisions in their dealership agreement reserving their right to manage the overall dealer network, including by establishing new dealer points or relocating existing dealerships. In addition to the terms of the dealership agreement, however, dealers and manufacturers alike should be mindful that a manufacturer's ability to establish nearby dealerships is also affected by a variety of other requirements and considerations, including the guidelines set out in National Automobile Dealer Arbitration Program (NADAP), if applicable, and the obligation that manufacturers deal with their dealers in good faith.

### The National Automobile Dealer Arbitration Program (NADAP)

If the manufacturer and dealers have opted into NADAP, the manufacturer must consider the NADAP rules when considering its right to establish a new dealer point or relocate an existing dealership. Under Rule 6 of the NADAP rules, the manufacturer has the right to determine the size and structure of its dealer body and to create new dealer points, relocate dealerships, appoint new dealers, and fill existing dealer points. The manufacturer is obligated, however, to provide notice to an existing dealership of its intention to create a new dealer point or relocate an existing dealership. Generally, in metropolitan markets, an existing dealer that sells identical vehicle brands as those of the proposed new dealer point or relocated dealership may challenge a new dealership that is established or relocated within 8 km of the existing dealer (20 km for non-metropolitan markets).

If these distance requirements are not offended, an existing dealer cannot bring its NADAP challenge. However, the distance requirements are not an absolute rule. If the new dealer point or relocating dealership offends the distance requirements, the



existing dealer must still prove that it is more likely than not that it will suffer a significant loss of sales and profits as a result of the new dealer point or relocated dealership. When considering whether encroachment has occurred, the arbitrator must balance the dealer's alleged significant loss of sales and profits with the interests of the manufacturer in creating the new dealership or relocating the existing dealership, as well as the collective interests of the manufacturer and all of its dealers, and the interests of the customers of those dealerships.

### The manufacturers' Duty of Good Faith

Separate and apart from any NADAP rules regarding relocation, pursuant to Canadian law, automotive manufacturers are required to exercise the powers granted to them by a dealership agreement honestly, fairly, and in good faith. Considering that a power imbalance may exist between a local dealership, on the one hand, and an automobile manufacturer on the other, courts are keenly focused on ensuring that neither party, through its conduct, can defeat the very purpose they entered into business together in the first place.

On multiple occasions, the courts have been called upon by aggrieved dealers to rule on whether a manufacturer, through its establishment of a new or relocated dealership, is encroaching upon the territory of an existing dealer, which will, ultimately, harm the existing dealer's profitability. The courts' analysis in these cases have provided us two key insights into how such claims will be dealt with.

Firstly, the courts have confirmed that, even if a manufacturer reserves itself broad powers under its dealership agreement, this does not mean it can act without consideration of the interests of existing dealers. Although manufacturers are not required to prioritize the interests of an individual dealership over its own interests or those of the dealership system generally, they are required to consider the interests of that individual dealership when the manufacturer's decision could have an adverse impact upon it. Manufacturers are well-advised to ensure that prior to taking any such action, proper consultation and studies are conducted to fully consider the impact on existing dealers.

Moreover, the courts have stressed that each situation involving dealership encroachment is different, and the existing dealer will need to provide substantive evidence that the establishment of a new dealer point or relocated dealership will harm its fi-

nancial interests before a court will intervene. Dealers challenging the encroachment of a new or relocated dealership should be prepared to provide meaningful evidence that the new or relocated dealership will have a significant impact on its business, including relevant consumer data, customer records, business and market reports, and expert evidence. Conversely, manufacturers should be prepared to prove that they have undertaken their own business and market research, and can demonstrate that their decision will not have a substantial effect on the profitability of the existing dealership and not substantially prejudicial to the dealership in question.

### Conclusion

When a dealer is granted an exclusive selling territory or a designated market area, it has a reasonable expectation that the manufacturer will not encroach on its territory. Manufacturers are under an obligation to treat their dealers fairly, and exercise the powers they have reserved for themselves under the dealership agreement in such a manner so as to not unfairly disadvantage their dealers. At the end of the day, a well planned dealership network not only meets the needs of the marketplace, but it provides its dealers with a favourable environment in which to obtain a reasonable return on their investment. **AWM**



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