Can a dealership unilaterally close its doors during a pandemic?

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On March 23, 2020, the Ontario Government deemed dealerships as "essential workplaces", permitting them to stay open during the COVID-19 pandemic. While the Government announcement allows dealerships to remain open during the crisis, it does not mandate that dealerships stay open. In fact, a variety of businesses that have been classified as essential workplaces by the Government have nevertheless temporarily shut down operations out of health and safety concerns to the public and employees and as a result of financial considerations.

The issue for dealerships is whether, because of these challenging business conditions, they would have the right to temporarily cease operations without the express written approval of the manufacturer. However, prior to shutting its doors, a dealer must make sure that it is not running offside the terms of its dealer agreement. Under most dealer agreements, it is a material default for the dealership to cease operations for a period of time, typically seven to 14 days, unless performance is rendered impossible. If a dealership ceases operations for this length of time, a manufacturer may be entitled under the dealer agreement to immediately terminate the dealer agreement (and ultimately, the dealership's ability to sell the manufacturer's vehicles and parts) without notice to cure. As such, if a dealer unilaterally elects to shut its doors because of the COVID-19 pandemic, then a manufacturer could potentially terminate the dealer agreement under the strict terms of the dealer agreement.

Before taking any steps to cease operations, a dealer should consider whether its dealer agreement contains a "force majeure" clause that permits it to temporarily cease operations. While some manufacturer dealer agreements contain force majeure clauses, not all do – dealer agreements should be reviewed on a case-by-case basis to consider whether one is present and if so, is it applicable to the situation at hand. The Supreme Court of Canada has described a force majeure clause as follows: "[a] force majeure clause…generally operates to discharge a contracting party when a supervening, sometimes supernatural, event, beyond control of either party, makes performance impossible."

Given the fact that the Government has permitted dealerships to remain open, it is unlikely that a broadly worded force majeure provision would relieve a dealer from operating because operations, while challenging and potentially not even profitable, have not been rendered impossible. As such, in order to constitute a force majeure, it is likely that the clause would have to expressly refer to a pandemic of the nature we are currently experiencing in order to excuse the dealer from performance under its dealership agreement. Financial difficulties in operating the dealership would typically not be considered a force majeure. However, if the Government goes a step further and mandates the closure of dealerships, then a broadly worded force majeure provision would likely apply since operation of the dealership has been rendered impossible.

Rather than relying on its strict legal rights, if a dealer is considering temporarily ceasing operations or fundamentally changing the nature of its operations by, for example, moving to online sales only and closing the showroom, it is best to engage the manufacturer at an early stage and before any decisions are made. The dealer should have a frank and open dialogue with the manufacturer of why operating the dealership in the traditional manner is imposing too much of a hardship on the dealer and why temporarily ceasing operations would be the right thing to do in the circumstances, both from a financial perspective, and a health and wellness perspective. This is a difficult period for both dealers and manufacturers and so there is incentive on both sides to reach a mutual satisfactory arrangement and to compromise so long as both sides are acting reasonably. If a temporary cessation is possible, the dealer and manufacturer should try to agree on the timelines and a plan going forward of when the dealership will fully re-open for business. Any temporary cessation of operations agreed to by the dealer and manufacturer should be confirmed by the manufacturer in writing.

It is important to remember that a manufacturer has an obligation to exercise its rights under the dealer agreement in good faith and in accordance with its duty of fair dealing. Courts have generally evaluated this duty with consideration to the surrounding context facing the parties. If a manufacturer is enforcing the dealer agreement in a heavy-handed manner in light of the business environment facing dealers at the present time, then arguably it is in breach of its duty of fair dealing. Forcing a dealership to remain open in light of COVID-19, and threatening termination, could run afoul of the manufacturer's duties of good faith and fair dealing to the dealers.

If a manufacturer does take steps to terminate, the National Automobile Dealer Arbitration Program (NADAP) rules may provide some protections to the dealer. Firstly, under NADAP, a termination of the dealer agreement is an arbitrable matter. Secondly, any termination is enjoined or paused while the merits of the termination are decided by the arbitrator. As such, provided the dealer files a timely NADAP proceeding, it can stop the termination coming into effect until there is a decision from an arbitrator on the merits of the termination.

In closing, if a dealership is considering temporarily ceasing operations as a result of the COVID-19 pandemic, it is best to notify the manufacturer in advance and obtain written authorization from the manufacturer. Given the current business climate, many manufacturers have already granted such requests, and we would expect most, if not all, to follow suit. If a manufacturer refuses, a dealership must know its legal rights before proceeding unilaterally. CAW

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