



## Key legal and business issues facing the automotive industry

As a number of factors continue to disrupt and transform the automotive industry, such as the COVID-19 pandemic and the introduction of new technology and international trade agreements, BLG's cross-practice team of advisors and advocates have identified key legal and business issues for automotive leaders to keep top-of-mind. **Click/tap the icons below to read more.**



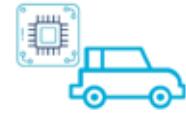
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# Continued disruption to the auto dealer retail model

Despite the past year's challenging economic environment, the auto dealer business has been remarkably resilient. However, dealers have been operating in an increasingly disrupted environment; resulting in the need for dealers to review their own operating models and discover new ways to serve their customers in an increasingly online retail environment. This includes the re-evaluation of all aspects of their business, including:



Adapting to evolving technology trends;



Mergers and acquisitions as a strategic tool; and



An examination of the dealer footprint.

## Adapting to evolving technology trends

The onset of the COVID-19 pandemic and related restrictions has accelerated the trend towards technology and digitalization across all retail sectors. The shift to the digital space has led to an evolution from the traditional "brick and mortar" model of the OEM dealer network to a "bricks-and-clicks" structure.

Our expectation is that the difference between buying a car inside or outside a showroom will continue to blur due to increased digital functionality within showrooms. Customer demands for contactless transactions will also determine the level of investment by dealers on their online sales platforms. While opinions diverge as to whether technology will serve to generate leads or provide solely online retailing, it is clear dealers recognize the importance

of emerging technologies in the car buying process. Along with enhanced CRM programs and new technologies to enhance contactless service appointments, this will likely have one result: auto dealers who are not proficient adapters of emerging technologies will not remain competitive.

Similarly, an increase in online activity may decrease the importance of dealer marketing territories, drive greater fluidity among traditional marketing tactics and factor into OEM geographic placement of dealerships under the NADAP Rules.

To the extent OEMs continue to use customer-facing sales platforms, (e.g. for accessories), amendments to the dealer agreements may be required. This will be increasingly important if OEMs begin to drive new car sales through online platforms, with dealers serving more as execution agents. With the growing acceptance of the application of provincial franchise law to the OEM-dealer relationship, OEMs will have to ensure that changes to permitted sales practices are reflected accurately in franchise disclosure documents, as well as dealer terms of trade and bulletins.

That said, the scale of the disruption should not be overstated. Online business can pose several opportunities for the alert OEM and its dealer network:

1. Recent studies have indicated that, while customers may prefer to conduct initial research and address the "paperwork" arising from a sale and financing through online means, they still place weight on physically attending a showroom to get a feel for the vehicle and seek a test drive. Accordingly, a showroom will likely remain central to the customer experience;

2. OEMs and their dealers can collaborate on ensuring that online “touchpoints” are uniform in their accessibility, features, and branding;
3. Dealers may be able to reduce their overall staffing needs and be more nimble in addressing customer onsite attendances; and
4. Used car trade-ins, aftersales maintenance and warranty repair, all cornerstones of dealer business, will very likely remain largely unaffected by the trend of greater online activity.

## Strategic M&A in the auto dealership industry

Recent history has provided consolidators in the automotive retail industry with the opportunity to acquire smaller dealer groups and single location dealerships. While most consolidators in today's market will still consider a transaction when provided a good acquisition opportunity, the focus has now shifted to using M&A as a strategy to realign their portfolio of capabilities.

With the global pandemic and mandated lockdowns, some people who once relied on public transportation, rideshare services, and air travel have turned to private cars instead. Evolving customer demands have led to auto dealers evaluating their service offering portfolios. Accordingly, consolidators in this space are evaluating M&A as an opportunity to:

1. Accelerate the innovation, scale, and growth of technological solutions developed by targets;
2. Secure used car inventory following a tightening of supply over 2020; and
3. Search for acquisition opportunities to expand geographic reach (locally or cross-border).

We also continue to see smaller dealer groups and single location dealerships coming to market and ready to exit, particularly those without an appetite to adapt to emerging technologies or those without clear succession plans. Consolidators remain optimistic about the industry's earnings growth, attracted to the sector's resilient business model and can capitalize on today's low interest rate environment.

## Examination of the dealer footprint

While showrooms are continuing to evolve and making use of new technologies, we do not expect large-scale reductions in the dealership footprint in the short term. That said, in the mid to long term, a reduction in overall customer traffic in dealerships may weigh against larger showroom spaces, and prompt rethinks of facility imaging programs and their corresponding capital investments. Moreover, as sales platforms allow for greater customization, the long-term trend seems to point towards dealers carrying a reduced amount of new car inventory.

We are also keeping an eye on an emerging trend where emerging technologies, strategic M&As, as well as an examination of the dealership footprint may also result in increased pressure from OEMs to shut down larger underperforming locations and replacing them with more centrally located urban locations with a smaller footprint but a more productive infrastructure.

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# Trending growth in ZEVs and EVs

Government incentives and legislation are affecting the market and promoting zero-emission vehicles (ZEVs) including electric vehicles (EVs).

For example, in British Columbia, the CleanBC Specialty-Use Vehicle Incentive and Commercial Vehicle Pilot Programs recently received a \$31 million boost in funding through B.C.'s economic recovery plan in response to COVID-19. This is in the broader context of \$227 million that the Province of B.C. reports it has committed to a variety of programs intended to promote zero-emission ZEVs. The most recent announcements are two-fold and provide:

1. Increased rebates for organizations purchasing specialty-use ZEVs, such as small, medium and heavy-duty passenger buses, airport and port service vehicles, transport trucks, motorcycles, cargo e-bikes, and low-speed utility trucks under the Specialty-Use Vehicle Incentive; and
2. Increased rebates to organizations for the purchase and infrastructure (e.g. charging requirements) to pilot or deploy medium, heavy-duty or very large ZEVs as part of the Commercial Vehicle Pilot Program.

The goals of these government programs are lofty and include making ZEVs more affordable for consumers at the time of purchase and over time with savings on fuel and maintenance. At the same time, these incentives are intended to encourage organizations in B.C. to make investments that support job growth and fight climate change.

In the spring of 2019, British Columbia passed the Zero-Emission Vehicles Act setting ambitious targets for the auto industry to meet for new light-duty ZEV sales and leases (10 per cent of light-duty vehicle sales by 2025, 30 per cent by 2030 and 100 per cent by 2040). In 2020, regulations made under

the Zero-Emission Act set phased-in annual targets and other compliance measures intended to ensure that automakers are on track to satisfy the targets set. This legislation places British Columbia in a small group of jurisdictions that include Québec, California and nine other U.S. states, mandating a 100 per cent zero-emission target.

In Ontario, the Independent Electricity System Operator (IESO), the system operator for Ontario's electricity system, began studying the impact of electrification of transportation in 2019. It funded a study on the impact of adopting electric transit on Ontario's electricity grid, as well as a smart EV charging program pilot at the City of Markham's Civic Centre. The Civic Centre pilot studies how smart charging systems at workplaces can minimize the impact on the local electricity grid and encourage employees' to drive electric.

The IESO has also provided funds to evaluate an electricity-pricing plan tailored for EV owners. The EV plan offers significantly reduced overnight electricity rates (when EV owners typically charge their vehicles) in exchange for high on-peak rates. Through sending stronger economic incentives, the pilot investigates how EV owners adapt their charging behaviour to take advantage of lower rates.

EV owners, plug-in hybrid vehicle owners and hydrogen fuel cell vehicle owners are also eligible for Green Licence Plates, which allow them to make use of Ontario's HOV and HOT (high occupancy toll) lanes on major highways with only one person in the car. See BLG's [Series on the Hydrogen Economy here](#). As of January 1, 2021, Ontario is also now ticketing cars that are parked in EV parking spots but are not EVs, or are EVs, but are not charging. Consider it the stick that goes with the carrot.

With more than 500 models of EVs estimated to be on the road by 2022 (BNEF Electric Vehicle Outlook, 2020), EV advocates will have much to choose from. Governments, and particularly the entities responsible for managing the provincial grid, are working to adapt to the changes electrification of transport will bring to electricity demand and the systems that support it. As consumer demand drives EV uptake, expect to see more government programs and incentives, aiming to please the electorate and help build out charging infrastructure. Already, we are seeing major auto-manufacturers announcing huge investments to re-tool plants and factories to keep production on pace with growing consumer demand and government requirements. We expect to see continued growth in these networks and markets in 2021 and beyond.

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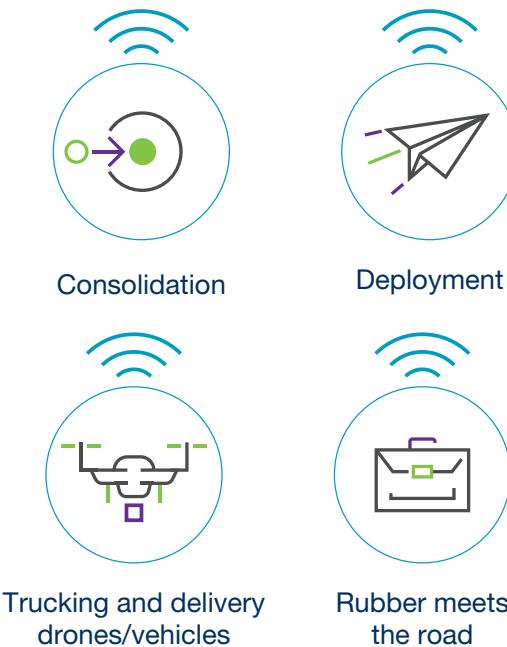
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# Autonomous vehicles: Moving forward in 2021

In 2021, we expect the Autonomous Vehicle (AV) industry to become increasingly part of daily life in North America through public transit pilots, driverless taxis, truck platooning and drone delivery. However, while government attention is needed to develop regulatory frameworks for the widespread deployment and rapid evolution of the AV industry, we expect the pandemic to hinder this process. In this article, we highlight key trends we expect will mark developments in the AV industry this year.

## 2021 Industry Hotspots



### Industry hotspot: Consolidation

In May 2020, the CEO of Intel's Mobileye, Amnon Shashua, said he expected to see a “[great consolidation](#)” in the AV industry, which proved to be correct as a wave of consolidation continues to sweep through the AV industry. A significant series of such consolidations took place in 2020, including most notably, [Amazon's acquisition of Zoox](#) and the Aurora Innovation's [acquisition of Uber's Advanced Technology Group](#).

This trend is likely to continue in 2021 due to the continuing development and push towards large-scale deployment of AV, which becomes more technically complex, expensive and interrelated with other AV components and systems. In particular, some industry insiders have suggested that this year may bring significant changes to the [Light Detection and Ranging \(LIDAR\)](#) ecosystem.

As a reference, we can look back to the previous era of great consolidation during the infancy of the North American automobile industry in the early 20th century, when more than 80 different carmakers consolidated [into the “Big Three” by 1929](#). Developments in 2021 may provide us with insight into whether or not the AV industry is headed in the same direction.

### Passenger AV hotspot: Deployment

Despite the COVID-19 pandemic causing significant disruption for a number of industries, there still appears to be a growing appetite, in both public and private transport, for ambitious deployments and pilots of passenger AV vehicles.

In public transport, an example of these ambitious deployments is the [Toronto Transit Commission and Metrolinx](#) agreement with Local Motors by LM Industries. As part of the city's [Autonomous Vehicles Tactical Plan](#), the city intends to begin a six to 12 month pilot of autonomous shuttles in 2021. Similar pilots continue to take place around the world and we expect to see even more announced in 2021.

In private transport, it is predicted that there will be an increasing number of publicly available AV taxi pilots/services. In October 2020, [Waymo announced a publicly available driverless taxi service](#) in Phoenix, Arizona, and early industry adopters and investors will watch any such pilots or services closely to determine if this attempt at deployment and commercialization proves palatable to the public and profitable.

COVID-19 has also [introduced the issue of biosafety](#), a fundamental new concern for policymakers and the public when considering passenger transit options. [Current trends](#) away from public transport systems may drive discussion, development and deployment of mass autonomous transit systems.

### Non-passenger AV hotspot: Trucking and delivery drones/vehicles

Trucking has consistently been one of the most active sectors of the AV industry and we expect this to continue in 2021. Active [truck platooning pilots](#) are underway around the world and more ambitious and autonomous truck platooning pilots are likely to appear. In particular, the continued rollout of 5G, improvements in AV technology, and the policy changes in key jurisdictions make the introduction of higher SAE level trucks and "automated following" truck platooning increasingly [likely this year](#).

As noted above, COVID-19 has introduced the concept of biosafety, not only affecting passenger transportation but also delivery services, which has [expedited the development and adoption of autonomous delivery](#)

[\*\*drones/vehicles\*\*](#). Leading organizations have already [received FAA approval](#) to launch and operate autonomous air delivery drones in the United States. We expect to see significant and ongoing development of the air-delivery drone sector in 2021 as the issue of biosafety and the [increasing volume](#) of home deliveries drives demand for the service.

Similarly, we expect the same needs will drive the continued deployment of autonomous "[delivery robots](#)" which will use existing public roadways and sidewalks. The continued impact of the COVID-19 pandemic, including extended lockdowns in many jurisdictions (meaning empty or emptier sidewalks and streets) and the need for innovative biosafety solutions to facilitate home delivery, may provide an opportunity for the adoption of delivery robots.

### Policy hotspot: Rubber meets the road

As outlined above, we predict it will be an active year in the AV sector with ongoing developments in autonomous taxis, shuttles, trucking and drone delivery. This has the potential to be the first year in which AVs interact with the public on a regular basis in North America. The AV industry requires government engagement to help facilitate and regulate the growing role and deployment of AVs. While COVID-19 is driving demand for AV deployment, it is also likely to keep policy-makers occupied with more pressing COVID-19 related concerns. We will be sure to closely monitor both private and public policy and regulatory proposals in key jurisdictions as they develop over the course of year.

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# Payments on wheels: Self-driving vehicles and the future of financial services

**Stephen Redican and Cindy Zhang in conversation with Barrie Kirk,  
P.Eng. Executive Director, CAVCOE**

**Connected and Autonomous Vehicles** (CAVs) will change people's lives in many ways, some of which remain unimagined but certainly not impossible.

According to **Barrie Kirk, executive director at CAVCOE** (formally, the Canadian Automated Vehicles Centre of Excellence), 2020 is not that different from 1908, when mass production of Model T Fords began. Henry Ford was a great inventor and entrepreneur, but it is likely that he did not foresee the impact and changes his commodity of cars would have on individuals, cities, infrastructure, businesses and governments.

In the present day, according to Barrie, we are going to see the same degree, breadth and depth of disruption in the next decades from the deployment of CAVs, similar in size and magnitude to what occurred following the launch of the Model T Ford.

In this installment of ***The Sensor***, our discussion focuses on the real expectation that CAVs will fundamentally transform the modern vehicle experience in the coming generations regarding everyday purchases or financial services.

Similar to the future of CAVs, the future of financial services, and in particular payment systems, is dependent on new technologies and a digital-first approach. From the implementation of payment system modernization in Canada to the ubiquity of FinTech payment service provider behemoths, digital innovation in the payments industry is happening at a quicksilver pace.

Success in this connection for the CAVs industry depends on understanding and harnessing its power and planning for what's next. At the same time, upcoming regulatory change in Canada for payment service providers, coupled with the advent of open banking and underscored by ever-present and evolving **cybersecurity and privacy concerns**, makes this a challenging time for the payments industry. What is certain is that with a widening array of choices for businesses and consumers and an unprecedented number of innovative market entrants and new service offerings, traditional payments models will face significant disruption as CAVs come online.

The COVID-19 pandemic and corresponding need for social distancing have only accelerated the digitization of services across virtually all sectors. In particular, it has driven home the need for financial, payment and banking services to be provided remotely or in a contactless way.

Barrie, who describes himself as a futurist with a passion for history, discusses his thoughts on the exciting intersection of new developments in CAVs with the future of payments systems. In particular, we focus on various use-cases and the possible technologies and potential paths forward for collaboration in the automotive and payments industries.

Entities and stakeholders involved in the development and provision of CAVs will need to consider obligations arising from regulatory oversight and legislative prescriptions applicable to them. These entities would include CAV suppliers and manufacturers, as well as FinTechs or financial institutions who partner with CAVs to provide payment and financial services to the vehicle's owners or operators.

At a broad level, for example, if a CAVs stores its owner's banking information, authentication or identity verification measures, then such information will need to be protected if the vehicle is stolen or hacked. Will insurance schemes account for the risk allocation involved with partnerships between CAVs and payment and financial services providers, or will contractual liabilities suffice?

Another key trend is that the expected arrival of robo-taxis will erase the traditional one-on-one relationship between a car and one or more humans. Given the higher price points of CAVs today compared to non-connected vehicles, it is likely we will see more prevalence of CAVs in the context of robo-taxis or the sharing economy before individual ownership.

### CAVs payments services



**Internal** mapping/traffic applications, streaming services



**External** food and beverage drive-through, fuel purchases, EV charging, car washes, toll road use or parking



**Fleet management** fuel, EV charging, service or maintenance of a particular vehicle

In the realm of payments, a number of industry prognosticators have already been discussing and considering various services that could be offered relative to CAVs. These range from payments for external services while using the vehicle (e.g., food and beverage drive-through, fuel purchases, EV charging, car washes, toll road use or parking), or payments for in-car

services while operating the vehicle (e.g., mapping/traffic applications (which are currently free) or streaming services for news or entertainment). Many are also talking about fleet management use-cases, where currently a payment card is issued to a vehicle, not a person, and the vehicle operator uses the payment card associated with that vehicle for payments related to use of that vehicle (e.g., for fuel, EV charging, service or maintenance).

There are also other potential more remote use-cases. For example, payments by or in respect of the vehicle itself when in autonomous mode and taking itself to a dealership for service, picking up groceries or even operating as an autonomous taxi and accepting payments for service. In this article, we are focusing on non-autonomous but connected payments, though it is possible that autonomous payment methods may not be much different than non-autonomous ones.

Barrie Kirk joins us in our first conversation about the matters above.

### In discussion with Barrie Kirk

#### 1. Question: What are the major ways that CAVs will change financial services?

**Answer:** First, the banks' car loans market will be disrupted because the trend to robo-taxis will result in fewer cars being sold, leading to a smaller market for consumer car loans.

Second, the auto insurance market will be disrupted: the number of collisions will decrease substantially. Also, the reduced number of consumer-owned vehicles will lead to fewer consumer insurance policies.

Third, vehicles of the future will be far more connected. Empty cars will drive themselves to a charging station, plug themselves in and pay. An interesting question is whether a fully autonomous car with artificial intelligence comparable to human intelligence will have its own bank account?

**2. Question:** In Canada, the average daily roundtrip commute by car is 56 minutes. The clearest advantage of CAVs for commuters is making the daily journey more productive, enjoyable, or both. Nevertheless, do you anticipate the increase in remote working and the growth of sharing economies as it relates to cars – and even the increase in demand for bicycles – to slow down public interest in CAVs? If not, why?

**Answer:** Cost savings are the primary motivation for people to move away from car ownership and use robo-taxis. This is true regardless of whether commuting levels go up or down. I expect a significant increase in the use of robo-taxis in the years ahead. In October 2020, [Waymo announced](#) that it was starting to offer a fully driverless taxi service to the general public in Phoenix, AZ. Significantly, there will be no safety driver. This means that the first generation of robo-taxis has arrived, although initially, there will be limited capability and limited deployment.

**3. Question:** Among any possible use-cases or methods, including those listed above, which do you see as the most likely to be introduced or succeed? Which do you see as least likely to be introduced or succeed?

**Answer:** There are two main segments to the CAVs ecosystem: passenger CAVs and non-passenger CAVs. The early deployments will be robo-taxis in downtown areas that are geographically constrained and have been subjected to HD mapping. I also expect to see a broad deployment of non-passenger CAVs for sidewalk winter maintenance, deliveries to homes and businesses, farming, mining, construction, etc. These use-cases are easier to deploy than passenger CAVs because the safety issues are easier to address. I do not expect to see the ultimate form of passenger CAVs, defined as go anywhere, anytime, in almost any weather, until we are well into the 2030s.

**4. Question:** What technology will be used to make the payment? For example, will it be contactless with some sort of broader-reach near-field communication (NFC); will it be dedicated short-range communications (DSRC) or will LTE or 5G technologies be used?

**Answer:** There is currently no consensus on this. However, I expect 5G will be a strong contender because it will be ubiquitous. The low-latency, high-speed and short-range features of 5G will make it attractive for payments.

**5. Question:** How will payments work? Will they be handled through an operator's mobile device or wallet? Will the vehicle become or host a mobile wallet (e.g., will the payment credentials be stored in the vehicle)? Is there a handoff and related data exchange between the mobile device/wallet and the vehicle when an operator enters a vehicle, or will payments be handled in some other way? Or will all these different payment models be brought to market? If so, in your view, which will be the winner and why?

**Answer:** It is too soon to tell. I expect that there will be an ecosystem with multiple stakeholders, just as there is for today's payments system.

**6. Question:** Will vehicle operators need to verify purchases (e.g., on a screen in the vehicle), or is it possible that authentication and verification will be automatic and tied to geolocation, condition of the vehicle (e.g., is it low on fuel or due for service), payment history (e.g., time, amount, frequency) and other operator or vehicle data?

**Answer:** We need to differentiate between purchases made by a human and those made by the vehicle itself. I expect that a human-generated transaction will need verification. Perhaps using voice or facial recognition systems. A transaction initiated by the vehicle will need to be secure, but no human authentication will be needed. And if the vehicle is driving with no human on board, then human authentication will be impossible unless done remotely.

**7. Question: Can you see greater potential for loyalty or reward points tied to use of certain retailers (e.g., fuel stations)? If so, which ones do you see as most prevalent or possible?**

**Answer:** Loyalty programs will be disrupted and will need to change. Robo-taxis will be owned and operated by companies offering Mobility-as-a-Service (MaaS). The percentage of vehicles owned by individuals will therefore decrease, so loyalty programs targeted to vehicle owners will become less relevant. However, loyalty programs for MaaS providers will become very popular.

**8. Question: On a broader “Internet of Things” point, do you think payments and CAVs will be connected to other devices (e.g., a connected refrigerator), that orders groceries when running low on staples and sends the vehicle to the grocery store to pick up and pay for the groceries? If so, using this example, would the refrigerator be the payment system, would it be the vehicle or would it be a combination of both (or neither), possibly using a cloud-based solution? Are there other examples?**

**Answer:** Ordering and payment systems will become more automated and interconnected, just as you described. There will also be non-passenger CAVs that are used for delivering parcels and food, which will be an alternative to passenger CAVs being used for deliveries.

An example of another use case is that robo-taxis will be able to drive themselves to service points to be cleaned, maintained and have the battery recharged – and then pay for everything.

**9. Question: What will be the ubiquity of the “operating system” (thinking in terms of iOS vs. Android)? For example, will vehicles from different manufacturers be able to “talk” to fuel pumps/charging stations from different providers at different fuel stations?**

**Answer:** Let's differentiate between operating systems and communication standards.

Each company will likely have its own vehicle platform specifications, including the operating system. But there will be industry standards for communications between the platforms, just as there are now. Today, emails can be exchanged between Android, Apple, Microsoft and other devices. Standards exist for FTP, HTTP, etc. The global 5G Automotive Alliance (5GAA) is also working on standards and best practices.

**10. Question: On the potential issue of disintermediation of banks and other traditional payment service providers by OEMs and FinTechs, do you have a view as to who will be responsible for the payment flows? For example, will it be a transaction sponsored or provided by an OEM, financial institution, payment network, electronics manufacturer or e-wallet provider?**

**Answer:** I don't know. But given recent history, I would expect non-traditional payment companies will see business opportunities and enter the market.

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# Shared mobility and Mobility as a Service (MaaS)

Transportation is undergoing a technological revolution. The Mobility as a Service (MaaS) model is becoming how vehicles are sold, owned and used.

MaaS means integrating various physical modes of travel (e.g., public transit, car sharing, ride hailing, deliveries and bike sharing) into a single digital platform that allows travellers to plan and manage their journeys. MaaS makes transportation simple for the end user and is designed to be consumed on-demand, without needing to own a car.



Transportation subscription services and payment models



The MaaS marketplace

## Transportation subscription services and payment models

Adopting and scaling MaaS will require complex contractual arrangements across the supply chain to navigate the interaction between MaaS participants in the public and private sectors. Providing a frictionless user experience through a singular digital platform will see the mobile device become a transportation hub for commuters, couriers and travelers.

The monthly subscription model has proven successful with consumers in other areas. Paying a monthly fee to receive bundled transit services such as unlimited travel on urban public transport in addition to a fixed number of taxi/bicycle/e-scooter kilometres is also likely to interest consumers.

In this model, pricing for each part of a trip may be separate, while the mobile travel app or travel planner could provide unified services and payment options.

## The MaaS marketplace

The digitization of transportation services will create a marketplace for personalizing transportation. Availability, convenience, control, connectivity and cost of transportation will all be at their fingertips.

Scheduling, booking and contactless app-based payment systems will continue to proliferate. Digital add-on and in-car services, such as concierge assistants, parking, and charging and fuelling services will create new revenue streams. The monetization of data will continue to provide opportunities, as well as concerns.

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# Trade issues in the automotive sector

## On-shoring

The tumultuous events that occurred during much of the Trump administration will continue to have effects in 2021. Some of these are longstanding trends that intensified between 2016 and 2020, whereas others are more recent.

The COVID-19 pandemic significantly affected global trade policy, highlighting global manufacturing supply chain vulnerabilities already weakened by geopolitical events of the last several years. The most notable of those, perhaps, is the rising challenge of China's unique form of state-sponsored economic mercantilism, its challenge to the economic hegemony of liberal democracies, and the response of the U.S., Japan, the EU and similar countries.

The term "on-shoring" is on the lips of manufacturers throughout the world, most of all in the automotive sector. Geopolitical trade instability highlighted by the U.S.-China tariff war, the destabilization of the global trading system and retrenchment into economic nationalism has demonstrated the risk to manufacturers of global supply chains in immediate and concrete terms. While this affects manufacturers with global supply chains across industrial sectors, the automotive sector has unique circumstances and challenges that make the trend toward on-shoring particularly interesting.

In the last two to three years, a number of factors have converged to energize on-shoring. While the trend toward on-shoring began several years ago, the advent of managed trade in North America in the form of the United States-Mexico-Canada agreement (USMCA), replacing the more liberal NAFTA, has emphasized the importance of local manufacture and supply

chains. The USMCA features higher domestic content requirements, unique steel and aluminum purchase and manufacturing requirements, relaxed rules for qualifying self produced intermediate materials, and other incentives for automotive manufacturers.

Furthermore, COVID-19 has laid bare the hidden costs and risks of diffuse global supply chains.

Following a period of trade disruption arising from the Trump administration China tariffs (and, more recently, limited tariffs directed at Vietnam and the threat of tariffs directed against EU automotive manufacturing throughout the Trump administration), the pandemic has demonstrated the negative side of relying on a diversified and far-reaching global supply chain. These negatives include rising freight costs, supply shortages and supply shutdowns, as countries managed their pandemic response in different ways and at different times. There is growing recognition that greater predictability arising from shorter lead times, shortened supply chains and controlling one's own destiny offers real cost savings that until recently could not be quantified in the same way.

In an industry that is razor focused on cost control, two other interesting trends have contributed to the increased momentum of on-shoring – momentum that is expected to continue through and beyond 2021.

The increase in automation has reduced the significance of labour costs as part of automotive production. This is particularly so as advanced research in the form of software, firmware, cybersecurity and intellectual property more generally make up not only greater cost but require heightened supply chain security and shortened supply chains overall.

The concurrent benefits of reducing project-management complexity associated with on-shoring have also been felt, and have been reinforced by government policy seeking to protect valuable intellectual property and ensuring that North American manufacturing remains in a leadership position as the automotive industry changes from fossil fuel based products to electric, hydrogen, and autonomous vehicles.

As Elon Musk recently said, borrowing not very subtly from Mark Twain, “rumours of the demise of U.S. manufacturing are greatly exaggerated.” The policy orientations of the new Biden administration, although differing substantially in tone from the previous administration, will be substantively oriented the same way. Therefore, we expect this trend to intensify in 2021 and beyond, meaning that the automotive industry, from the original equipment manufacturer to the dealer, will become less global and more regional.



1. The vehicle itself will need to satisfy a 75 per cent regional value content requirement;



2. Certain “core” parts in the vehicle will need to qualify as “originating” in the USMCA region;



3. The producer will need to source 70 per cent of its steel and aluminum in North America; and



4. The producer will need to achieve “high-wage” labour value content requirements, totalling 40 per cent of expenditures.

## USMCA compliance challenges

At the heart of the USMCA negotiations were the automotive rules of origin. Unlike many parts of the agreement, they represent a significant departure from the equivalent provisions in the NAFTA. Overall, they are significantly more restrictive than those in the NAFTA, reflecting the objective of the Trump administration – an objective largely shared by Canada – to encourage higher levels of production in North America while stemming the flow of that production to Mexico.

When the USMCA is fully phased in, a passenger vehicle and its producer will need to satisfy four different origin requirements in order for the vehicle to qualify for duty-free treatment:

1. The vehicle itself will need to satisfy a 75 per cent regional value content requirement;
2. Certain “core” parts in the vehicle will need to qualify as “originating” in the USMCA region;
3. The producer will need to source 70 per cent of its steel and aluminum in North America; and
4. The producer will need to achieve “high-wage” labour value content requirements, totalling 40 per cent of expenditures.

The complexity of the USMCA’s automotive rules of origin will make their understanding and application a challenge for businesses in the sector, as will a lack of clarity around many of the key elements in the rules. The USMCA parties have addressed some of these compliance issues, as they have now finalized and issued the uniform regulations that govern the interpretation and application of the rules of origin.

Nevertheless, it remains an open question whether North American producers will find it more beneficial in some cases to pay duties at the relatively low U.S. (and Canadian) most-favoured nation (MFN) rates on

passenger vehicles and parts, rather than complying with the USMCA rules of origin in order to benefit from tariff preferences. This may or may not change as time passes. Throughout the automotive provisions, both vehicle producers and those providing parts to vehicle producers are required to certify that vehicles and parts meet the requirements of the agreement. This will require an ongoing and expensive process of updates and changes to supply chain agreements throughout the sector, especially to reflect the transition regime, the new labour value content requirements, and the new North American steel and aluminum requirements.

Because automotive supply chains are highly integrated, complex and often involve long-term contractual commitments, they cannot be changed overnight. The USMCA, therefore, provides for a transition period that allows a portion of a producer's passenger vehicles and light trucks to receive tariff preference without complying with the USCMA rules of origin.

During the transition period, up to 10 per cent of a vehicle producer's North American production of passenger vehicles or light trucks can be non-conforming with the USMCA's rules of origin until Jan. 1, 2025, or five years after the agreement comes into force, whichever is later.

As part of these transition mechanisms, content requirements overall, along with content requirements for core parts, steel and aluminum, and labour value are increasing over time in keeping with the transitional phase-in schedule. This is putting considerable pressure on compliance given the unrelenting approach of the USMCA's final requirements in a few years' time (which differ considerably for cars and trucks, respectively).

## Canada may enact modern slavery legislation in 2021

Although not an issue specifically about the automotive sector, one noteworthy development for all manufacturers to be aware of is the movement toward Canada's version of legislation that addresses

forced labour in global supply chains, and the growing prominence of Environmental, Social, and Governance issues for all companies.

The proposed *Modern Slavery Act* (currently Bill S-216) would require mandatory modern slavery disclosure by companies subject to the Act, as well as new provisions in the *Customs Tariff Act* to prohibit importing goods produced using forced labour and goods made by children.

The draft legislation is broad in its application. The proposed application would include most medium and large companies that produce, sell, or import goods.

The proposed legislation imposes disclosure and compliance requirements, significant penalties, and broad search and seizure powers, which the federal government could use to verify compliance with the Act.

The majority of Canadian companies, including automotive companies, likely already have substantial resources in place to comply with the proposed legislation. Nonetheless, there will be additional compliance costs and an increased chance of reputational risk. The process of vetting suppliers and on boarding new ones will require enhanced risk identification and mitigation.

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# Product liability and class actions

As in recent years, class actions are anticipated to be an ever-present concern for the automotive sector in 2021, increasingly seeking to certify classes national in scope. While the national scope is, in part, a function of the national distribution and sale of automotive products in Canada, legislation in Alberta, Saskatchewan, British Columbia and Ontario specifically require proposed representative plaintiffs to provide notice of proceedings to other representative plaintiffs in other jurisdictions with alleged claims or issues of the same or similar subject matters.

With respect to the defence of class actions, courts are expected to engage in a more critical analysis of plaintiffs' theories on liability and damages, particularly in regards to articulating alleged defects and demonstrating a workable methodology to assess and quantify damages on a class-wide basis in 2021. Part of this shift is due to changes in legislation, such as the amendments to the Class Proceedings Act, 1992 introduced in Ontario in October of 2020, while favourable case law is emerging in Ontario and other provinces to challenge plaintiffs' theories of damages.

The COVID-19 pandemic may also create unique claims from customers, such as claims for repairs outside of warranty due to delays in attending for service alleged to be caused by COVID-19.



Theory of defect



Proof of damages



Breach of warranty

## Theory of defect

In automotive class actions, the focus of plaintiffs' theory of liability often rests on the alleged existence of a defect somewhere in the vehicle.

The specific defect alleged by a plaintiff is lacking in detail, pleading that particular parts or components located inside the vehicle are "defective" without much more. Recent case law clarifies that boilerplate or vague pleading of an alleged defect is not sufficient to meet the requirement that the pleadings disclose a cause of action.

For example, in *Kuiper v Cook (Canada) Inc.*<sup>1</sup>, a proposed class sought to certify a class action concerning a medical device. The plaintiffs alleged that the device was defective, but suggested that the defect causing the device to fail arose out of a "matrix of factors" such as the device's shape and type of material. The plaintiffs also alleged that the various factors causing the defect made the device "more dangerous to use than they would have been had other and safer design choices been made."

Ultimately, the Divisional Court held that the plaintiffs' pleading of defect was insufficient and did not meet the criteria necessary to properly plead a design defect. While the plaintiffs properly pleaded the details of the portions of the design they believed to be defective, they failed to articulate the specific alternative design that they deem to be safer. By only alleging that "other" designs would have been safer, rather than explaining what the alternatives were, the pleading was doomed to fail. Other recent decisions have cited the Divisional Court's decision, denying certification of poorly pleaded causes of action including negligent design, testing and manufacture.<sup>2</sup>

## Proof of damages

Often, plaintiffs in an automotive class action are motivated to seek damages on a class-wide basis by alleging a “diminution in value” or other form of aggregate damages. In these circumstances, plaintiffs are required to put forward a credible or “workable” methodology to assess the alleged damages on a class-wide basis. Recently, courts have put an increasing focus on the necessity to put forth a “credible and plausible methodology” that can prove damages common to all members of the class, highlighting that a theoretical or hypothetical methodology is insufficient.<sup>3</sup>

In *Maginnis and Magnaye v FCA Canada et al.*,<sup>4</sup> a proposed class sought damages arising from an emissions “defeat device” that was already being repaired by the manufacturer at no cost to customers. The plaintiffs alleged that they had purchased vehicles without knowledge of the emissions issue, and that if they had known about the emissions issue they would not have purchased the vehicles. They also argued that they had paid a “premium price” for diesel vehicles they believed to be emissions-compliant, and that the free repair caused poor fuel economy and vehicle performance. The court found there was no compensable harm and no basis for certification.

While the court agreed that compensable loss claims were “certainly possible” even when a defective product had been repaired, the loss claimed must be presented with “some thought, with the right plaintiffs and, of course, with at least some evidence”. The plaintiffs’ attempt to point to a settlement of a parallel action in the U.S. was not sufficient to support a claim for damages in Canada, nor was there any evidence that any of the class members paid a “premium price” for the emission features of their vehicles. Further, the free repair resulted in an emission compliant vehicle with a fair market value that was unaffected by the defeat device. Similarly, there was no evidence before the court that the repair of the defeat device resulted in reduced fuel economy or performance. Therefore, the

court concluded that a theory as to what “could” happen and a proposed methodology about how to test whether it happened was “obviously not evidence that anything did in fact happen”.

In *Fortin v. Mazda*<sup>5</sup>, a class action commenced in Québec with respect to an alleged defect with vehicles’ door locking mechanism. Similar to Maginnis, Mazda had repaired the issue at no cost to its customers. The plaintiff’s argument was based on the *Consumer Protection Act*, suggesting that customers would pay less for vehicles with the alleged defect than they would have paid had the defect had never existed. To support this theory, the plaintiff put forth expert evidence in the form of a survey asking consumers what level of compensation would be appropriate for weaknesses in a vehicle’s locking system. Ultimately, these claims for damages and the plaintiff’s methodology were rejected and the court confirmed that plaintiffs alleging a breach of the Consumer Protection Act must nevertheless prove an “actual financial impact” on customers such as the alleged loss of value of the effected vehicles.

There is hope that courts will continue to take a hard look at cases alleging class-wide damages without sufficient theories of damages or workable methodologies to assess damage.

## Breach of warranty

In the current COVID-19 context, there is anticipation that auto manufacturers will be forced to contend with a higher volume of claims arising from warranties offered with their vehicles. Generally, warranties applicable to vehicles are for a limited duration (i.e. for three years or 60,000 kilometres, whichever comes first) and exclude coverage for circumstances where customers fail to have their vehicle serviced or repaired within a reasonable period of time. While claims from customers who allege failures of warranted parts shortly after the expiry of warranty periods are not

unique, it is anticipated that a greater volume of these claims may arise due to COVID-19 risks and restrictions in Canada. For example, it may be that customers feel uncomfortable or unwilling to have vehicles serviced at authorized dealerships despite reasonable and appropriate precautions being put into place. It may also be that government-mandated restrictions hinder customers' ability to bring vehicles in for service or repair.

Though the volume of these claims may increase, assessment of these cases are expected to be highly fact-specific with determinations for extended coverage or goodwill being considered on a case-by-case basis.

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- 1 *Kuiper v. Cook (Canada) Inc.*, 2020 ONSC 128 (Div Ct)
  - 2 *Williamson v Johnson & Johnson*, 2020 BCSC 1746.
  - 3 *Kett v Mitsubishi Materials Corporation*, 2020 BCSC 1879 at para 159; *Pro-Sys Consultants Ltd. v Microsoft Corporation*, 2013 SCC 57.
  - 4 2020 ONSC 5462 ("Maginnis")
  - 5 2020 QCCS 4270

