

# Limits of good faith and relational nature of franchise agreements in Quebec

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## Introduction

The scope of the duty to act in good faith in commercial dealings has been a topic of much discussion in recent years, particularly in the context of franchise relationships. In *Churchill Falls (Labrador) Corp v Hydro-Quebec*, the Supreme Court of Canada has confirmed that, in the context of transactional contracts, the general civil law duty of the parties to exercise their rights in good faith does not impose a duty to renegotiate a long-term contract where, as a result of significant changes in the market, one party reaps substantial benefits from an otherwise legally formed contract. In rendering this decision, the court has emphasised the differences between transactional and relational contracts by drawing examples from franchise law.

## Facts

In 1969 the Churchill Falls (Labrador) Corporation Limited (CFLCo) entered into an electricity purchase agreement with Hydro-Quebec. The contract stipulated that Hydro-Quebec would purchase electricity from CFLCo at fixed prices for a 65-year term. Following the signing of the agreement, the price of electricity increased substantially and the prices set out in the contract no longer reflected market standards. Hydro-Quebec proceeded to resell the electricity that it had bought from CFLCo to third parties at current market prices, resulting in substantial profits for Hydro-Quebec.

CFLCo then sought an order from the courts to have the prices provided in the contract increased in order to reflect current market rates and restore equilibrium between the parties. CFLCo based its claim, among other things, on the premise that the contract was of a relational nature and therefore subject to a more rigorous standard of good faith. Accordingly, CFLCo argued that renegotiating the contract was warranted considering the unforeseen changes in the electricity industry and the resulting unfair advantage granted to Hydro-Quebec. For its part, Hydro-Quebec contended that CFLCo was attempting to impose a new bargain on the parties, which, in Hydro-Quebec's view, violated the principles of the binding force of contracts.<sup>(1)</sup>

## Decisions

### Lower courts

The Quebec Superior Court and the Court of Appeal rejected CFLCo's claim, finding no legal basis which warranted the courts' intervention in the contractual relationship between the parties.<sup>(2)</sup>

### Supreme Court of Canada

In assessing whether the contract qualified as a relational contract, the court considered *Dunkin' Brands Canada Ltd v Bertico inc*, which identified a relational contract as one that does not spell out all of the terms between the co-contracting parties in an explicit manner. In comparing *Dunkin' Brands* to the case at hand, the court noted that, although the contract was similar to a relational contract (ie, it was of a long duration and the relationship between the parties was somewhat interdependent), these facts were insufficient to characterise the contract as relational, given that it had not been structured as a relationship of cooperation between the parties, as are franchise agreements. Indeed, the court believed that each party's obligations had been clearly defined and quantified in the contract and that it had not provided for flexible economic coordination.<sup>(3)</sup>

Further, the court acknowledged the occasional use of the doctrines of equity and fairness as a tool

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to correct inequalities between co-contracting parties in certain relationships (eg, consumer contracts or contracts of adhesion), particularly in situations where an inherent power imbalance exists between the parties. However, the court found that nothing about the relationship between Hydro-Quebec and CFLCo could justify this type of intervention.(4)

The court then addressed CFLCo's claim that renegotiating the contract was necessary in order to maintain the contract's relevance in light of the unprecedented boom in the electricity market. In support of its claim, CFLCo relied on *Provigo Distribution Inc v Supermarche ARG Inc*, another franchising decision. In *Provigo*, the Quebec Court of Appeal found that the franchisor of a grocery store chain had changed the marketing structures (and pricing) for products sold at its own retail locations, thereby competing more effectively with its franchisee which had been selling the same products at its neighbouring retail location. While not contrary to the franchise agreement's express terms, the franchisor's actions had been detrimental to the franchisee's interests.

The court rejected CFLCo's argument distinguishing the circumstances in *Provigo* from the case at bar. In *Provigo*, the franchisor's actions had resulted in a disruption of the contractual equilibrium between the franchisor and its franchisee, as the franchisor had failed to adopt proper measures to counterbalance the effects of its own competitive actions on its franchisee's business. The court noted that, unlike in *Provigo*, the shift in the contractual equilibrium between CFLCo and Hydro-Quebec could not be attributed to Hydro-Quebec's actions, but rather to market fluctuations. The court further distinguished *Provigo* from the present case as the franchise contract at issue in *Provigo* had been a relational contract, whereas the relationship between CFLCo and Hydro-Quebec could not be qualified as such.(5)

As a result, the court upheld the lower courts' decision and dismissed the appeal.(6)

## Comment

In *Churchill Falls (Labrador) Corp v Hydro-Quebec*, the Supreme Court of Canada reiterated the fact that franchise agreements are relational contracts and are therefore subject to a heightened duty of good faith pursuant to Quebec civil law. This decision is in line with a series of recent Quebec civil law decisions that have broadly interpreted, and arguably extended, the duty of good faith owed by a franchisor to its franchisees.

Although this decision was not rendered in a franchise law context, franchisors may take comfort in the court's assertion that the duty of good faith is neither absolute nor synonymous with charity or distributive justice.(7) This decision further demonstrates that the notion of good faith cannot serve as a cure-all for poorly drafted contracts, but will rather find application in situations where there is an inherent imbalance of power between the parties, as is often the case in contracts of adhesion such as franchise agreements.

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## Endnotes

(1) *Churchill Falls (Labrador) Corp v Hydro-Quebec* (2018 SCC 46), Paragraphs 1-24; 107.

(2) *Ibid*, Paragraphs 25-39.

(3) *Ibid*, Paragraphs 68-71.

(4) *Ibid*, Paragraph 109.

(5) *Ibid*, Paragraphs 122-123.

(6) *Ibid*, Paragraphs 136-139.

(7) *Ibid*, Paragraph 107.