FRANCHISING - CANADA

'Special relationship' between franchisors and franchisees: could it give rise to a pre-contractual duty of good faith?

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Introduction

Canadian common law courts have not recognised a general obligation to negotiate agreements in accordance with the requirements of good faith.(1) This contrasts with the applicable civil law rules in the province of Quebec, which require parties to conduct themselves in good faith at all stages of their contractual dealings. However, common law jurisdictions do recognise that certain circumstances could arise that would lead contracting parties to have some type of pre-contractual good-faith obligation, including where they have a 'special relationship' – typically characterised by an imbalance of information. Such a special relationship has led courts to consider the existence and scope of a duty to disclose important facts during the negotiation phase.(2) A franchise arrangement has been characterised as an example of such a special relationship that could, in certain factual circumstances, fall within the narrow set of particular requirements for good faith in the pre-contractual context.

Pre-contractual duty of good faith generally

In a 2001 decision, the Ontario Court of Appeal introduced the possibility that a duty of pre-contractual good faith may arise from a special relationship between the parties under common law.(3) The main characteristics of such a special relationship are that:

- one party justifiably relies on the other for information necessary to make an informed choice; and
- the party in possession of the information has the opportunity, by withholding it, to bring about the choice made by the other party.

In its decision, the Ontario Court of Appeal described five factors indicative of situations where reliance on the other contracting party may be justified – namely:

- a past course of dealing between the parties involving reliance on advice;
- the explicit assumption by one party of advisory responsibilities;
- the relative positions of the parties, particularly in their respective access to information;
- the manner in which the parties were brought together and their expectations; and
- whether trust and confidence have been knowingly given to one party.

In these instances, a party's entitlement to rightfully rely on the information provided by the other party to the special relationship could, at least in principle, lead the latter party to have a corollary obligation to conduct itself in good faith, even at the pre-contractual stage. This would be a significant departure from ordinary contract rules, which impose no duty for parties to act in good faith in advance of entering into an agreement.

The Court of Queen's Bench for Saskatchewan recently revisited the special relationship concept in its 2019 decision *University of Regina v HTC Purenergy Inc.*(4) The court noted that while the Supreme Court of Canada recognised good faith with respect to contractual performance in *Bhasin v Hrynew*,(5) there is no such recognition of a good-faith duty applicable to pre-contractual negotiations. However, the court did confirm that a pre-contractual duty of good faith has been recognised where special relationships exist. In applying the five factors described above, the court

held that there was no special relationship between the parties to the case on the basis that:

- they had no past dealings;
- there was no explicit assumption of an advisory role;
- there was no imbalance in power or access to information; and
- there was no vulnerability due to the placing of trust and confidence in another person.

The court therefore held that no duty to negotiate in good faith applied in such circumstances.

While not all Canadian common law courts have applied the special relationship doctrine to infer a duty to negotiate in good faith,(6) even where courts have followed this doctrine, there is a high evidentiary threshold to imply such a duty, requiring more than self-interested dealing from parties to an ordinary commercial negotiation.

Conversely, in the civil law province of Quebec, the pre-contractual duty of good faith is a recognised rule requiring parties to act honestly and loyally during negotiations at all times, regardless of any special status or imbalance of power in their relationship. The scope and intensity of the obligation to negotiate in good faith may vary depending on the factual circumstances and a party's particular vulnerability; however, even where no contract is ultimately consummated between negotiating parties, they may be liable for any failure to negotiate in good faith, although it may be more difficult to prove the damages suffered as a result of such failure in such circumstances.

Pre-contractual duty of good faith in franchising

In Canadian common law jurisdictions, the case law states that it is unclear whether a franchisor is subject to duties of fair dealing or good faith in relation to pre-contractual discussions with a prospective franchisee.(7) Arguably, the franchisor's statutory disclosure obligations towards prospective franchisees are similar to such duties, particularly given that the strict laws regarding pre-contractual disclosure in franchising have been specifically developed with a view to addressing widespread information asymmetries and uneven bargaining power between franchisors and prospective franchisees.

Moreover, the remedies associated with violations of franchise disclosure legislation are specifically meant to address damages that could be suffered by a franchisee as a result of entering into a franchise arrangement with inexistent or insufficient disclosure; these statutory remedies largely serve to short-circuit the burden that would otherwise be associated with a claim for damages resulting from misrepresentation or other failures by a franchisor to comply with applicable duties before entering into the formal franchise agreement.

Notably, a 2003 Ontario Court of Appeal decision discussed many of the characteristics of the franchisor-franchisee relationship, which are similar to the five factors assessed in the special relationship doctrine.(8) The court made noteworthy observations that:

- imbalances in bargaining power are common between franchisors and franchisees since franchise agreements are contracts of adhesion; and
- franchisees are dependent on franchisors for information about the franchise.

As such, a franchise would likely be considered a special relationship for purposes of the relevant doctrine, where applicable.

Comment

At present, it is unlikely that franchisors have any pre-contractual duty of good faith towards prospective franchisees by virtue of the special relationship doctrine in Canadian common law provinces. This will come as a welcome confirmation for franchisors, which often consider the stringent requirements of pre-contractual franchise disclosure legislation to be all-encompassing with respect to their duties, obligations and risks as concerns prospective franchisees.

However, given the ever-evolving landscape that appears to be broadening the horizons of the application of good faith in Canadian common law generally, it remains possible that a pre-contractual duty for parties to conduct themselves in a manner consistent with the governing principles of honesty and integrity may ultimately be recognised even where franchise-specific statutes apply, where pre-contractual dealings mature to a definitive agreement.

Franchisors must satisfy their pre-contractual disclosure obligations imposed by law, where applicable, in order to avoid liability on this basis. As the rules applicable to good faith in pre-contractual dealings continue to evolve, they should otherwise be cautious and avoid withholding or mischaracterising information that could affect a prospective franchisee's decision to acquire a franchise. Moreover, any pitches, presentations, discussions, meetings and correspondence with prospective franchisees should be properly documented, particularly any information that may

later be construed as a representation or, perhaps more importantly, silence with respect to any material aspects of the franchised business or related information that could have caused a reasonable prospective franchisee not to enter into the franchise arrangement had such material aspects or information been known.

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Endnotes

(1) *Martel Building Ltd v Canada*, 2000 SCC [2000] 2 SCR 860.

(2) *Amertek Inc v Canadian Commercial Corp*, 2005, 76 OR (3d) 241 (Ont CA) (application for leave to appeal to Supreme Court of Canada (2006 CanLII 4733) dismissed 16 February 2006).

(3) *978011 Ontario Ltd v Cornell Engineering Company Ltd*, 2001 CanLII 8522 (ON CA).

(4) 2019 SKQB 126.

(5) 2014 SCC 71 [2014] 3 SCR 494.

(6) See *Kosaka v Chan* [2008] BCJ, 1724; appeal dismissed in *Kosaka v Chan*, 2009 BCCA 467 (CanLII).

(7) *Essa v Mediterranean Franchise Inc* [2016] AJ, 491.

(8) *Shelanu Inc v Print Three Franchising Corp*, 2003 CanLII 52151 (ON CA).
