Cassels

Guidance from the Supreme Court of Canada On Relational Contracts and the Duty of Good Faith

Colin Pendrith

December 17, 2018

In the recent decision of *Churchill Falls (Labrador) Corp. v. Hydro Québec*,[1] the Supreme Court of Canada engaged in a discussion regarding franchise law in a non-franchise context.

The Issue Before The Supreme Court of Canada

The core issue before the Court was whether the general duty of good faith under Quebec law could give rise to an obligation to renegotiate a long-term contract to reflect or restore the "equilibrium" of the initial agreement. Specifically, the Supreme Court considered whether the contract at issue - which required Hydro-Québec to purchase electricity from a hydro-electric plant owned by Churchill Falls (Labrador) Corp. (CFL) over a 65 year period - was a "relational contract" giving rise to a higher standard of good faith. The dispute arose because the purchase price for electricity set in the contract was well below current market price.

The Supreme Court of Canada's Analysis

In conducting its analysis, the majority of the Supreme Court considered other categories of "relationship contracts" that have been recognized at law, including franchise relationships.

The Supreme Court referred to the franchise decision of *Dunkin' Brands Canada Ltd. v. Bertico Inc.*, in which the Quebec Court of Appeal explained that the relational nature of a franchise agreement was apparent from the fact that its terms were not stipulated. In rejecting CFL's argument that its contract ought to be defined as a relational contract due to its long-term nature and interdependence of the parties, the Supreme Court reasoned that the more a contract defines the obligations of the parties, the less likely that contract is to be a relational contract.

Having determined that the agreement with Hydro-Québec was not a relational contract, the Supreme Court distinguished the Quebec Court of Appeal's franchise decision in *Provigo Distribution inc. v. Supermarché A.R.G. Inc.* In that decision, which did involve a relational contract, the Quebec Court of Appeal held that a franchisor had breached its duty of fair dealing by failing to provide its franchisees with the tools they needed in order to prevent, or at least minimize, economic losses flowing from the franchisor's decision to change marketing structures for its products. The Supreme Court noted that in the *Provigo* decision, the franchisor had taken the initiative of changing its marketing structures, which had disrupted the contractual equilibrium. By comparison, Hydro Québec was not responsible for disrupting the contractual equilibrium and therefore had no duty to cooperate with CFL to mitigate the effects.

Key Take-Away Principle

While the Supreme Court noted that in rare cases, "an exceptional duty to make slight changes to a contract has been held to exist," it gave little guidance beyond this and ultimately concluded that neither good faith nor equity can provide a legal basis for requiring that the initial equilibrium of a contract be modified.

Accordingly, this decision serves as confirmation from Canada's highest Court that franchise agreements may be seen as relational agreements, and as a result, subject to a higher degree of good faith under Quebec's civil law.

---

[1] 2018 SCC 46
