The Limitations of the Duty of Good Faith

written by Rory Lodge | March 1, 2014

The recent Superior Court of Ontario decision in *Robert Moore Pharmacy Ltd. et al. v. Shoppers Drug Mart Inc.* is an interesting reminder of the legal status of the duty of good faith as it applies to franchises.

In Ontario, franchises are regulated by a specific statute, the *Arthur Wishart Act*. This statute appears to have been enacted in response to a number of cases in which franchisors appeared to be taken advantage of franchisees in some significant way. I say that because its provisions are extremely favourable to franchisees.

The obligations that it places on a franchisor are onerous. A franchisor's failure to comply with even the most technical of requirements under the Act may well have disastrous results for it.

Among the more significant policy principles behind the Act is the obligation on franchisors to act in good faith.

In this case, the Plaintiff was a Shoppers Drug Mart franchisee. Its franchise agreement provided for an original one-year term and the potential for two one-year renewal terms. The renewal terms were to come into existence automatically if neither party took the steps to terminate the agreement during its existence by giving notice.

Neither party took any such steps during the agreement and accordingly, it was extended to December 30, 2012. The agreement specifically provided that at the expiry of the second automatic renewal, there would be no further renewal.

In early December, 2012, Shoppers notified the franchisee that no new agreement would be made available and that Shoppers would be taking over the premises at the end of the term.

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The franchisor brought this action seeking an injunction requiring Shoppers to permit the franchisee to continue to operate. The franchisee claimed that Shoppers had breached its obligation to act in good faith as contained in the *Arthur Wishart Act* by failing to act fairly. At this point, the franchisee asked to be reinstated until the issue could be determined at trial.

The Court observed that under Canadian law, there is no stand alone duty of good faith that is independent from the terms of a contract. As the judge put it, "the implication of a duty of good faith has not gone so far as to create new, unbargained-for rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties …".

If this had been an ordinary commercial contract, that would have ended the matter right there. As there is no independent duty to act in good faith, a contract that calls for a termination date cannot be amended by the court on the basis of a finding that the terminating party did not act fairly. A terminating party has no independent duty to do anything of the kind.

Because this was a franchise case, the Court referred to a previous case where it was made clear that the duty of fair dealing under the *Arthur Wishart Act* includes a duty to act in good faith but does not compel a party to renew an expiring relationship when it considers it to be commercially unreasonable. A general duty of fair dealing without more cannot turn a written term of expiry into a right to renew.

The reference to commercial unreasonability is interesting. It makes sense that the Act would require a franchisor to act in a commercially reasonable way in deciding as to whether or not to agree to a renewal of a franchise agreement where there is a specific renewal provision in the agreement itself.

In this case, however, the Court seems to have concluded that this duty will also apply where there is no operative renewal provision in the agreement any more, and the only issue is as to whether or not the franchisor must agree to an entirely new franchise agreement with the franchisee. Those were the facts in this case, and the Court decided that it had to consider and assess the reason why the franchisor refused to enter into a new franchise agreement.

The Court went through this process and determined that Shoppers Drug Mart did indeed have a commercially reasonable basis for its decision not to enter into a new franchise agreement. Accordingly, the motion was dismissed. However, it does give rise to the remarkable possibility that the duty of good faith on a franchisor may well apply even in circumstances in which there is no longer a franchise agreement in existence.

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