

# THE IMPACT OF THE CIVIL CODE OF QUEBEC ON FRANCHISING

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The advent of the *Civil Code of Quebec*<sup>1</sup> ("C.C.Q.") on January 1, 1994, replacing the previous *Civil Code of Lower Canada*<sup>2</sup> ("C.C.L.C."), has had a far reaching impact on the legal interpretation of franchise agreements in the Province of Quebec. While the reformation contained the C.C.Q. includes the codification of various established caselaw principles, it also contains entirely new provisions in response to developing technologies, attitudes and morals in the province not contemplated by the C.C.L.C.

The C.C.L.C. was criticized for its non-interventionist approach, having adopted the prevailing "laissez-faire" ideology of the nineteenth and early twentieth century in contractual relationships, which resulted in a near absolute freedom of contract in commercial relationships. The C.C.Q. significantly departs from this approach - it goes to astonishing lengths to establish a sense of fairness and reasonableness in order to protect a weaker party in contractual relationships. These principles are recurring themes in the C.C.Q.: Articles 6 and 7 establish the general principles in the following manner.

"**Art 6.** Every person is bound to exercise his civil rights in good faith.

**Art. 7.** No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner which is contrary to the requirements of good faith."

The principle of good faith is reinforced in contractual matters by Article 1375:

"**Art. 1375.** The parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished. "

While Quebec courts have not yet been given the opportunity to fully circumscribe the scope of this principle, many feel that it goes so far as to impose an obligation on each party to a contract to disclose to the other parties any matter or information which may be considered material to the contemplated transaction.

As part of this general overhaul, the Quebec legislature felt that certain contracts, namely adhesion contracts, required particular attention, by reason of the inferior bargaining position of one of the contracting parties.

Although the notion of adhesion contracts had surfaced quite some time ago in doctrinal writing, Quebec courts have been somewhat reluctant to endorse this concept. In an effort to correct the real (or perceived) economic disequilibrium between parties to this type of contract, the C.C.Q. contains various rules of interpretation applicable to such contracts which give Quebec courts considerable latitude for redress. It is these rules of interpretation which will have a profound impact on franchise agreements.

## 1. ELEMENTS OF A CONTRACT OF ADHESION

Adhesion contracts are defined as follows in the first paragraph of Article 1379 of the C.C.Q.:

"**Art. 1379.** A contract of adhesion is a contract in which the essential stipulations were imposed or drawn up by one of the parties, on his behalf or upon his instructions, and were not negotiable."

The key consideration in characterizing a contract as an adhesion contract is whether one of the parties imposed or drew up the essential stipulations without the other having had the ability to alter their terms. This broad definition will encompass contracts as varied as franchise agreements, insurance contracts and leases. In addition, doctrine in both Quebec<sup>3</sup> and France has developed other considerations that may lead to such characterization, which Quebec courts will likely refer to in resolving litigation in this area. These considerations include the unilateral and profitable character of a contract in favour of the party having imposed it, its complexity, the existence of a monopoly in law or in fact, the essential nature of the product or service to be obtained by the adhering party, the existence of alternatives to the contract, as well as whether the adhering party was unaware of the content of the contract.

It is our opinion that Quebec courts will not hesitate to characterize franchise agreements as adhesion contracts. The use of lengthy standard form franchise agreements, the relative economic and bargaining strength of the parties and the lack of sophistication of most franchisees are factors which will weigh heavily in favour of such characterization. The fact that various parliamentary reports of the Quebec legislature expressly state that it intends to remedy inequities in franchise agreements under the banner of adhesion contracts, will also weigh heavily in favour of court intervention in franchise agreements.

The few Quebec court decisions in respect of adhesion contracts since the implementation of the C.C.Q. contain little, if any, analysis on this point; generally, judges have simply declared the disputed contract to be an adhesion contract, including cases involving franchise agreements. Therefore, although conceptually possible in light of previous doctrinal writings on adhesion contracts, it is doubtful that circumstances could exist which would not lead to the characterization of a franchise agreement as an adhesion contract under the C.C.Q.

Consequently, franchise practitioners must become familiar with the essential attributes of an adhesion contract under the C.C.Q., and with those effects which flow from such a characterization.

### A. DRAFTING THE ESSENTIAL CONDITIONS BY ONE OF THE PARTIES

Article 1379 requires that the *essential conditions* of an adhesion contract be imposed or drawn up by one of the parties. However, it is difficult to establish parameters for what constitutes an "essential condition" of a contract - is the condition only to be essential for the adhering party or for both parties? Must there be an absolute imposition of the essential conditions or can they be negotiated to some minimal extent so as to avoid being labelled as an adhesion contract? These and many other questions remain to be resolved by Quebec courts, although it seems clear that such considerations must be examined on a individual case basis.

It should be noted that the adhering party has the burden of proof to show that it had not and was not allowed to negotiate the essential conditions; that rather, they were imposed by the other party or on its behalf.

B. ESSENTIAL CONDITIONS ARE NON-NEGOTIABLE

This appears to be the most fundamental characteristic of an adhesion contract. Quebec courts are given considerable latitude to make an objective determination as to whether the essential conditions of an adhesion contract were non-negotiable.

Other factual circumstances discussed earlier will probably become important in this regard, including the economic strength of the parties, the speed with which the contract was entered into, whether a monopoly in fact exists, and whether there were viable alternatives to the execution of the contract. It follows that the inability to negotiate must be subjectively proven by the adhering party; indeed, if one had the opportunity to but did not negotiate the contract, he should not benefit from court protection.

**2. CONSEQUENCES OF CHARACTERIZATION AS AN ADHESION CONTRACT**

Legislative intervention with respect to adhesion contracts occurs on two fronts, namely as to the formation of the contract and as to its contents. This has been achieved through rules of interpretation, which will now be examined.

A. FORMATION OF AN ADHESION CONTRACT

The Quebec legislature has formulated specific rules of interpretation governing external provisions of an adhesion contract, as well as for illegible or incomprehensible provisions. The legal regime applicable to these clauses is founded upon an implicit pre-contractual disclosure obligation which is distinct from any such obligation associated with the requirement of good faith in Article 1375 of the *C.C.Q.* discussed earlier. The specific disclosure obligations which result from the rules of interpretation applicable to adhesion contracts are unilateral and imposed on the stipulating party<sup>4</sup> in order to ensure that the adhering party<sup>5</sup> has knowledge of and has consented to all of the provisions contained in the adhesion contract. The Quebec legislature has even gone a step further, by placing the burden of proof of such knowledge and consent on the franchisor.

(i) ILLEGIBLE AND INCOMPREHENSIBLE CLAUSES

Typical contracts of adhesion such as insurance policies, ticket stubs and purchase orders are often printed in a manner which discourages one from reading the contract, by reason of its presentation, its size or other similar factors: these provisions are considered "illegible" by the *C.C.Q.* In addition, the provisions of the *C.C.Q.* relating to "incomprehensible" clauses monitor the substance of an adhesion contract; convoluted sentences, legal ease and other factors which render a clause incomprehensible are also sanctioned by Article 1436 of the *C.C.Q.*, which states as follows:

"**Art. 1436.** In a consumer contract or a contract of adhesion, a clause which is illegible or incomprehensible to a reasonable person is null if the consumer or the adhering party suffers injury therefrom, unless the other party proves that an adequate explanation of the nature and scope of the clause was given to the consumer or adhering party."

To a certain extent, the rules of interpretation governing illegible clauses represent a codification of caselaw; for example, prior to the introduction of the C.C.Q., clauses in small print or those appearing after the signature of the adhering party have at times been declared null by Quebec courts<sup>6</sup>. The more contentious portion of this article deals with incomprehensible clauses. Clauses which are particularly complex or difficult to read raise serious concerns as to whether the adhering party understood and consented to them. Accordingly, any provision of a franchise agreement or a related agreement may be declared null and void if the court determines that it is incomprehensible to a reasonable person, the franchisee suffers damages, and the franchisor fails to prove that it has complied with its disclosure obligation.

It is important to recognize that the franchisee has the burden to show that the provision is incomprehensible to a reasonable person and that the franchisee suffered damages. Once it has discharged its burden of proof with respect to the foregoing, the franchisor must prove, in order to avoid liability, either that adequate explanations were given by it or on its behalf to the franchisee with respect to the scope and nature of such provision or that the franchisee has not discharged its burden of proof in respect of either one of the first two matters discussed above.

Again, the proof advanced on behalf of the franchisor to rebut its liability is to be weighed objectively<sup>7</sup>. While it is possible that the claiming franchisee has not understood the provision, the franchisor will be vindicated if it provided explanations to the franchisee which are considered adequate to a reasonable person.

While not expressly stated in the text of Article 1436 of the C.C.Q., it would seem that a court will apply the standard of a reasonable person in the same circumstances as the adhering party; in fact, it is difficult to imagine that the courts would treat a seasoned businessman who purchased a franchise with the support of legal, accounting or franchise professionals, in the same manner as a person who may be uneducated, unrepresented and who has invested his life savings in a similar purchase<sup>8</sup>.

In conclusion, the following course of action is recommended for franchisors in order to reduce the risk of having various provisions of the franchise agreement and related documents declared null by reason of the fact that they are illegible or incomprehensible: (1) use clearly legible contracts and large enough print, ensure that all provisions appear before the signature of the franchisee (other than schedules) and avoid using fax copies; (2) review your franchise documentation and rewrite in plain language those clauses which seem difficult to understand; (3) ensure that proper explanations of all important provisions of the franchise documentation are given to the franchisee, whether verbally at various meetings preceding the execution of the documentation or in writing; and (4) inasmuch as possible, strongly recommend or insist that the franchisee consult with an independent lawyer.

Finally, it is important to note that the courts have not been empowered to rewrite illegible or incomprehensible clauses - they will be declared null and void if contrary to the foregoing rules.

(ii) EXTERNAL CLAUSES

External clauses are clauses which refer to and incorporate provisions not expressly included in the contract itself or in its schedules. Article 1435 of the C.C.Q. provides:

**"Art. 1435.** An external clause referred to in a contract is binding on the parties.

In a consumer contract or a contract of adhesion, however, an external clause is null if, at the time of formation of the contract, it was not expressly brought to the attention of the consumer or adhering party, unless the other party proves that the consumer or adhering party otherwise knew of it."

This article has the effect of reversing the burden of proof and requiring the franchisor to prove that the franchisee had knowledge of the external clause at the time of formation of the contract, failing which the external clause will be null and void<sup>9</sup>. Accordingly, a presumption of nullity exists although rebuttable by the franchisor with proof of any of the following: the franchisee had knowledge of the external clause; the clause has been expressly brought to the attention of the franchisee at the time of formation of the contract; or the external clause is so commonly used that it may be presumed to be known by the franchisee.

A good example of external clauses are the provisions in a typical franchise agreement relating to an operations manual<sup>10</sup>. In order to comply with the avowed intention of the Quebec legislature to prevent an adhering party from being bound by the terms of a document which it had not read or understood prior to signing, it is strongly recommended that the franchisor provide the franchisee with a copy of the operations manual at the time of execution of the franchise agreement. Yet, even if this obligation is fulfilled, it may still be difficult to convince a court that the franchisee had the opportunity to read the whole of a particularly lengthy manual at the time the franchise agreement was executed. A less attractive option would be for the franchisor to provide a copy of the operations manual to the franchisee *prior* to the execution of the franchise agreement, subject to the franchisee executing a confidentiality agreement in respect of its contents. Alternatively, it may be more appealing to simply allow the franchisee whatever time is necessary to consult and read the manual at the franchisor's offices prior to completion of the franchise agreement without making any copies of it and after having signed a confidentiality agreement or an offer to purchase which contains adequate confidentiality obligations.

The operations manual is the source of other difficulties since it is often modified during the term of the franchise agreement. It could be argued that any such modification to the manual constitutes in law an amendment to the original franchise agreement. This would then require the franchisor to comply with the disclosure obligation each time an amendment is made to the operations manual<sup>11</sup>. This interpretation is burdensome because by its nature, an amendment must be agreed upon by both parties at the time it is made. It is difficult to predict whether Quebec courts will adopt the same position with regards to minor amendments to operating standards, as they will with respect to amendments having a major impact, either by reason of the nature of the franchise business or the expenditure required from the franchisee to comply with such amendments.

It should be noted once again that the courts are not given the power to rewrite external clauses; these can only be entirely upheld or declared null. The consequence is severe, as the nullity of external clauses relating to an operations manual would mean that the franchisee is no longer bound by the provisions of the manual. In these circumstances, the importance of being cautious cannot be overstated.

## B. CONTENTS OF THE ADHESION CONTRACT

### (i) ABUSIVE CLAUSES

The rules of interpretation for adhesion contracts which we have already examined relate to the formation of the contract. The rule of interpretation relating to abusive clauses in adhesion contracts is different; even if consented to fully by the adhering party, abusive clauses remain objectionable, and the courts are given substantial powers to deal with them.

Article 1437 of the *C.C.Q.* reads as follows:

**"Art. 1437.** An abusive clause in a consumer contract or contract of adhesion is null, or the obligation arising from it may be reduced.

An abusive clause is a clause which is excessively and unreasonably detrimental to the consumer or the adhering party and is therefore not in good faith; in particular, a clause which so departs from the fundamental obligations arising from the rules normally governing the contract that it changes the nature of the contract is an abusive clause."

For clauses held to be abusive, the contract no longer governs the relationship of the parties; the courts are given the power to declare such clauses null or rewrite them to whatever extent deemed appropriate in order to establish contractual fairness.

It would seem that the "excessively and unreasonably detrimental" nature of a clause in an adhesion contract is to be determined objectively, without taking the particular circumstances into consideration<sup>12</sup>. It is important to mention that the detrimental nature of an abusive clause does not necessarily relate to monetary or financial matters - a waiver of liability clause may be deemed excessive and unreasonably detrimental to the adhering party. It is also likely that the harmful nature of a clause will be judged relative to the remaining provisions of the agreement to determine whether the former is excessively and unreasonably detrimental. Since the legislative definition of an abusive clause is vague, it will be difficult to predict with any certainty which provisions of a franchise agreement Quebec courts are likely to consider abusive. One suspects, for example, that the following provisions would be subjected to careful scrutiny: provisions requiring the franchisee to continue paying royalties regardless of any breach by the franchisor; an absolute prohibition against the franchisee from assigning its rights under the franchise agreement or from selling its business; or provisions containing prohibitive transfer fees.

While not related to franchising specifically, a number of recent court decisions have given rise to some concern. In the case of *Société Générale Beaver Inc. v. Métaux ouverts St-Philippe Inc.*<sup>13</sup>, the plaintiff and the defendants entered into an equipment lease agreement, which provided that if the defendants failed to pay the rent, the plaintiff would be entitled to terminate the lease agreement, take possession of the leased equipment, recover all unpaid and future rent owing, as well as have the right to liquidated damages. The defendants ceased paying the rent after a few months and the plaintiff sued pursuant to the foregoing provisions of the agreement. The Quebec Superior Court concluded that this agreement constituted an adhesion contract and that the foregoing provisions were clearly abusive, given that the plaintiff had regained possession of the equipment and re-leased it to another party. Accordingly, the court reduced the claim from \$61,000 to \$10,000.

In the case of *Slush Puppie Montreal Inc. v. 153226 Canada Inc.*<sup>14</sup>, the parties entered an agreement whereby the plaintiff provided the defendants with a freezer and the right to distribute Slush Puppie products and the defendants agreed to purchase only Slush Puppie products. In addition, the plaintiff retained the right to conduct spot inspections to ensure that only Slush Puppie products were being used by the defendants. Lastly, the agreement provided that the findings from any inspection of the defendants' freezers were final and binding upon the parties, without any possibility for the defendants to contest them. In fact, the plaintiff conducted an inspection and concluded that the defendants had been using products other than those sold by Slush Puppy and proceeded to terminate the agreement on this basis. The court concluded, once again without detailed analysis, that the agreement constituted an adhesion contract, and determined that the provision rendering the plaintiff's findings final and binding was an abusive clause; the court then proceeded to strike this provision from the agreement, declaring it to be null and void. Given the outcome of this decision, it may be advisable to review inspection provisions contained in franchise agreements, in order to ensure that the franchisee is given the opportunity to contest the results of an inspection and to provide adequate explanations.

In the case of *Grenier-Lacroix v. Lafond*<sup>15</sup>, the plaintiff claimed from the defendant arrears of rent under a lease agreement between the parties, together with liquidated damages equal to 25% of the amount of rent collected using the assistance of an attorney. The court concluded that the lease agreement constituted an adhesion contract and reduced the liquidated damages from 25% to 15% as being excessive and unreasonable.

In the unreported decision of *Denis St-Pierre v. Gérald Laprise*<sup>16</sup>, three land surveyors sought to collect their fees for services rendered, together with interest at the rate of 18% per annum pursuant to the agreement executed among the parties. The court concluded that this agreement constituted an adhesion contract, without providing any analysis as to how it arrived at this conclusion, and that the rate of 18% per annum was abusive in the circumstances; accordingly, the court reduced the rate of interest to the legal rate. Consequently, it would seem prudent to include only floating interest rates in franchise agreements, linked to the prime or base rate of an independent bank.

Contrastingly, a few cases have refused to use the pretext of an adhesion contract to intervene and rewrite the terms of an otherwise valid contract. In the case of *Entreprise L.T. Limitée v. Aubut*<sup>17</sup>, the plaintiff entered into a supply agreement with a company of which the defendant was a shareholder, and obtained from him a personal guarantee of payment for amounts owing by the company to the plaintiff. The defendant claimed that the guarantee was an adhesion contract. The court refused to accept such a claim based on the fact that the defendant was granted the opportunity to review the text of the guarantee for a few days prior to signing it, had discussions with the plaintiff concerning the terms of the guarantee, and obtained various amendments to the guarantee prior to signing it. This decision highlights the importance of providing adequate explanations and opportunity for the franchisee to discuss the terms of the franchise documentation.

In conclusion, the broad array of powers available to Quebec courts in respect of adhesion contracts will not necessarily result in drastic changes to the enforceability of franchise agreements. The dominant purpose behind these powers is to allow Quebec courts to reach an equilibrium between parties of uneven bargaining strength. Ultimately, a careful review of the franchise documentation and franchise selling techniques in light of these rules of interpretation will provide more than sufficient protection for franchisors to continue to prosper in the Province of Quebec.

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<sup>1</sup> *Civil Code of Quebec*, S.Q. 1991, c. 64. 2.

<sup>2</sup> *An Act respecting the Civil Code of Lower Canada*, S. Prov. C. 1865, c. 41, as amended.

<sup>3</sup> See, for example, in Quebec doctrine: L. Beaudoin, *Droit civil de la province de Québec: Modèle vivant de droit comparé* (Montreal, Wilson and Lafleur, 1953) 665; P.-A. Crépeau, "Contrat d'adhésion et contrat type" in *Mélanges Louis Beaudoin* (Montreal, Les Presses de l'Université de Montréal, 1974) 69.

<sup>4</sup> The term "franchisor" will be used interchangeably with the term "stipulating party" throughout the remainder of this article.

<sup>5</sup> The term "franchisee" will be used interchangeably with the term "adhering party" throughout the remainder of this article.

<sup>6</sup> See, for example, *Burchmore v. Harold Cummings Ltd.*, (1961) S.C. 220 and *Mertens v. Bob Gratton Sport Inc.*, *Jurisprudence Express* 84-391 (S.C.).

<sup>7</sup> A. Popovici, "Le nouveau Code Civil et les contrats d'adhésion" (1992) *Meredith Memorial Lectures* (Montreal, Faculty of Law, McGill University) 137 at 145.

<sup>8</sup> B. Moore, "À la recherche d'une règle générale régissant les clauses abusives en droit québécois" (1994) 1 *Revue Juridique Thémis* 177 at 217-218.

<sup>9</sup> A. Popovici, *supra*, note 7 at 141.

<sup>10</sup> A typical franchise agreement is likely to contain a definition of the operations manual which refers to, *inter alia*, documents, policies, rules and regulations provided by the franchisor to the franchisee from time to time, as well as all changes and amendments thereto. This clearly encompasses materials which are unavailable to the franchisee at the time of formation of the franchise agreement.

<sup>11</sup> A. Popovici, *supra*, note 7 at 143.

<sup>12</sup> A. Popovici, *supra*, note 7 at 152; B. Moore, *supra*, note 8 at 223.

<sup>13</sup> (19 July 1994), Montreal 500-05-016209-924 (C.S.).

<sup>14</sup> (4 April 1994), Montreal 500-02-021245-928 (C.Q.).

<sup>15</sup> (28 January 1994), Three-Rivers 400-02-000613-933 (C.Q.).

<sup>16</sup> (14 April 1994), Three-Rivers (Nicolet) 435-02-000027-908 (C.Q.).

<sup>17</sup> (13 April 1994), Quebec 200-02-005715-935 (C.Q.).