Ending negotiations and the obligation of good faith in the province of Québec

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In Québec, the obligation of good faith exists between the negotiating parties even before the contract is entered into. Parties which are at the negotiation table, or which have already entered a pre-contractual arrangement such as a letter of intent, non-binding term sheet, agreement in principle or memorandum of understanding, have an obligation to conduct negotiations in good faith. Such obligation imposes limits on a negotiating party's right to end negotiations unilaterally.

This short note, firstly, introduces and describes the obligation of good faith in the pre-contractual negotiation phase and, secondly, outlines some of the limits on the right to end negotiations. This note also identifies some factors to consider when assessing the risks related to ending commercial negotiations.

Obligation of good faith

The obligation of good faith is one of the key concepts of private law in the province of Québec and is based on the following three articles of the Civil Code of Québec:

6. Every person is bound to exercise his civil rights in accordance with the requirements of good faith.

7. No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner, and therefore contrary to the requirements of good faith.

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

In Québec, the obligation of good faith is implied in every contract and in relationships outside of contract.

At the pre-contractual level, the freedom to enter into contract or not to enter into contract, including the correlative right to end negotiations, is the general rule.[1] As in other jurisdictions in Canada, Québec civil law recognizes the autonomy of the wills and commercial certainty as key principles underlying contract law. In and of itself, refusal to enter into a contract is not considered blameworthy, and no personal liability may ensue from such a refusal, whatever the reasons may be.[2]

However, there are some limits on the right to end negotiations. The right to not enter a contract and end negotiations cannot be exercised in a manner that is contrary to the

obligation of good faith, namely with the intent of injuring another or in an excessive or unreasonable manner. Despite connotations associated with the term "good faith" and its opposite "bad faith", a breach can occur even in the absence of malicious intent. In the absence of evidence of malicious intent, courts look to see whether the party's conduct when ending negotiations was excessive or unreasonable to the extent that the party's conduct significantly departed from the norms of conduct in the commercial context.[3]

More concretely, the obligation to conduct negotiations in good faith gives rise to obligations of disclosure, discretion, coherence and collaboration to a certain degree.[4] The obligation of disclosure requires that a negotiating party inform, at an opportune time, the other party of all the important elements that can influence the other party's decision to contract and to determine the terms and conditions that it is prepared to accept.[5] The obligation of discretion prohibits a party from entering negotiations for the purpose of gaining access to information that is otherwise not accessible without the other party's consent.[6] The obligation of coherence prohibits a party from continuing to negotiate from the moment that such party no longer intends to enter into the contemplated contract.[7] The obligation of collaboration prohibits a party from ending negotiations without justification when such party induced confidence and expectations in the other party that the contemplated contract will be entered into.[8]

Proving a breach of the obligation of good faith

In Québec, good faith is always presumed unless the law requires that it be proved first.[9] Therefore, it is up to the alleged victim of an improper termination of negotiations to prove that the termination constituted a breach of the obligation of conducting negotiations in good faith.

The threshold for demonstrating a breach of good faith is relatively high, and the analysis is fact-driven. For instance, serious or tough negotiations, in and of themselves, are not incompatible with the obligation to conduct negotiations in good faith. Moreover, disagreement and failure to reach an agreement, in and of themselves, are not a sign of lack of collaboration, bad faith or abuse from one party or the other.[10] Courts need something more to find malicious intent or a significant departure from the norms of conduct in the commercial context.

Factors to consider

Courts consider the following factors when determining whether a party breached its obligation of good faith when such party ended negotiations unilaterally:

- **Length, cost, and effort** – As negotiations get longer and more expensive, a negotiating party needs a relatively clearer and more serious reason to end the negotiations,[11] and the negotiating parties need to apply greater efforts to conclude the transaction.[12] Depending on the circumstances, the obligation to conduct negotiations in good faith may require the party contemplating ending the negotiations to give the other party a reasonable extension to satisfy certain conditions.
- **Importance of the contract** – Ending negotiations of a relatively more important contract,

such as a purchase agreement for a change of control transaction or a sale of all or substantially all of the business, requires a relatively clearer and more serious reason.[13]

- **Actual negotiations** – The obligation to conduct negotiations in good faith does not apply when there is a simple manifestation of intent to contract or when the parties are merely making preliminary requests for summary information with a view of eventually entering into a contract. The obligation kicks in when the negotiations solidly start.[14] In other words, the obligation to conduct negotiations in good faith does not apply during the period of time when parties merely "go fishing"; namely when they explore whether there is even a basis for possible negotiations.[15]
- **Level of progress** – As negotiations get more advanced and items are settled, a negotiating party needs a relatively clearer and more serious reason to end the negotiations.[16]
- **Expected outcome** – Ending negotiations that are certain to fail does not constitute a breach of the obligation to conduct negotiations in good faith. For example, a party that ends negotiations after accepting several extensions following repeated failures by the other party to comply with a condition set out in a non-binding term sheet, does not breach its obligation of conducting negotiations in good faith. [17] On the flip side, it also goes without saying that a party should not continue negotiating after it no longer intends to enter into the contemplated contract. [18]
- **Leading on and reasonable reliance** – Courts assess (i) whether the party ending negotiations led on the other party and elicited high expectations or confidence in the other party and (ii) whether such reliance by the other party was reasonable. In making this assessment, courts consider documents prepared during the negotiations,[19] communications between the negotiating parties, quality and level of sophistication of the negotiating parties, and the existence or absence of prior business relations between the negotiating parties.[20] In other words, the fact that a negotiating party may have had high expectations about the outcome of the negotiations is not conclusive of a breach in itself. Those expectations need to have been elicited by the party ending negotiations, and those expectations need to have been reasonable in the circumstances.
- **Lack of honesty and transparency** – A party ending negotiations is likely breaching its obligation to conduct negotiations in good faith when such party is found to have been dishonest, not transparent or making repetitive subterfuges and excuses during the negotiations.[21]
- **Conduct of the other party** – A party ending negotiations is likely not breaching its obligation to conduct negotiations in good faith when the other party is found to have been dishonest, not transparent or making repetitive subterfuges and excuses during the negotiations.[22]

Damages

After demonstrating that a party breached its obligation to conduct negotiations in good faith, the alleged "victim" party has to prove damages and a causal link between such breach and the damages.

Proving the existence of an injury or loss resulting from such a breach is difficult. After all, courts recognize that unexpected and inexplicable changes in commercial negotiations are an ordinary business risk.[23] The Court of Appeal of Québec confirmed that, depending on the circumstances, the following types of damages could be compensated in situations where negotiations are terminated in a manner that breaches the obligation to conduct negotiations in good faith:

- Loss of time
- Expenses incurred in the context of the negotiations
- Loss of opportunities
- Impossibility to enter into a contract with a third party
- Damage to credit and reputation[24]

The threshold for these types of damages is relatively high; the damages need to fall outside the realm of the risks ordinarily associated with the type of negotiation. For example, loss of time will be compensated "in the most exceptional of circumstances",[25] as courts recognize that spending some time on negotiations is an ordinary risk of engaging in negotiations. For expenses incurred in the negotiations, the alleged victim needs to prove that it was induced into making expenses in view of the eventual implementation of the expected contract,[26] as courts recognize that incurring certain expenses is an ordinary risk when engaging in negotiations.

In addition to the five types of damages listed above, "victims" of ruptured negotiations have tried to claim damages for the loss of profits that were expected from the contemplated contract that ultimately was not concluded. However, the Court of Appeal of Québec has stated that damages for the expected profits from the lost contract are not available in the context of ruptured negotiations where there is no obligation to enter into a contract.[27] In Québec civil law, damages for improperly terminated negotiations at the pre-contractual phase are not the same as damages for a breach of a contractual obligation to not proceed with a transaction.

Takeaway

Parties that are considering entering or ending commercial negotiations in Québec should carefully weigh the implications of the obligation to conduct negotiations in good faith and the limits that such obligation imposes on their ability to end the negotiations.

For any questions concerning risks related to ending commercial negotiations in the province of Québec, please contact the members of our litigation and corporate law teams at our Montréal office.

[1] Jean-Louis Baudouin and Pierre-Gabriel Jobin, Les obligations, 7th ed., by Pierre-Gabriel Jobin and Nathalie Vézina, Cowansville, Éditions Yvon Blais, 2013 at para 136 (Jobin & Vézina); See also Didier Lluelles and Benoît Moore, Droit des obligations, 2nd ed., Montréal, Éditions Thémis, 2018 at paras 249 and 255 (Lluelles & Moore).

[2] *Singh c Kohli*, 2015 QCCA 1135 at para 66 (Singh).

[3] *Matte c Charron*, 2010 QCCA 1496 at para 75.

[4] Lluelles & Moore at para 249.3.

[5] *Wykanta Canada Limited c Lafrance*, 2020 QCCS 1003 at paras 277-283 (Wykanta).

[6] *Ibid*; See also Jobin & Vézina at para 137.

[7] Lluelles & Moore at para 249.3.

[8] *Ibid*.

[9] Art 2805, CcQ.

[10] Singh at para 74.

[11] Jobin & Vézina at para 137; See also Singh at para 78.

[12] Wykanta at paras 350-351.

[13] Lluelles & Moore at para 249.3.

[14] Jobin & Vézina, *supra*, note 1 at para 136.

[15] Singh at para 76.

[16] Singh at para 76; Wykanta at paras 354-355.

[17] *Beauregard c Boulanger*, 2020 QCCS 2090 (Beauregard).

[18] Jobin & Vézina at para 137.

[19] Wykanta at paras 273-275, the exchange of documents prepared by reputable professional service providers make a finding of reasonable reliance more likely.

[20] Singh at paras 75-76, 84 to 88. In the context of a preliminary negotiations of a purchase agreement, a founder and significant shareholder suddenly and without notice discontinued negotiations with the purchasers after vouching for the acceptance of the deal by the target company's other shareholders when he must have known that their approval was nothing but uncertain or even improbable. However, the Court of Appeal of Québec found that the purchasers could not reasonably believe that the deal was certain because the purchasers were "experienced businessmen" who had a copy of the shareholders agreement that required the approval of 66% of the shareholders in connection with the deal and "had every

reason to be suspicious of the sudden, unexpected change of mind of their vis-à-vis [...] and to doubt his renewed assertion (bragging would be a better word) about his co-shareholders".

[21] Wykanta at paras 238, 298-301.

[22] Beauregard.

[23] Singh at para 90.

[24] *Ibid*.

[25] Singh at para 92.

[26] Singh at para 93.

[27] Singh at paras 95 and 107 where the Court of Appeal of Québec clarifies that the loss of the profits expected from an unsigned contract may in certain circumstances lead to a condemnation for damages; for example, such damages may be available (i) if a public body, contrary to the terms of a public call for tenders or the law, does not award the contract to the lowest conforming bidder or tries to circumvent the bidding process altogether or (ii) if there is an actual binding contract which one of the parties refuses to formalize.