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# Newsletter

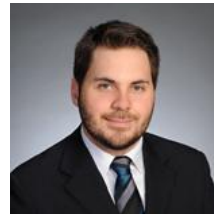
## Civil and Commercial Litigation

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### Automatic Renewal Clauses and Cancellation Penalties: Make Them Stick



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#### Introduction

Service providers and contractors often enter long-term agreements with clients in which they are afforded substantial freedom in completing the work or providing the services. To protect clients from abusive or excessive penalties and to account for changes to the client's personal and economical needs, Quebec law stipulates special protections for clients. These protections are found in articles 2125-ff of the CCQ.

Article 2125 in particular, reads: "*The client may unilaterally resiliate the contract even though the work or provision of service is already in progress.*" If left unmitigated, this protection can pose a great risk to service providers and contractors who would be unable to recover remaining fees owed over the term of the agreement.<sup>1</sup>

Automatic renewal clauses are the norm for companies with service and construction contracts. Many such enterprises will factor the costs of the services over a period of time extending beyond the original term, to make their contract attractive to the customer. Profitability usually occurs in the long term. It is therefore an industry standard for such companies to try to exclude this right to unilaterally resiliate without penalty. However, the means by which a service provider or contractor may exclude this

provision have been interpreted restrictively in Quebec jurisprudence.

For these reasons, it is very important for service providers and contractors to know how they can effectively limit the risks associated with the premature cancellation of service contracts and ensure the enforceability of cancellation penalty clauses.

#### Waiver of unilateral resiliation: the principles

The provider will generally enjoy a remedy for damages incurred by the premature termination, when a client resiliates a service contract. However, the provider may only claim profits lost for the remaining term of the agreement if the client had totally waived the protection provided by 2125 CCQ.

When a service contract also contains an automatic renewal clause, once the term arrives the agreement is automatically renewed under the same conditions as the initial contract.<sup>2</sup> If the initial service contract contained an enforceable waiver, the protections of 2125 CCQ would be waived throughout the term of the new agreement as well, unless the renewed contract contains a new stipulation that eliminates the waiver.<sup>3</sup>

For a number of years, Quebec courts have contemplated the language of clauses through which a client waives its right to the protections of 2125 CCQ, to determine if the waiver can be enforced throughout the initial agreement and any successive renewal. The overarching principle

remains that the protections afforded by 2125 CCQ are not of public order and may be waived by the client.<sup>4</sup> Such waiver clauses must be clear and unequivocal for the waiver to be enforceable, though they need not be explicit.<sup>5</sup>

Courts have affirmed that a simple enumeration of situations in which termination of the agreement by the client without cause is permitted, is not sufficient to consist of a waiver, as it does not limit the client from resiliating the agreement in other situations.<sup>6</sup> In those cases, a client that resiliated the service contract was not liable to pay the provider for lost future profits.

### **Enforceable waiver clauses: what you need to know**

Since 2125 CCQ provides clients with the general right to terminate service contracts without cause at any time during the agreement, waiver of this right may come in one of two forms: (1) a partial waiver of the right, by limiting some protections and the extent to which the right may be exercised, (2) or a total waiver of the protections offered by 2125 CCQ.

A waiver will be partial when the client retains the right to terminate the agreement, though certain contractual conditions must be fulfilled in order for it to do so, such as submitting a notice to the service provider prior to resiliating the agreement.

For example, if the service contract stipulates that the client may unilaterally resiliate the agreement by providing prior notice of 60 days to the service provider, failure to provide that notice will entitle the provider to loss of profits for the duration of the prior notice period of 60 days.<sup>7</sup> However, claims for damages beyond the contractual notice period will not be admitted in these circumstances, as the protections of 2125 CCQ would still apply.

### **Total waiver of unilateral resiliation**

The most explicit total waiver clauses will make direct mention of the protections waived by the client, by directly citing 2125 CCQ. These clauses are among the clearest and are generally recognized by courts as enforceable waivers of the client's right to unilateral resiliation.<sup>8</sup>

Courts have affirmed that while such direct mention of waiving 2125 CCQ in the clause is certainly sufficient, it is not necessary for the contract to be so explicit for the client to waive the protection.<sup>9</sup> The client may therefore waive the protections of 2125 CCQ through other drafting formats.

The case *2642-3079 Québec Inc. (Multi Services professionnels) vs Équipements pétroliers Claude Pedneault*, heard by the Superior Court of Quebec in 2010, provides a useful example of how a waiver clause must be drafted for it to be enforceable. In that case, the Court evaluated the following clause in a consulting services contract:

*(1) The CLIENT cannot for any reason whatsoever, with the exception of fraud, illness, or if it does not reach the objectives fixed by the board of directors, terminate the present service contract. (2) For any other reason, a period of six (6) months shall be provided, to jointly permit the consultant and the business to find a replacement.*<sup>10</sup> [Our translation]

The Court ultimately concluded that the client had not waived the protections of 2125 CCQ, as the second sentence of the clause created a mechanism by which the client could terminate the agreement without cause, by providing notice of 6 months. The Court further remarked that if that second sentence had not been included, the clause would have been a valid total waiver of the protections provided under 2125 CCQ, and the client could have been liable for the future profits lost by the consultant due to the premature termination.<sup>11</sup>

This case instructs us that a waiver clause may mention specific circumstances in which the waiver will not be enforceable, without preventing the waiver from being set-up in situations that are not enumerated in the clause.

When a client has a general right to terminate an agreement with prior notice, this is interpreted by the court as an indication that the client retains the protections beyond that period. In such a case, the client is said to have only partially waived the protections.<sup>12</sup>

To further illustrate this point; in *Côté vs Mirabel (Ville de)* the Superior Court of Quebec concluded that the following clause was not a waiver of 2125 CCQ:

*“Notwithstanding article 2, the City can end this agreement, if the agent:*

*a) becomes insolvent, declares bankruptcy, makes a proposal or if its assets are seized by one of its creditors;*

*b) does not perform one of its obligations and does not remedy the default in the thirty (30) days that follow the reception of a written notice from the City stating its intent to end the agreement, unless the default is remedied within that delay.”*<sup>13</sup> [Our translation]

According to the Court, stipulating that client may resiliate the contract in the enumerated circumstances does not prevent the protections of 2125 CCQ in other situations. Service providers should therefore draft agreements with negative language when they would like to exclude a client's 2125 CCQ protections.

In other words, a clause stating that: *“a client may not unilaterally resiliate the service contract unless one of the following circumstances arises...”*, will generally be interpreted as a valid total waiver. Conversely, a clause stipulating that: *“...the client may resiliate the service contract in the following situations...”*, is not in itself treated as a limitation of the protections offered by 2125 CCQ.

In other cases, valid total waiver of 2125 CCQ is even less explicit. For example in *Gestion Environnementale Nord-Sud vs Municipalité Ste-Marthe-sur-le-Lac*,<sup>14</sup> a municipal waste-disposal service contract stipulated that in order to unilaterally resiliate the agreement, the municipality had to establish that the service provider had defaulted on its obligations on three distinct occasions. The Court concluded that since the municipality failed to satisfy these conditions (as it had only invoked a single case of default), it could not enjoy the protections of 2125 CCQ.

This judgment demonstrates the extent to which a relatively implicit waiver of 2125 CCQ may be admitted by courts in some circumstances. Such interpretations are not guaranteed when the waiver clause is subtle. Service providers should therefore proceed with caution and use relatively explicit language in total waiver clauses, to mitigate the risk of being unable to claim loss of the future profits.

Note that a different set of rules applies to service and construction contracts formed with consumers, as those agreements are covered by the *Consumer Protection Act*. Pursuant to that act, clauses which waive consumers' rights under 2125 CCQ are generally invalid.<sup>15</sup> As such, the principles explained above do not apply to contracts covered by that act.

## Conclusion

Even if a client has effectively waived 2125 CCQ, the service provider will not always be allowed to claim all future profits lost due to the client's decision to prematurely terminate the agreement. Penal clauses binding a client that has waived 2125 CCQ to pay the service provider all future losses are on many occasions declared abusive by courts and may therefore be reduced by a court exercising its discretion.<sup>16</sup>

When it comes to service contracts, effective drafting is essential to minimize risks and secure long-term profitability. It would be our pleasure to assist you with the drafting of a practical service contract that protects the interests of your business and the profitability of your contracts.

6. *Ibid*, see also: *Phoenix Flight Operations Ltd vs Royal Aviation Inc.*, 2000 CanLII 29916 (QC CS).
7. *Boudreau vs Interstan Inc.*, 2002 CanLII 23844 (QCCS).
8. *Ascenseurs A-1 Technic Inc. vs Huang*, 2016 QCCQ 3825, par 64-66. See also: *Services Matrec Inc. vs CFH Sécurité Inc.*, 2014 QCCA 221, par 10.
9. *Unifirst Canada ltée vs Linteaux structuraux ajustables Lintech Inc.*, 2013 QCCQ 661, par 19-21.
10. 2642-3079 *Québec Inc. (Multi Services professionnels) vs Équipements pétroliers Claude Pedneault*, 2010 QCCS 225, par 48.
11. 2642-3079 *Québec Inc. (Multi Services professionnels) vs Équipements pétroliers Claude Pedneault*, 2010 QCCS 225, par 50-51.
12. See also: *Sita Canada Inc. vs 9033-5944 Québec Inc.*, 2005 CanLII 47909 (QC CQ), par 22, and *8657939 Canada Inc. vs Boutique G2 Vape Inc.*, 2015 QCCQ 5631, in which the Court of Quebec concluded that the client waived the protection of 2125 CCQ, even though the clause did not explicitly reference article 2125 CCQ.
13. *Côté vs Mirabel (Ville de)*, 2015 QCCS 1751, par 42-45, 59.
14. *Gestion Environnementale Nord-Sud vs Municipalité Ste-Marthe-sur-le-Lac*, 2010 QCCS 2633.
15. *Consumer Protection Act*, CQLR c P-40.1, s. 11.4, *Tenedora 87, s.r.l. (Phoenix Spa & Resort) vs Massé*, 2016 QCCQ 5775.
16. See for example: *Immeubles Le Proprio courtier immobilier agréé Inc. vs Duguay*, 2002 CanLII 20775 (QC CS) and *DF Coffrages Inc. vs Côté*, 2003 CanLII 16524 (QC CS), *Unifirst Canada ltée vs Salaison Alpha ltée*, 2010 QCCQ 2474.

**The content of this newsletter is intended to provide general commentary only and should not be relied upon as legal advice.**

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1. *Pelouse agrostis turf Inc. vs Club de golf Balmoral*, 2003 CanLII 2728 (QCCA).
2. *Services Matrec Inc. vs CFH Sécurité Inc.*, 2014 QCCA 221, par 31-42, *GSI Environnement Inc. vs Entreprises HDJS Gascon ltée*, 2007 QCCS 5706, par 68-70, 81-82.
3. Karim Vincent, *Contrats d'entreprise, contrat de prestation de services et l'hypothèque légale*, (2015), at par 1731.
4. *Novacentre Technologie ltée vs Corporation d'Urgences-santé de la région de Montréal métropolitain*, 2012 QCCS 4055, *MCA Valeurs mobilières Inc. vs Valeurs mobilières Marleau Lemire Inc.*, 2007 QCCA 92.
5. *Société canadienne des postes vs Morel*, 2004 CanLII 21187 (QC CA), par 46.