

Franchising - Canada

Outer limits of late payment and collection fees in Quebec

Contributed by [Lapointe Rosenstein Marchand Melançon LLP](#)

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Introduction

A persistent concern in Quebec has been whether interest or late payment clauses could be considered abusive under civil law in the context of the rules of interpretation applicable to contracts of adhesion⁽¹⁾ – as franchise agreements are normally considered – or by being re-characterised as penalty clauses that may be reduced by the court if considered abusive in any contract.⁽²⁾

In several recent decisions the Quebec Court of Appeal has provided guidance regarding the enforceability of a late payment interest clause when coupled with a collection fee penalty clause. The recent decision in *Diamantopoulos v Construction Dompat Inc*⁽³⁾ is of significant interest in relation to the interpretation of franchise agreements that contain both late payment/interest provisions and collection fee provisions, or a combined clause to the same effect.

Facts

Diamantopoulos appealed a judgment of the Quebec Superior Court ordering him to pay Construction Dompat Inc, a contractor which worked on his home, the balance owing to it, as well as 24% interest on that balance and a 20% collection fee. The contract between the parties specified an interest rate of 24% a year on overdue amounts, as well as a distinct collection fee penalty of 20% of the aggregate amounts owing.

The superior court allowed Dompat's claim including interest at 24% a year, although on a reduced invoice amount as some charges were found to be baseless. Diamantopoulos appealed on the grounds that certain other invoiced amounts were baseless and the interest and collection fee clauses were abusive.

Decision

On appeal Diamantopoulos argued that the interest and collection fee clauses, especially when coupled with Dompat's claim relating to Article 1620 of the Quebec Civil Code – which provides that "interest accrued on principal does not itself bear interest except where that is permitted by agreement or by law or where additional interest is expressly demanded in a suit" – constituted abusive penal clauses.

The court considered whether Diamantopoulos could avail of the reduction provided in Article 1623 of the Quebec Civil Code, which states that:

"a creditor who avails himself of a penal clause is entitled to the amount of the stipulated penalty without having to prove the injury he has suffered. However, the amount of the stipulated penalty may be reduced if the creditor has benefited from partial performance of the obligation or if the clause is abusive."

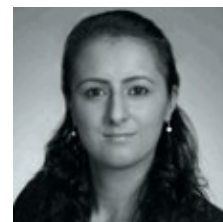
In its earlier decision in *9149-5408 Quebec Inc v Groupe Ortam Inc* the Quebec Court of Appeal considered a contract with very similar clauses, containing an annual interest rate of 24% and a collection fee at 25% (as opposed to 20%). The Quebec Court of Appeal concluded that the annual interest rate of 24% not only was intended to compensate for the late payment, but also contained a punitive element, given the amount by which such rate exceeded the legal interest rate of 5%, together with the statutory additional indemnity of roughly 1% to 2% that may be requested in legal proceedings. Similarly, the Quebec Court of Appeal also concluded that a collection fee

Authors

[Bruno Floriani](#)



[Kiran Singh](#)



of 25% also contained a punitive element. Taken together, these clauses were considered abusive within the meaning of Article 1623 of the Civil Code of Quebec and were accordingly reduced to an aggregate annual rate of 15%.

Without specifically addressing whether the 24% annual interest clause was abusive in the particular circumstances of this case, the court acknowledged that it was not necessarily excluding the possibility that a 24% annual interest charge could be considered abusive in and of itself. However, the court pointed out that these clauses appeared particularly exorbitant in a context in which Dompat had manifestly and significantly exaggerated its monetary claims without being able to prove several elements of such claims, which led to a legitimate debate in respect of which Diamantopoulos should not be the only party to support its costs through the collection fee clause.

Rather, the court concluded that the combined effect of both clauses was abusive. It therefore exercised its discretion under Article 1623 of the Quebec Civil Code to reduce the aggregate amount of the penalty (ie, interest and collection fees) to an effective annual rate of 15%.

Comment

Several interesting issues arising from this decision merit consideration in a franchising context.

Collection fee clauses entitling a contracting party to a fixed percentage of amounts owing in case of legal proceedings to recover overdue amounts from the other party have been recognised as valid penalty clauses by Quebec courts – subject to being reduced if stipulated as an excessive percentage.

With regard to interest clauses, the appeal court stated that an annual 24% interest rate is not intrinsically and necessarily abusive (eg, in the case of a loan subject to a third-ranking hypothec – the Quebec civil law equivalent of a security interest in common law). On the other hand, the court did not exclude the possibility that an annual 24% interest rate could be considered abusive in certain circumstances.

The analysis of the abusive nature of the interest clause was unusual insofar as it occurred in the analysis of a contract that was expressly acknowledged by the court not to constitute a contract of adhesion, in respect of which courts may reduce any obligation considered abusive. In the absence of particular rules of interpretation applicable to a contract of adhesion, the only basis for engaging in such analysis to consider the interest clause was to constitute a penalty clause, which would be a novel development in Quebec law.

Despite such analysis by the appeal court, it is unquestionable that the issue facing the court was the abusive character of the combination of a 20% collection fee with an annual 24% interest rate. Would the court conclude that an interest clause constituted a penalty in the absence of a collection fee clause (or any other form of penalty) that was also applicable in the same circumstances? That appears to be the critical issue in a franchising context, as franchise agreements are often considered to be contracts of adhesion.

Finally, it is noteworthy that the court reduced the payment obligations under these clauses to an aggregate annual rate of 15%, which was characterised as reasonable in the circumstances. This may lead franchisors and other contracting parties to conclude that charging interest and collection fees (or other amounts paid in the same circumstances) whose combined effect exceeds an effective annual rate of 15% would attract judicial intervention and reduction. Unfortunately, the court did not provide detailed reasoning underlying the reasonableness of this rate.

While the appeal court's comment that a 24% interest rate was not intrinsically and necessarily abusive was helpful, the inference from the example cited is that the abusive character of the rate will be judged on the basis of an analysis of the degree of risk associated with the underlying obligation.

Ultimately, these decisions provide much-needed guidance as to the judicial interpretation of the notion of abusive clauses regarding interest provisions and other amounts that may be charged in late payment circumstances. However, they are also indicative that the Quebec courts will exercise a fair amount of discretion in evaluating the circumstances when analysing whether a clause is abusive and subject to judicial intervention.

For further information on this topic please contact [Bruno Floriani](mailto:bruno.floriani@lrm.com) or [Kiran Singh](mailto:kiran.singh@lrm.com) at Lapointe Rosenstein Marchand Melançon LLP by telephone (+1 514 925 6300), fax (+1 514 925 9001) or email (bruno.floriani@lrm.com or kiran.singh@lrm.com). The Lapointe Rosenstein website can be accessed at www.lrm.com.

Endnotes

(1) Article 1437 of the Quebec Civil Code.

(2) Article 1623 of the Quebec Civil Code. It should also be noted that, contrary to common law, civil law recognises the validity of penalty clauses on which the creditor can rely in lieu of proving its actual damages.

(3) 2013 QCCA 929.

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