

Your Contracts: a Systematic and Disciplined Approach is Called for

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Every day, and several times a day, we enter into contracts without knowing it or without considering and controlling their effects.

This bulletin provides a brief and non-exhaustive summary to help you better understand, prepare for and monitor your contractual environment.



Do you know that?

- a contract is a **meeting of minds** that may be expressed and entered into in different ways (written, verbal, e-mail, filling of orders, etc.);
- a contract may be **amended** or **rights abandoned** by actions, words or subsequent writings, or by failing to take action in a timely manner;
- the **law governing** the interpretation and performance of a contract is determined based on various factors and circumstances if the parties do not choose what law applies;
- the **imperative provisions** of certain statutes may take precedence over certain contractual clauses;
- the **suppletive provisions** of certain statutes may complete a contract which is silent with respect to matters covered by the suppletive provisions;
- the **laws are not the same** from one jurisdiction to another and some contractual clauses may be valid and enforceable under the laws of one state but not under the laws of another state;
- the recognition by the courts of the validity of a contractual clause may depend on whether it is **reasonable**;

- the courts are **not bound by the designation, description or name** given to a contract by the parties and will examine the true nature of the relationship and transactions between the parties;
- under the *Civil Code of Québec* (articles 6, 7 and 1375), the entering into and performance of contracts must be carried on in **good faith**;
- in Quebec law, **good faith is not limited** to the absence of malice, vindictiveness or bad faith;
- in Quebec law, the **legality** of a right **does not necessarily mean that it is being exercised legitimately** (the answer to the following question determines whether it is being exercised legitimately: “Would a reasonable person placed in the same circumstances act that way?”);
- under the *Civil Code of Québec* (article 1434), a contract binds the parties “not only as to what they have expressed in it but also as to **what is incident to it** according to its nature and in conformity with usage, equity or law”;
- under the *Civil Code of Québec* (article 1425), “the **common intention** of the parties rather than adherence to the literal meaning of the words shall be sought in interpreting a contract” (i.e. the court may look to other texts to find the meaning);
- under the *Civil Code of Québec* (article 1435), “an **external clause** referred to in a contract is binding on the parties”;
- also under the *Civil Code of Québec* (article 1428), a contract must be interpreted in a way that gives a clause “a **meaning that gives it some effect** rather than one that gives it no effect”; and
- a contract **with a consumer** is subject to specific rules, both as to its substance and its form.



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Examples of case law interpretations

The case law provides us with several examples of the courts' teachings. Here are a few:

- in a **service contract**, unless he has unequivocally waived his **termination right**, a client is entitled to terminate the contract before the expiry of the stated term¹;
- in a **franchising or distribution contract**, even in the absence of a territorial or geographical exclusivity clause or a non-competition clause, **unfair competition** by the franchisor may be suppressed by the court²;
- the **right to unilaterally terminate** a contract may be set aside by the courts if the particular exercise of the power constitutes a breach of the duty of loyalty³;
- in some cases, it has been held that a **unilateral term** that was not negotiated and explicitly accepted by the other party cannot be used against such other party³;
- even where a party's **termination right** (for example, upon 60 days' prior notice) is set out in a contract with an indefinite term, a notice of termination that is longer than that provided for in the contract could be required if the contract has been in effect for several years⁴.

Practical advice before you enter into a contract

Before entering into a contract, it is important to:

- verify the **identity, capacity and solvency** of the other party;
- understand the milieu, **goals and business expectations** of both parties;
- **avoid** statements, or concealing or omitting facts, which could **lead** the other party into **error** regarding your abilities or aspects of your products or services;
- understand and define the nature and features of the products or services, the rights to use them, etc. (**specifications**);
- specify and understand the laws governing the contract and the **legal framework** which will apply (mandatory and suppletive provisions);
- be informed about the **relationships and experiences** involving the other party in general (other contracts, performance quality, disputes) and the purpose of the contract in particular (letter of intent, written communications, etc.);
- be aware of the **power relationships**, time constraints and alternative solutions (e.g. withholding payment and the non-availability of services or products);
- **anticipate the risks** of failure to perform or insolvency of the other party and the steps which could be taken to reduce its adverse effects, through both contractual rights and practical means;
- clarify all the **main elements of the contract** to be drawn up, i.e. prepare a document, ideally working with the other party, in the form of a **term sheet** or checklist;

- **choose** the form, **type of contract** (letter, short contract, long contract, contract of adhesion or negotiated contract) and the language of the contract;
- provide for a **dispute settlement** procedure;
- determine what will be the **internal review and approval procedure** for each party.

¹ *Centre régional de récupération C.S. inc. v. Service d'enlèvement de rebuts Laidlaw (Canada) Ltd.*, J.E. 96-1048 (C.A.)

² *Provigo Distribution inc. v. Supermarché A.R.G. inc.*, [1998] R.J.Q. 47 (C.A.).

³ *E. & S. Salsberg inc. v. Dylex Ltd.*, [1992] R.J.Q. 2445 (C.A.); *Ameublement 640 inc. v. Meubles Canadel inc.*, REJB 2001-24923 (S.C.)

⁴ *Bertrand Équipements inc. v. Kubota Canada Ltée*, REJB 2002-32020 (S.C.).

Practical advice for drafting and negotiating contracts

In drafting and negotiating contracts, it is advisable to:

- adopt a **balanced**, legitimate and reasonable **approach**;
- **beware of models** which were negotiated under different circumstances;
- be **consistent** in the use of words and expressions and include definitions;
- **avoid being overly complicated**, but be precise enough;
- set out the common business goals and those which are specific to each party and state the context (in **recitals**), if they might be relevant in the case of a dispute;
- clearly provide for what will happen **in the event of a default** and at the end of the contract;
- describe how **disputes** will be dealt with and how any price, product and service adjustments will be made;
- if you are the client, favour the **progressive payments** approach and if you are the supplier, provide for **payment guarantees**;
- state how and by whom the contract may be **amended** and who can bind you;
- protect your **intellectual property** and the **confidentiality** of your information;
- define the **exclusivities, non-competition** restrictions and territorial or business sector protections required from each party.

Advice regarding the performance and monitoring of contracts

It is important to:

- not **begin to provide** goods or services without having come to an agreement on the terms and conditions of the contract;
- not let **deadlines** expire and, therefore, to keep a schedule indicating what deadlines are coming up;
- **not** involuntarily **waive** rights;
- not **amend** the contract before those in **authority** have given their explicit approval; beware of purchase orders that modify the contract;
- **document** any failure to perform by either party;
- quickly determine what you intend to do if the other party is in **default**, quickly notify the other party about the default noted and, if there are discussions, clearly inform the other party in writing that they are being held under reserve of, and do not constitute any waiver of, your rights;
- avoid letting any **ambiguity** continue if it is not in your favour;
- designate a **person in charge** in your company to coordinate and monitor the performance of the contract;
- if you are the **purchaser**, check the **compliance** with the contract of any **service** or **product** provided by the other party immediately upon receipt and **avoid signing any receipt** or bill of lading which states in print that the product is in good condition;
- if you are the **supplier**, require that the product be **examined** and the purchaser acknowledge satisfaction quickly, or create a presumption of acceptance.

Conclusion

In summary, clarity, transparency, a mutual understanding of the goals and expectations of each party, good faith and the use of a systematic and disciplined approach will smooth the way for your contracts.

Have good contracts!

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