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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 newsletter 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 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; the Supreme Court of Canada also recognized a duty of honest performance in common law1;[1] ;
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”; however, when the meaning of the words used, placed in the context of entering into and performing a contract is clear, the courts will not intervene;
under the *Civil Code of Québec* (article 1435), “an external clause referred to in a contract is binding on the parties”; an external clause is one that is found in another document, such as the general conditions found on a website;
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.

Examples of case law interpretations

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

in a service contract, unless he has unequivocally waived his termination right, a client is entitled to terminate the contract unilaterally and without cause before the expiry of the stated term, as provided under article 2125 of the *Civil Code of Québec*[2];
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 will not be tolerated by the court[3];
the right to unilaterally terminate a contract may be set aside or be made subject to conditions by the courts if the particular exercise of the right constitutes a breach of the duty of loyalty or is abusive[4];
a unilateral amending clause is valid to the extent that it contains objective criteria and limits which do not depend upon the exclusive control of the beneficiary[5];
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 by the court if the contract has been in effect for several years[6];
the common error of the parties to a contract may be corrected by them by mutual consent and the court may intervene to ascertain the legitimacy and necessity of the amendments made by the parties[7].

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 environment, 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 property, products or services;
understand and define the nature and features of the property, 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 relative strengths, time constraints and alternative solutions (e.g. withholding the financial consideration, the nonavailability of property, services or products, etc.);
be prepared for the risks of failure to perform or insolvency of the other party and plan 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, but be wary of arbitration clauses conferring on one or several arbitrators the power to make business decisions or conferring upon persons who do not have legal training the authority to interpret contractual clauses;
determine what will be the internal review and approval procedure for each party.

Practical advice for drafting and negotiating contracts

In drafting and negotiating contracts, it is advisable to:

adopt a balanced, legitimate and reasonable approach;
use simple language, readily understandable by persons who do not have legal training;
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;

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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 products or services or to transfer property 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 which deadlines are coming up;
not involuntarily waive rights;
not amend the contract before those in authority have given their explicit approval; for instance, 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, property 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 property or product is in good condition;
if you are the supplier, require that the property or 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 should be favored.

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1. *Bhasin* v. *Hrynew* [2014] 3 S.C.R. 494.
2. *Centre régional de récupération C.S. inc.* v. *Service d'enlèvement de rebuts Laidlaw (Canada) Ltd.*, J.E. 96-1048 (C.A.); *Société canadienne des postes* c. *Morel*, 2004 CanLII 21187 (QCCA); *Services Matrec inc.* v. *CFH Sécurité inc.*, 2014 QCCA 221.
3. *Provigo Distribution inc.* v. *Supermarché A.R.G. inc.*, [1998] R.J.Q. 47 (C.A.).
4. *E. & S. Salsberg inc.* v. *Dylex Ltd.*, [1992] R.J.Q. 2445 (C.A.); *Mabe Canada inc. (Camco inc.)* c. *2849-9937 Québec inc.*, 2008 QCCA 847.
5. *Laflamme* c. *Bell Mobilité*, 2014 QCCS 525.
6. *Bertrand Équipements inc.* v. *Kubota Canada Ltée*, REJB 2002-32020 (S.C.).
7. *Québec (Agence du revenu)* v. *Services Environnementaux AES inc.* [2013] 3 S.C.R. 838.

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