

CERTAINTY IS ON THE MENU: CONSIDERATIONS FOR LOWER RISK SERVICE CONTRACTS

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Standard form service contracts are common across many industries. Using the restaurant industry as an example, standard form is the norm for linens, equipment, and cleaning services contracts. While the standard form makes for easier and efficient transactions, it also means limited opportunities to alter or negotiate terms of the agreement. Both parties should be aware of the terms and conditions in standard form contracts and their impact in the event of an early termination.

Awareness of four types of provisions is particularly important:

1. Automatic or self-renewing clauses;
2. Early termination clause or conditions on breach;
3. Choice of law clause; and
4. Choice of forum clause.

The True Price of an Unending Contract

Automatic or Self-Renewing Clauses

Many standard form contracts include automatic or self-renewing clauses for a specific term. Often, contracts renew for two or three years after the expiry of the previous term unless notice of termination is provided. Such clauses eliminate the need to renegotiate or resign at the end of each term, which can save both parties time and money. It can be reassuring for busy business owners to know that key services and equipment they rely on will arrive when needed. For service providers, such contracts provide a dependable source of long-term revenue. Renewal terms can be written in several different ways, but are often seen as:

This Agreement shall automatically be extended for additional terms of sixty (60) months each, unless either party gives the other party written notice (by registered mail) of termination at least ninety (90) days, but not more than one hundred eighty (180) days, prior to the termination of the then current term.

Contracts with these or similar provisions continue until notice as required by the contract is provided.

Self-renewing clauses, however, have drawbacks. It can be difficult for businesses under many contracts with several different service providers and vendors to track the relevant notice periods. The cost of failing to provide adequate notice can be significant. To avoid the risk, and because business owners may want a chance to renegotiate the basic terms of the agreement, it may make sense to delete the self-renewing clause and opt for either "month-to-month" terms or a clause that requires a new agreement be signed by both parties.

Early Termination clauses

Most self-renewing contracts also contain an early termination or cancellation clause that applies when a party ends the contract without providing the required notice (90 days in the above example). Typically, these provisions, known as "liquidated damages clauses", set out a formula to calculate the amount owed to the service provider for business lost due to the customer's breach. Formulas vary in terms of how these amounts are calculated, but the general principle remains the same: the service provider should receive no more than the payment it would have received if the contract had been fulfilled. The amount owed can be determined by referencing the time between the breach and the end of the current term.^[1]

There is good reason to carefully draft this type of provision; Courts will not enforce any provision which would amount to a "penalty" even if the contract specifically says it is not a penalty. If the early termination clause threatens a higher cost after termination than would be owed if the contract had been paid normally over the course of the term, it is an unenforceable penalty.^[2]

Another type of liquidated damages clause is an "acceleration clause", where on termination, all payments that would be due at the end of the term are required immediately on breach. If drafted properly, acceleration clauses are enforceable and severe, but care must be taken not to inadvertently create a penalty.

Both parties can avoid costly and time-consuming litigation by ensuring that the early termination clause is a fair representation of the value of the contract. Reviewing the clause with a lawyer is the easiest way to ensure a party understands how the contract can be terminated.

Where to go? The Importance of Choice of Law and Forum Clauses

A choice of law clause allows parties to determine in advance which province's laws will be applied to any dispute about the contract. Many service providers operate in different provinces than the businesses they serve, so it allows all parties to the agreement to fully understand their obligations under the law. Canada's National Capital Region is a prime example for the importance of attention to choice of forum clauses. Businesses in Ottawa and Gatineau cross the Ontario and Quebec provincial borders, so it is important to pay attention to the standard forms that set out where a dispute is going to be heard and the choice of law to be used to interpret the agreement.

Choice of law provisions are simple and are often written as:

This agreement will be governed by the laws of Ontario [or another province].

A choice of forum clause must be explicit to be effective. Choice of forum clauses are often written as:

The Parties agree to elect as domicile the province of Ontario and choose Ottawa as the appropriate forum for any dispute arising out of the interpretation or performance of this contract.

This clause confirms the contract was made in Ontario and that any disputes should be dealt with in Ottawa. A recent decision from the Ontario Superior Court has found that without explicit language to that effect, the court will apply its own test, creating more uncertainty for contracting parties. The Court also clarified that a choice of law clause cannot substitute for a choice of forum clause.^[3] A choice of law provision is not enough to determine which province's courts will hear a dispute. If parties want to specify the court in which a disagreement about the contract will be heard, they must include a choice of forum clause.

Some service contracts contain several service provider addresses and use a checkmark box approach for the customer to select the applicable address. In the absence of a choice of forum clause, it is tempting to assume that the selected address is a choice of forum. However, that form of address selection is likely only intended to provide contact information for parties with locations in several provinces. Given the court's strict interpretation of choice of forum clauses, it is unlikely that a "selection by checkmark" would be sufficient to substitute for a choice of forum clause. However, that form of address selection could provide evidence of where the contract was made, if the court has to look for jurisdiction. It is important that address selection by checkmark on a service contract be accompanied by a clear choice of forum clause to avoid unnecessary confusion.

It can be quite a surprise to business owner in Ottawa that the law governing the cleaning contract is Quebec and the forum to litigate is Montreal. Take the time to look at the provision and make sure it works for everyone.

Certainty is a valuable commodity in any contract, but particularly when a business is contracting for necessary services to support its successful operation. All parties must know exactly what they are agreeing to and what happens if a dispute arises. Clarity is the easiest way to increase confidence in your contracts and minimize litigation risk. Look for clear choice of forum clauses to ensure that disputes are not longer and more expensive than necessary. Ensure that early termination and renewal clauses are clear and fair to avoid disputes over what happens when one party wants to end the contractual relationship.

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[1][ps2id id='1' target=''] *Roynat Inc v Transport Training Centres*, 2010 ONSC 4894.

[2][ps2id id='2' target=''] *32262 BC Ltd v See-Rite Optical Ltd*, 1998 ABCA 89 at para 14.

[3][ps2id id='3' target=''] *Christmas v Fort McKay*, 2014 ONSC 373.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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