

TERMINATION CLAUSES: DON'T LEAVE THE TABLE WITHOUT THEM
By Christopher Garrah and Christopher Bergs, Lang Michener LLP
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Introduction

When people form contracts they have usually settled on an arrangement that they find mutually beneficial and are therefore happy to be doing business with one another. This can often mean that they will not be thinking about how to terminate the agreement. For some contracts, such as a one-time sale of goods, this is not really an issue – the contract will either be performed or it will be breached with a lawsuit to follow, but for ongoing contracts such as distributorship agreements the question of what happens when the parties no longer wish to be bound is not purely academic.

Parties who do briefly turn their minds to this issue when the contract is being written may believe that they can simply give some period of notice and part company, just as when they fire an employee without cause. There are at least two reasons why following this line of thought is a bad idea:

1. it is uncertain that a contract can always be terminated in this way; and
2. the period of notice would be both uncertain and costly.

Given the uncertainty and potential costs, all contracts of an ongoing nature should have clear termination provisions allowing either party to terminate with a specified period of notice.

The Law

Once they turn their mind to the issue of how to terminate a contract of indefinite duration, most lawyers and business people would likely expect that any contract of an ongoing nature can be terminated on reasonable notice. The ambiguity in the law and the case-by-case style of analysis applied by judges in these cases make this an unreliable rule of thumb.

Presumption of Perpetuity

In fact, up until the last few decades there was generally a presumption that continuing contracts which were silent as to termination were perpetual and that a party seeking to terminate such a contract, even on reasonable notice, would have to rebut this presumption. This was stated broadly in the House of Lords by Lord Selborne in the 1875 case of *Llanelly Railway & Dock Co. v. London & North Western Railway Co.*¹ in which he said “an agreement *de futuro*, extending over a tract of time which, on the face of the instrument, is indefinite and unlimited, must (in general) throw upon any one alleging that it is not perpetual, the burden of proving that allegation, either from the nature of the subject, or from some rule of law applicable thereto.”² The contract in question was one which granted running powers over railway lines with no mention of term or termination. In that same case the Court of Appeal had earlier made a similar

¹ L.R. 7 H.L. 550.

² *Ibid.* at pg 567.

statement of principle, but with certain exceptions that are still cited in modern Canadian jurisprudence.

Exceptions to Presumption of Perpetuity

These exceptions to the idea that contracts of indefinite duration are to be perpetual include any contract involving:

1. trust or confidence;
2. delegation of authority;
3. the necessity of being satisfied with each other's conduct; and
4. personal relations between the parties.

These contracts include employment contracts, partnerships and agency agreements. These sorts of contracts have often been terminable on notice. The employment contract is of course the best example. It typically possesses all of these properties and is always terminable on reasonable notice.

Construction of Contract

In 1955, *Martin-Baker Ltd. v. Canadian Flight Ltd.*,³ another English case still cited by Canadian judges on the issue, was decided. The judgment of McNair J. of the High Court went a good way towards tempering Lord Selborne's statement of principle in *Llanley*. McNair J. pointed out that the law lords had based their finding of perpetuity in *Llanley* on the nature of the contract itself and the strong regulatory background of the railway industry. McNair J. therefore held that the question of notice versus perpetuity should be judged based on construction of the contract itself without any presumption, and that if Lord Selborne's principle was valid it should not apply to merchant contracts. He did this because there were no cases where the principle was applied to merchant contracts cited before him, and because he believed that the practice among merchants would be not to look at such agreements as being intended to be permanent.

Reasonable Notice

In 1986 the Supreme Court of Canada, in *Hillis Oil & Sales v. Wynn's Canada*⁴, held that if "a distributorship agreement does not contain a provision for termination without cause it is so terminable only upon reasonable notice of termination."⁵

At first glance, it would appear the Supreme Court has solved our problem. However, the *Hillis Oil & Sales* decision:

- (a) only applied to distributorship agreements; and

³ [1955] 2 Q.B. 556 (Q.B.) [*Martin*].

⁴ [1986] 1 S.C.R. 57.

⁵ *Ibid.* at paragraph 16.

(b) the agreement in question did contain two termination clauses.

This was a case of an exclusive distributorship in the Maritimes for engine lubricants and additives. The contract allowed for termination without notice for cause but was ambiguous as to the procedure to be followed when no cause was present. The Court was only implying the right to terminate on notice to resolve this ambiguity against the drafting party who was seeking to terminate without cause and without notice. It should also be noted that the contract was a standard form take-it-or-leave-it proposition from the supplier to the distributor. Therefore, this case can be seen more as a *contra proferentum* case than a termination case.

While it is true that some judges simply take for granted that reasonable notice is all that is required to terminate a commercial contract of indefinite term, such as in *SR & J Customer Care Call Centres Inc. v. Craig Wireless International Inc.*⁶, *Martin-Baker Aircraft*⁷, *Bernard-Norman Specialties Co. v. S.C. Time Inc.*⁸ and *Hardware Agencies Ltd. v. Medeco Security Locks Canada*⁹, as will be seen, others post-*Hillis* still look closely at the agreement in question to determine the true intent of the parties.

Can employment law reasonable notice provisions be applied?

It is tempting to apply employment law principles to these situations and imply reasonable notice into all contracts, as is invariably done in contracts between master and servant. However, the Ontario Court of Appeal said just last year, in a case dealing with the termination of a distributorship agreement for flooring products, that “at this stage in the development and application of the law, there is no need, nor is it appropriate in a commercial law context, to import employment law concepts to govern distributorship agreements”¹⁰ and that the idea of reasonable notice will need to be found in contractual analysis rather than analogizing to the employment relationship. Consequently, the Ontario courts cannot be counted on to import employment law concepts into other commercial agreements.

As is the case in the development of other areas of the law, the facts are key and the courts, in ensuring justice is achieved for a specific fact situation, do not necessarily consider broader scenarios. For example, from the perspective of business efficiency, surely two commercial parties to a contract must have intended that a commercial contract be terminable on reasonable notice. However, in our common law tradition, these broad concerns are not necessarily considered in judgments.

Recent Cases

As recently as 1996 and 2006 in Manitoba and Ontario, respectively, courts have held commercial contracts to be non-terminable even with notice as they were intended to only be terminable on certain grounds. The courts did not read in an “implied term of reasonable notice”.

⁶ 2004 MBQB 205 (CanLII)

⁷ *Martin*, supra note 3.

⁸ (1989) 31 C.P.R. (3d) 158.

⁹ [1995] O.J. No. 1800.

¹⁰ *1193430 Ontario Inc. v. Boa-Franc Inc.*, 2005 CanLII 39862 (ON C.A.) at paragraph 47.

Manitoba

The Manitoba case, *Shaw Cablesystems (Manitoba) Ltd. v. Canadian Legion Memorial Housing Foundation (Manitoba)*¹¹, which was affirmed at the Manitoba Court of Appeal, dealt with a contract for cable television for non-profit housing for seniors and veterans. The contract terms had been giving the subscribers a significant discount since 1971 and the provider, understandably, wanted out. Under the contract the provider could terminate for certain breaches on the part of the subscriber, such as unauthorized extensions of the cable system. The contract allowed the subscribers to cancel their service upon giving two months notice before the end of each one-year period, but it contained no such option for the provider. The court held that since the provider had obviously turned its mind to provisions for termination with notice and had not written one for itself there was no basis to imply such a term or read one in. The court also noted that the contract did not specify a fixed price in dollars but rather a 75% discount from normal rates. Therefore the cable provider was still facing the same proportionate loss on the contract as it always had and was not actually providing service at 1970's prices. This was relevant because previous cases decided in favour of the promisor involved fixed prices, which led to the conclusion that the contract was likely not intended to be perpetual, such as a 1978 case where water rates had been frozen since 1929.¹²

Ontario

The Ontario case, *Credit Security Insurance Agency Inc. v. CIBC Mortgages Inc.*,¹³ prevented Canadian Imperial Bank of Commerce from walking away from a contract under which it was buying mortgage insurance. The contract was originally made between the insurance agency and a small mortgage company. The agency was in the business of providing life insurance for customers of such companies. The strategy was to pool the insurance to achieve rates closer to what large lenders received. CIBC later acquired the mortgage company and, since it had its own insurance services, tried to get rid of the small-scale insurance agency. Unfortunately for CIBC, the contract could only be terminated by mutual agreement or on fundamental breach. A memo from an executive at the mortgage company said that, in the event they wanted to terminate, they “would have to make an offer to L&L [the other party] which was acceptable to L&L. Therefore FLT [the mortgage company] could escape from the arrangement, but it would be painful to do so.”¹⁴

The court agreed with this assessment of the situation. The court held that “One does not look at the circumstances at the time that one of the parties wishes to terminate to see if it is then commercially reasonable. One must look at the time of the formation of the contract to make that determination.”¹⁵ At the time of the contract the parties expressed exactly what they intended regarding termination and they intended that the contract could only be terminated in two specific circumstances.

¹¹ [1996] M.J. No. 267.

¹² *Staffordshire Area Health Authority v. South Staffordshire Waterworks Co.*, [1978] 3 All E.R. 769 (C.A.).

¹³ 2006 CanLII 12966 (ON S.C.).

¹⁴ *Ibid.* at paragraph 15.

¹⁵ *Ibid.* at paragraph 36.

The court held that the agreement was a valid and subsisting contract between the parties and that CIBC's notice to terminate was of no force or effect.

Recommendations

It is clear that modern courts are sometimes willing to hold commercial parties to their contracts such that no amount of notice can free them. These cases are relatively rare, but it should be obvious that such a result could be disastrous for a client and should be avoided at all costs.

If you find yourself defending a client who has purported to terminate a contract on reasonable notice without explicit rights to do so, the best strategy is to characterize the arrangement between the parties along the lines of the exceptions to the old presumption of perpetuity, namely that there was:

- (a) trust or confidence;
- (b) delegation of authority;
- (c) the necessity of being satisfied with each other's conduct; and
- (d) personal relations.

It would also be best to stress any evidence of the parties' intention that the contract not be perpetual, including anything in the contract itself that would make the continuation of the contract appear to be absurd.

Notice Periods

Even if one were able to terminate a contract of indeterminate length by giving reasonable notice this result would also be far from ideal. Based on the case law, notice periods tend to be long and are less predictable than those found in wrongful dismissal cases.

Whereas in employment law a rough estimate for common law notice would be one month for every year of service, the situation in business contracts is quite different. For contracts where there is a significant degree of dependence on the terminating party, such as in a distributorship agreement, it would be possible to pay 12 months' notice for a five-year relationship.¹⁶ There is also a great deal of variability of awards from case to case which presents its own problems. It must also be noted that each of those 12 months will be more costly than in the employment arena so that, while a year's salary may not be too hard to swallow when terminating an employee making \$60,000, the expense could suddenly take on real significance to a client's business if they are terminating relations with a major partner.

¹⁶ *Salex Technical Products Ltd. v. N.S.I. Holdings, Inc.*, 2003 CanLII 28427 (ON S.C.), affirmed 2004 CanLII 48651 (ON C.A.).

Conclusion

Given the uncertainty in this area, there is every reason to obtain clauses for termination without cause upon specified periods of notice in all your clients' contracts. It may be difficult to convince them that they might ever want to terminate a great deal with their new best friend, but a few years from now they could be equally incredulous at the thought of making an entire year's payments to someone who has been making them miserable almost since the day they signed – or worse, being stuck with them forever.

Christopher Garrah is a partner in the Business Law Group at the Toronto office at Lang Michener LLP. He practices corporate and commercial law, with an emphasis in mergers and acquisitions. He may be reached directly at (416) 307-4211.

Christopher Bergh is a student-at-law at the Toronto office at Lang Michener LLP

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