

# Happily ever after: the perpetual franchise

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## Introduction

## Facts

## Decisions

## Comment

### Introduction

The option to renew is an integral part of many contractual relationships and renewal clauses are common in commercial contracts, particularly in the case of franchise agreements. In *Uniprix inc v Gestion Gosselin*,<sup>(1)</sup> the Supreme Court upheld the validity of a clause which had the effect of allowing a franchisee to renew a franchise agreement perpetually. In its majority judgment, the Supreme Court affirmed the lower courts' determination that a renewal clause which does not limit the number of times that a contract of affiliation may be renewed is legal pursuant to Quebec civil law. The court further emphasised the importance of respecting contractual autonomy and analysing the parties' common intent in the absence of specific rules prescribed by the Civil Code of Quebec. This landmark decision was also the courts' first opportunity to address the legality of perpetual renewal clauses in Quebec civil law directly, and its reasoning may also find application in the interpretation of renewal clauses governed by the common law of Canada.

### Facts

Quebec-based pharmacy chain Uniprix was initially created by a group of pharmacist owners who joined together for the purpose of developing their respective commercial practices and pooling their resources. In 1998 each member pharmacist:

- entered into a contract of affiliation with the appellant, Uniprix, in order to operate under the Uniprix banner; and
- acquired one share of Uniprix's capital.

The contract's renewal clause stipulated that the member pharmacists could terminate the contract at their own discretion by providing Uniprix with notice six months before the term's expiration. Failing such notification, the contract would automatically be renewed for additional five-year periods (with the contract being silent as to the number of times that it could be renewed). Further, according to other clauses concerning termination, Uniprix could terminate the contract only for cause. Therefore, unless the member pharmacists exercised their right not to renew the contract or were in default, the contract could remain in force perpetually.

The contract was automatically renewed on this basis in 2003 and 2008 with no objection from Uniprix. In 2012 – following a disagreement between the parties pertaining to the location of pharmacies – Uniprix notified the member pharmacists that their contractual relationship would terminate as of January 2013. This termination notice was sent slightly more than six months before the expiration of the contract's third term. As a result, the member pharmacists instituted proceedings in the Quebec Superior Court, contesting the validity of Uniprix's non-renewal notice on the basis that the renewal option had been stipulated solely for their benefit. In addition, the member pharmacists asked the court to declare that the contract had been renewed for an additional five years. In January 2013 the court issued a safeguard order enjoining Uniprix to comply with its contractual obligations until the case was decided on the merits.<sup>(2)</sup>

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## Decisions

### *Quebec Court of Appeal*

The Quebec Court of Appeal confirmed the Quebec Superior Court's conclusion that unilateral renewal clauses are valid under Quebec law despite the fact that they may result in a contract having perpetual effect. The majority further stated that perpetual contracts are perfectly enforceable and that there is no general prohibition against them. Further, the recognition of perpetual obligations by the court would not jeopardise the fundamental principles of Quebec contract law.<sup>(3)</sup>

### *Supreme Court*

Uniprix appealed the Quebec Court of Appeal decision to the Supreme Court. The Supreme Court stated that the analysis must be performed in two steps:

- the first step must characterise the contract; and
- the second must interpret it.

More particularly, the court noted that, under Quebec civil law, contractual analysis must always begin with a classification exercise to determine whether an agreement is a nominate contract subject to specific rules in the Civil Code of Quebec. In this case, the parties were found to have entered into a freely negotiated bilateral contract of affiliation that was governed by the general rules of contract law and not subject to a specific civil law regime that would inform the analysis of the renewal clause – in other words, an innominate contract. In so classifying the agreement, the court noted that the affiliation contracts were not dissimilar to franchise agreements, but could be distinguished on the basis that Uniprix had been expressly created for the benefit of its member pharmacists, as opposed to franchisors that enter into franchise agreements with the intention of selling their pre-existing and independently developed brand and business model to pharmacists. This seems to have been a determining element for the majority in its analysis of whether the textual wording of the term and renewal clause was consistent with the parties' intention.

After characterising the contract as innominate, the court proceeded to consider whether the terms of the renewal clause were clear. Having determined that the wording of the contract was unambiguous, the majority of the court limited the court's role to applying the terms of the contract to the facts: it was the parties' common intent to be bound for definitive successive five-year terms and for the member pharmacists to have full discretion with respect to renewing the contract. In reading the agreement as a whole, the court determined that Uniprix could terminate the contract only for cause and the court could not read into the contract an option for Uniprix not to renew the contract or to terminate it without cause.

The majority held that this interpretation was also consistent with the circumstances surrounding the contract – namely, that Uniprix was created for the benefit of its member pharmacists, who were also its shareholders. It was therefore logical to conclude that Uniprix would serve its members until they decided to withdraw from the arrangement. Further, Uniprix and the member pharmacists were found to be sophisticated entities that had agreed on this renewal mechanism in order to provide stability and predictability to their business relationship. The parties' conduct also suggested that the renewal clause was meant to be perpetual, given the uncontested renewals in 2003 and 2008. In short, the majority could not grant Uniprix's appeal, for such a decision would not only negate the textual wording of the renewal clause, but also conflict with:

- the contract's general scheme;
- the circumstances in which it was concluded; and
- the parties' intent as to its application.

Nonetheless, Uniprix contended that a unilateral and perpetual renewal clause that does not otherwise allow for termination without cause is contrary to public order according to Quebec civil law. The majority of the court determined that this argument was unsubstantiated and speculative, stating that:

- Quebec law does not prohibit innominate contracts from remaining in effect for a perpetual term; and

- there would be no basis for concluding that a perpetual contract would be against public order.

Further, an express stipulation would not be required to give a contract such an effect. The majority was also of the opinion that nothing in law or academic literature supported Uniprix's position; rather, in enacting the Civil Code of Quebec, the legislature had specifically provided that only certain contracts – such as employment contracts, suretyship agreements and commercial leases – cannot have a perpetual term for public policy reasons. This restriction was not found to apply to contracts of affiliation or franchise agreements.

Public order is known to be one of the few limits on contractual freedom. As was the case in the Quebec Court of Appeal decision, Uniprix failed to identify fundamental societal values that would be undermined if the contract of affiliation were of a potentially perpetual duration. Ultimately, the fact that Uniprix may be bound perpetually by the contract and its lack of a right to termination for reasons other than cause were not found to offend public order.

The court's strong dissent is notable. The minority determined that the wording of the term and renewal clause was ambiguous and that the creation of Uniprix for the benefit of its member pharmacists did not preclude circumstances where a particular member's interest could conflict with the collective interests of all member pharmacists. As a matter of law, the minority concluded that the plain reading of the clause resulted in one party being bound to a term of potential perpetuity and the other to a term of only five years – a hybrid term, which would be contrary to Quebec civil law – rather than expressly providing for a perpetual term for both parties. Based on the general principle that a contract's term must function symmetrically for both parties, given the correlative nature of one party's rights with the other party's obligations, the minority concluded that a contract with a purportedly extinctive term is to be characterised as having an indeterminate term when the extinction of the term is dependent on the decision of only one of the parties to the contract. Despite agreeing with the minority as to the foregoing principle, the majority concluded that:

- the parties had intended to be bound by definite, successive five-year periods; and
- the contract had a five-year term in law, even if it could potentially be perpetual in effect for Uniprix.

## **Comment**

With this long-awaited decision, the Supreme Court has finally confirmed that perpetual renewal clauses are not prohibited in Quebec. Franchise and affiliate networks, as well as banner associations, must comply with renewal clauses as written in their agreements even where no strict time limits are provided, and the courts will likely enforce such provisions even though they may lead to perpetual obligations. This decision also highlights the importance of respecting contractual autonomy and promoting predictability and stability in commercial relationships.

In determining that perpetually renewable terms are valid, the Supreme Court's majority noted that contracts of affiliation are similar to franchise agreements. This decision is therefore a reminder of the importance of having clear renewal conditions and processes in place in the context of franchise, affiliate and banner association agreements. These agreements should always:

- clearly provide for the notices, conditions precedent and other formalities required for renewals; and
- unambiguously identify the party or parties entitled to exercise renewal rights.

Despite the views of the majority of the Supreme Court on the issue of perpetual renewal clauses, caution is warranted given the strong dissenting opinion of the minority which, given the unique factual circumstances of this case, may constitute compelling reasoning for distinguishing this case from other situations.

In any event, automatic renewal clauses are not typically recommended for franchise, affiliate and banner networks given that repeated renewals or perpetuity in such arrangements may be detrimental to a network insofar as they may limit the possibility for franchisors or banners to respond to changes in the market and evolving operational considerations.

Where automatic renewal provisions cannot be avoided, the renewal of an agreement should be expressly stated to be contingent upon the satisfaction of various conditions, such as the franchisee or affiliate not being in default under its existing agreement and the execution of the existing form of agreement as put forth by the franchisor or the banner at the time of renewal.

In addition, renewal clauses should clearly specify that any failure to satisfy the prescribed renewal conditions will result in the expiration of the term without any further right to renew.

Parties should also avoid drafting renewal clauses that may be exercised unilaterally by one party indefinitely. Among the variety of options available, parties may limit the number of times that an agreement may be renewed by one party or consider the possibility of allowing either party to end the relationship after a certain number of renewals by providing reasonable notice to the other, thereby allowing both parties the flexibility to stop the renewal cycle.

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## **Endnotes**

- (1) *Uniprix inc v Gestion Gosselin*, 2017 SCC 43.
- (2) *Gestion Gosselin v Uniprix inc*, 2013 QCCS 6251.
- (3) *Uniprix inc v Gestion Gosselin*, 2015 QCCA 1427.

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