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Memorandum

"Hell or High Water" Clauses in Equipment Leases
~ their enforceability in Québec

by
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March 2001. Equipment lessors usually see themselves as providing financing to their customers. For this reason, lease contracts generally include obligations that the lessee must satisfy even where the leased equipment does operate as expected or is lost, damaged or destroyed.

Commonly called "hell or high water" clauses, these contractual provisions essentially require that the lessee perform its obligations under the lease without right of setoff, deduction, abatement, compensation or counter-claim for any reason whatsoever. For the lessor, the purpose is to ensure that it will invariably receive its monthly rental payment. Accordingly, the enforceability of these clauses in law are very important to a lessor.

In Quebec, with the introduction of the new Civil Code, the enforceability of "hell or high water" clauses in equipment leases governed by Quebec law will depend on whether the lease is considered to be a "contract of lease" (a *"contrat de louage*") or a "contract of leasing" (a *"contrat de crédit-bail*"). While this terminology may appear confusing to those outside of Quebec, the distinction is critical to how the courts will treat "hell or high water" clauses in the province.

Contract of Lease ("*contrat de louage*")

The Civil Code of Quebec defines a "contract of lease" (*"contrat de louage")* as a contract where a person, the lessor, undertakes to provide another person, the lessee, with the enjoyment of a movable or immovable property for a certain time in return for rent.

The Civil Code does not expressly state that these provisions cannot be varied by contract in commercial leases. As a consequence, parties to a commercial lease take for granted that they can waive whatever provisions of the Civil Code they wish. In most instances, it is the lessor that requires the lessee to waive certain provisions of the Civil Code which impose positive obligations on the lessor. Unfortunately for lessors, the Quebec courts have held that certain of the "contract of lease" rules in the Civil Code are mandatory. In other words, the parties cannot contract out of such rules.

A clause in commercial lease would be unenforceable in circumstances where its application deprived the lessee of all enjoyment of the property and require the lessee to continue to perform its obligations. The enjoyment of the property throughout the term of the lease is an essential element of a "contract of lease" and, as such, the courts do not accept that the lessee is without a recourse if it is completely deprived of the enjoyment of the leased property. The common “hell or high water” clauses usually provide that rent remains due under all circumstances including the total loss of enjoyment of the property. Such clauses have been struck down by the Quebec courts because they have been held to violate the lessee’s right of enjoyment.

Contract of Leasing (“contrat de crédit-bail)

A "contract of leasing" (*“contrat de crédit-bail")* is defined by the Civil Code as a contract where a person, the lessor, puts movable property at the disposal of another person, the lessee, for a fixed term in return for a payment of rent. The lessor acquires the property from a third party at the demand of the lessee. Upon termination, the lessee is bound to return the property unless it has exercised an option to purchase.

Unlike the "contract of lease" above, the "contract of leasing" requires a tripartite contractual relationship that meets strict legal requirements:

- The lessor must acquire the property from the supplier, at the demand of and in accordance with, the lessee’s instructions;
- The "contract of leasing" must be disclosed in the agreement between the lessor and the supplier;
- The "contract of leasing" may only be entered into for purposes of the lessee’s enterprise (business purposes);
- The "contract of leasing" must have a fixed term and exist in return for lease payments; and
- The leased property must be placed at the lessee’s disposal.

A contract which does not fulfil these requirements will not be considered "contract of leasing" (*“contrat de crédit-bail"),* rather it may be deemed a "contract of lease" (*“contrat de louage")* and be treated in accordance with the legal rules governing the latter.

If the requirements listed above are followed, however, the Civil Code provides that the lessee assumes all risks of loss from the moment it takes possession of the leased property. It should also be noted that the lessor in a "contract of leasing" (*“contrat de crédit-bail")* is not required at

law to provide the enjoyment of the property leased. Therefore, a “hell or high water” clause is enforceable in such a contract.

Conclusion

A pure financing lease is essentially recognized in Quebec law as a "contract of leasing" (“contrat de crédit-bail"). Under such a lease, a “hell or high water” clause is normally enforceable.

When a transaction does not satisfy the stated requirements for a "contract of leasing" *(“contrat de crédit-bail")*, it risks being construed as a "contract of lease" (*“contrat de louage").* In which case, the enforceability of a “hell or high water” clause is problematic and will depend upon the circumstances of each case.

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(CFLA EDITOR'S NOTE: *This commentary concentrates on the effect of the "hell or highwater" clause in equipment leases under Québec law. It does not address the effect of such clauses in vehicle leases because of the additional complications imposed by consumer protection legislation in the province.)*