Contract Law Update: Developments of Note

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Over the years, I have developed the practice of preparing a paper on recent developments in contract law and presenting it at external seminars and within Lawson Lundell LLP. This is the 2010 annual update.

Principles of contract law are quite settled in Canada and changes to those principles tend to be incremental rather than sudden and revolutionary. Accordingly, for the most part, my paper will give you snapshots of contract law principles as they currently stand, using recent cases as examples. To the extent there have been ground-breaking decisions, I will deal with them as well.

Because of time and length constraints, each year I select six or seven contract law topics based on the following criteria:

- Relevance to commercial practice;
- Whether there are recent cases either changing or illuminating the law on the topic;
- Whether there is recent legislative reform that commercial practitioners will want to know about;
- Whether there are any relevant developments in private international law; and
- Whether I have covered the topic in the past.

For your information, the prior papers, which are available from Insight,[1] cover the following topics (leaving aside those that have been overtaken by this year's paper):

> **2009**: Enforceability of exculpatory clauses (exclusion clauses and limitation of liability clauses); illegal contracts and severance; good faith obligations in contract; frustration and *force majeure*; contract termination; privity of contract and third party beneficiaries.
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> **2006:** Good faith in contract law; assignment of contractual rights; mistake; rectification; entire agreement and exclusion clauses; termination clauses;

[1] The 2009 paper is also posted on Lawson Lundell's website: go to http://www.lawsonlundell.com/Team/Lawyers/Lisa-Peters.

frustration; severability of illegal provisions; penalty and liquidated damages clauses; unilateral contracts

This year I will cover: fundamental breach; arbitration clauses; choice of court clauses; time of the essence clauses; economic duress; pre-incorporation contracts; and illegal contracts (statutory illegality).

Fundamental Breach

The term "fundamental breach" is used in two contexts in Canadian jurisprudence, which sometimes leads to confusion. First, that term is used to describe a doctrine that arose out of England through which courts relieved an innocent party of the harsh consequences of exclusion or other exculpatory clauses that would otherwise apply to limit or exclude liability on a breach by another party to the contract.

The term is also frequently used when courts are discussing the doctrine of repudiatory breach. As you may recall, the doctrine of repudiatory breach determines whether an innocent party is entitled to disaffirm the contract and be released from their performance obligations as a consequence of a breach by the other party. When discussing repudiatory breach and the rights of an innocent party, courts often use the terminology "fundamental breach" when describing a breach of a term that is so fundamental or essential that it goes "to the root of the contract" or when describing a breach that has such grave consequences for the innocent party that the breach itself may be characterized as being fundamental.[2]

I have frequently heard lawyers express the sentiment that the decision of the Supreme Court of Canada in *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*[3] laid to rest the doctrine of fundamental breach. While they are drawing on a comment made in the majority judgment (which is reproduced in the headnote), I am not entirely sure what they mean by that statement.

[2] See the helpful discussion in John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005) at 752-4.
[3] 2010 SCC 4.

First, *Tercon* only deals with fundamental breach in the context of exclusion and other exculpatory clauses and, in that specific context, the Court did not eliminate the judicial power to refuse to apply an exculpatory clause in certain circumstances. What the Supreme Court of Canada did in *Tercon* is articulate a new framework for the analysis that should be applied whenever a party is seeking to escape the effect of an exclusion clause or other exculpatory clause. All of the members of the Court agreed on the framework set out by Binnie J., although they disagreed on the results of its application on the particular facts.

What the Supreme Court of Canada did not do is alter the doctrine of repudiatory breach (and the concept of fundamental breach within that doctrine) in a more general way. As one Ontario judge recently noted, "I would not think it appropriate to consider that the decision in *Tercon* has affected the legal principles relating to repudiation. The two issues are distinct and should be kept separate."[4] It is still open to a party to argue that a breach was "fundamental" thereby justifying termination of the contract by the innocent party. A helpful summary of fundamental breach in this context is found in a recent decision of the Manitoba Court of Queen's Bench.[5]

What then is the analytical framework laid out by the Court[6] for dealing with exclusion clauses where there is a breach of the contract by a party *prima facie* entitled to rely on such clause, and an allegation by the innocent party that the breaching party should not be permitted to so rely?

The Court first must ask whether, as a matter of interpretation, the exclusion clause even applies to the circumstances established in evidence. If the exclusion clause does apply, the second step is to consider whether the exclusion clause was unconscionable and thus invalid at the time the contract was entered into.

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[4] *BP Global Special Products (America) Inc. v. Conros Corporation,* 2010 ONSC 1094 at para. 53.
[5] *Pioneer Hi-Bred International, Inc. v. Richardson International Limited*, 2010 MBQB 161 at paras. 109-115. See also, *Petrelli v. Lindell Beach Holiday Resort Ltd*., 2010 BCSC 956 and *McVie v. Summit Steel Cladding Inc*., 2010 BCSC 1025.
[6] At paras. 122-23.

If the answer to the second question is "no", then the court may consider whether it should nevertheless refuse to enforce the exclusion clause because of overriding public policy.

Does this test simplify things? Not in my view. By articulating this new framework the Court has not "laid to rest" the doctrine of fundamental breach, even in the context of exculpatory clauses: I predict parties will still continue to litigate the issue.

The first part of the *Tercon* test emphasizes the importance of drafting comprehensive exculpatory clauses but also underscores the reality that courts will continue to find ways to interpret what may appear to lawyers to be clear language so as to assist the innocent party. The Court of Appeal[7] found that the "no claim" clause in *Tercon* was clear and unambiguous. It struck me as such:

> Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a Proposal each Proponent shall be deemed to have agreed that it has no claim.

Yet the majority of the Supreme Court of Canada found that the exclusion clause only barred claims for compensation "as a result of participating" in the tendering process. This language, it said, could not capture conduct by the Province in accepting a bid from an ineligible bidder and conduct that breached the express and implied terms of the contract in a manner that was an affront to the integrity and business efficacy of the tendering process.

The second part of the *Tercon* test is not likely to be relevant in the context of commercial transactions.

The third part of the Tercon test, rooted in public policy, gives rise to a great deal of uncertainty. The Court did confirm that the burden of persuasion falls on the party seeking to avoid enforcement of the clause to demonstrate an abuse of the freedom of contract that outweighs the very strong public interest in the enforcement of contracts.

[7] 2007 BCCA 592.

The Court gave specific examples of the type of egregious conduct that would meet this burden of persuasion, such as a milk supplier that adulterates its baby formula with a toxic compound to increase its profitability at the cost of sick or dead babies. It cited a recent Alberta decision where the Court of Appeal of that province refused to enforce an exclusion clause where the defendant knowingly supplied defective plastic resin to a customer who used it to fabricate natural gas pipelines, resulting in considerable property damage and risks to human health.[8]

We will have to see what categories of conduct Canadian courts consider sufficiently egregious to displace the important policy of freedom of contract under this test. To date, there are only two cases in which lower court judges have considered the *Tercon* test in any substantive way.[9] Since both cases involved certification of a class action, they provide little or no guidance on the practical application of the test to particular fact scenarios.

Bottom line: Post-*Tercon*, courts still have the ability to let a party out from under an exclusion or limitation of liability clause with the result that no exculpatory clause can be said to be bullet-proof. Only time will tell whether the reformulated fundamental breach test from *Tercon* has made it easier or harder for parties to be relieved from the bargain they made in relation to allocation of liability (including exclusion and limitation thereof).

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[8] *Plas-Tex Canada Ltd. v. Dow Chemical of Canada Limited*, 2004 ABCA 309.

[9] In *Lam v. University of British Columbia*, 2010 BCCA 325, the Court of Appeal had to consider the *Tercon* test when ruling on whether issues raised as to the enforceability of an exclusion clauses were common issues in an appeal from a denial of certification of a class action. The Court found that the question of whether the exclusion clause was unenforceable as contrary to public policy was a common issue.

In *Dennis v. Ontario Lottery and Gaming Corporation*, 2010 ONSC 1332, proposed plaintiffs sought to certify a class action against the Ontario Lottery and Gaming Corporation. The class of individuals in question had signed "self-exclusion" forms provided by the Gaming Corporation, which were designed to provide a process for players with gambling addictions excluding themselves from playing games of chance. The proposed plaintiffs alleged that the Gaming Corporation failed to exercise its best efforts and to take care to exclude them from its gambling venues and sought to recover their gambling losses. The forms contained exclusion or limitation of liability clauses. In the context of the certification motion, the Court had to consider how the *Tercon* analysis might apply to these facts. Cullity J. noted the conflict between the Gaming Corporation's interest in maximizing profits from its gambling operations and its avowed commitment to responsible gambling and that the proposed plaintiffs alleged breaches of *Criminal Code* provisions and the Ontario *Business Practices Act* as being potentially relevant factors in the third stage of the *Tercon* analysis. Since it was only a certification motion, he only had to conclude that it was not plain and obvious that the exclusion clauses absolved the Gaming Corporation.

Arbitration Clauses

There are numerous sources discussing both the rationales for including an arbitration clause in a commercial agreement and the various options as to what such a clause should contain in terms of place of arbitration, applicable rules, number of arbitrators, scope of matters subject to arbitration, *etc*.[10] I am not going to attempt to summarize the large body of commentary on these topics but will address briefly a recent development significant to international arbitration agreements.

In June of 2010, UNCITRAL[11] adopted a revised and updated version of the UNCITRAL Arbitration Rules, which are effective as at August 15, 2010. The Rules were first promulgated in 1976, [12] and as a result had become rather dated and out of step with arbitration practice. An UNCITRAL working group embarked on a lengthy and detailed review commencing in 2006, seeking to modernize the Rules and promote arbitral efficiency.

There is a wide array of choices when it comes to arbitration rules of procedure. In order to advise clients on which ones to choose, you need to review the rules and consider their advantages and disadvantages as compared with other choices.

Factors that might cause you to select the UNCITRAL Arbitration Rules in an arbitration clause where the parties are from more than one jurisdiction include:

- They are viewed as being unbiased toward either civil law or common law concepts and therefore may be more palatable to parties in civil law jurisdictions (the bulk of jurisdictions in the world);
- They are not linked specifically to any nation's domestic law;
- They mesh well with B.C.'s *International Arbitration Act*[13] (which is based on the UNCITRAL Model Law on Arbitration[14]);

[10] See, for example, J. Kenneth McEwan and Ludmilla B. Herbst, *Commercial Arbitration in Canada: A Guide to Domestic and International Disputes* (Aurora, Ont.: Canada Law Book, 2009) (chapter 2 in particular) and Wendy J. Earle, *Drafting ADR and Arbitration Clauses for Commercial Contracts* (Toronto: Carswell, 2005).
[11] The United Nations Commission on International Trade Law.
[12] UN GAOR, December 15, 1976.
[13] R.S.B.C. 1996, c. 233.

- They are modern and expressed in plain language.

Some advantages associated with arbitration clauses, such as speed and efficiency of the process and favourable cost when compared to litigation, may well be illusory.

However, one of the clear-cut advantages of including an arbitration clause in contracts involving parties from more than one jurisdiction, or where enforcement of the award outside the local jurisdiction is anticipated, has been, for many years, the ready enforceability of arbitration awards in a large number of jurisdictions around the world. This widespread enforceability arises as a consequence of the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* (the "New York Convention"), a convention promulgated by UNCITRAL.[15] The New York Convention requires Contracting States both to give effect to private arbitration agreements and to enforce arbitration awards made in other Contracting States. Currently, 144 States have ratified the Convention. Many States have limited its application to matters considered commercial under the applicable national law.

Article V of the Convention sets out very limited grounds for refusal by a Contracting State to enforce an arbitral award.

Arbitral awards are recognized and enforced under the Convention in accordance with the rules of the forum in which enforcement is sought (Article III).

While international enforceability is still a good reason to opt for an arbitration clause, two recent cases involving enforcement of foreign arbitral awards serve as useful reminders of potential pitfalls.

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[14] UNCITRAL Model Law on International Commercial Arbitration, UN Doc. A/40/17, Annex 1, adopted by UNCITRAL June 21, 1985.
[15] *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 21 U.N.T.S. 2517 (entered into force 7 June 1959).

The lesson to be learned from the Supreme Court of Canada decision in *Yugraneft Corp. v. Rexx Management Corp*.[16] is to seek enforcement of a foreign arbitration award in a timely fashion (and otherwise be alert to local rules of procedure affecting enforcement rights). Generally speaking, the matter of limitation periods is left to local procedural law in the jurisdiction where recognition and enforcement is sought. There may be a great deal of variation of limitation periods as among jurisdictions in which your client wants to enforce the award.

In *Yugraneft*, a dispute arose between a Russian corporation and an Alberta corporation ("Rexx") from whom it purchased materials for its oilfield operations. When a dispute arose, Yugraneft commenced arbitration proceedings before the International Commercial Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation (the "Russian ICAC") pursuant to the arbitration clause in the agreement. The tribunal issued an award ordering Rexx to pay US$952,614.43 in damages to Yugraneft. More than three years after the award was rendered, Yugraneft applied for recognition and enforcement of the award in Alberta.

A threshold question was whether any limitation statute applied at all since the New York Convention itself does not list application of a limitation period as a ground on which recognition and enforcement may be refused by a Contracting State. The Court, however, noted Article III and its stipulation that local rules of procedure are to apply insofar as they do not conflict with the express requirements of the Convention. The Court concluded that even if domestic law treats limitation periods as substantive (from a conflicts of law perspective), where the local court is being asked to enforce a foreign arbitral award, limitation periods are procedural within the meaning of Article III of the New York Convention.

In the absence of more specific statutory provisions applying to international arbitration awards, Alberta's general limitation statute applied. That statute brought with it, in turn, codified limitation law concepts such as discoverability.

[16] 2010 SCC 19.

Alberta has one of Canada's strictest limitation statutes, with most claims being captured by a two year limitation period. Yugraneft sought to characterize the arbitral award as "akin" to a judgment, so as to be able to rely on a 10 year limitation period. The Court ruled that an arbitral award is not a judgment or order and instead fell under the more general limitation period for claims seeking a remedial order (two years). The Court held that the limitation period would not ordinarily be triggered until the possibility that the arbitral award might be set aside by the local courts in the country where the award was rendered has been foreclosed. On the facts, Yugraneft was out of time.

Under B.C.'s *Limitation Act*,[17] an arbitral award to which the *Foreign Arbitral Awards Act* or the *International Commercial Arbitration Act* applies is expressly included within the definition of "local judgment" to which, in turn, a 10 year limitation period applies.[18]

The cautionary note sounded by a series of decisions out of Ontario, also involving an arbitration held in Russia, is that having chosen a foreign arbitration venue and process, you cannot ignore that process as it unfolds and later expect the Canadian courts to excuse you from the process you agreed to or to refuse to enforce the award because of concerns you raise before it about the process or questionable conduct of the other side. Furthermore, you need to be sure you understand the scope of the arbitration clause, since it may capture much more than disputes under the contract and may prevent you from seeking relief in tort or unjust enrichment in a separate proceeding in Canada.

In *Donaldson International Livestock Ltd. v. Znamensky Selekcionno-Gibridny Center LLC*,[19] a contract between a Canadian pig producer and a Russian agro-industrial company contained an arbitration clause providing for settlement of "any dispute, controversy or claim, which may arise out of or in connection with the present contract", by the Russian ICAC in accordance with that entity's Rules and Regulations. When certain of the pigs for export were quarantined, a heated verbal exchange between the principal of the plaintiff, Mr. Donaldson, and his Russian

[17] R.S.B.C. 1996, c. 266, s. 1.
[18] Paragraph 3(f).
[19] 2008 ONCA 872.

counterpart ensued during which (according to Mr. Donaldson) death threats were made. The Russian company refused to accept delivery of some of the pigs and demanded repayment of certain advance payments. Ultimately, it filed for arbitration. Donaldson International brought an action in Ontario Superior Court seeking a declaration that the arbitration clause was null and void, that recognition or enforcement of any arbitration award would be contrary to public policy, and for injunctive relief to prevent the Russian party from pursuing the arbitration.

Donaldson International claimed that its witnesses were afraid to participate in the Russian arbitration due to the prior threats. The Russian company pointed out that it was prepared to consent to witness participation by video conference or to hold the arbitration in a convenient location outside Russia. Donaldson International was unsuccessful on its motion seeking interlocutory injunctive relief preventing the Russian arbitration from going ahead. The motion judge also permanently stayed the Ontario action, which included a claim for damages for the tort of intimidation by Donaldson International.

The arbitration proceeded in Moscow. Donaldson International did not participate. The Russian ICAC awarded over $1 million in damages to the Russian company. Donaldson International had appealed the motion judge's decision to the Ontario Court of Appeal but was unsuccessful there as well. The Court of Appeal held that the appeal in relation to the motion judge's refusal to grant an injunction was moot, as the arbitration had concluded by the time the appeal was heard. The Court of Appeal refused to grant an injunction prohibiting the Russian company from enforcing the Russian award in Ontario. It also refused to set aside the stay of the Ontario action. Donaldson International argued that its tort claim fell outside the arbitration clause and should be permitted to proceed. The Court of Appeal held that the arbitration clause was extremely broad and captured the tort claim, even though that claim was also made against an individual who was not a party to the pig sale contract.

When the Russian company applied for recognition and enforcement of the arbitral award,[20] Donaldson International tried once more to make all the same arguments it made previously in

[20] 2009 CanLII 51197 (ON S.C.).

the Court of Appeal. The Superior Court held that issue estoppel applied and noted that the proper venue for raising the alleged death threats was before the Russian ICAC.

It was worth noting that at the trial level in the *Yugraneft* case,[21] the Canadian party asserted public policy grounds for the Court refusing to enforce the Russian arbitral award in addition to the limitation argument. Chumka J. of the Alberta Court of Queens Bench noted the very narrow scope of this ground for resisting enforcement of an arbitral award and the importance of raising allegations of illegality, fraud, *etc.* before the arbitral body at first instance.

Bottom line: When drafting an arbitration clause, inform yourself about the various options in terms of arbitral bodies and their rules and procedures. Consider the jurisdictions in which the party you act for will be seeking to enforce the award and confirm that they have implemented the New York Convention. Inform yourself as to the applicable limitation periods for enforcing arbitration awards in those jurisdictions so as to assist your client in enforcing any arbitral awards it obtains.

Choice of Court (Forum Selection) Clauses

The Hague Conference on Private International Law has not been successful in achieving consensus on a comprehensive treaty on choice of court clauses and recognition and enforcement of judgments that is equivalent to the New York Convention. The European Union branched out on its own and has a comprehensive regime dealing with court jurisdiction and recognition and enforcement of judgments within the EU.[22]

After many years of discussion and debate, the Hague Conference produced the *Convention on Choice of Court Agreements*[23] in 2005. This Convention is not yet in force.

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[21] 2007 ABQB 450.
[22] **Council Regulation (EC) No. 44/2001of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.**
[23] *The Hague Convention of 30 June 2005 on Choice of Court Agreements*. For text of the Convention, go to http://www.hcch.net/upload/conventions/txt37en.pdf.

The Choice of Court Convention (as it is referred to colloquially) is a compromise convention, having grown out of the much broader discussions at the Hague Conference on the potential for a multilateral treaty on jurisdiction and recognition and enforcement of judgments.

The scope of the Convention is narrow – it sets rules for when a court must take jurisdiction or refuse to do so where commercial parties have entered into an exclusive choice of court agreement. It also provides for the recognition and enforcement of resulting judgments. The Convention only applies to international agreements, and it contains a long list of matters to which it will not apply, including many subject-matters readily described as commercial, such as insolvency and most intellectual property claims.

The Convention is not yet in force, but has been signed by the European Union and the U.S. and ratified by Mexico. I predict that we will see it come in to force on the international plane and be ratified and implemented in Canada, U.S., Mexico and Europe relatively soon. It is worth noting that the Uniform Law Conference of Canada adopted a uniform implementing Act in relation to the Choice of Court Convention at its meeting in August.[24]

Despite its somewhat narrow scope, the Choice of Court Convention, once in force and ratified by Canada and its trading partners, should provide more certainty for commercial parties in terms of their exclusive forum selection clauses being respected and enforced by foreign courts.

Implementation of the Choice of Court Convention may also clarify domestic law on enforcement of exclusive forum selection clauses within Canada. There is an unfortunate lack of clarity as to the test Canadian courts should apply when asked to take jurisdiction of a proceeding where the parties to the contract in question have selected some other jurisdiction as the exclusive forum.

[24] For details, go to the Uniform Law Conference of Canada website at www.ulcc.ca.

The governing Supreme Court of Canada case on choice of forum clauses articulates what has become known as the "strong cause" test.[25] In a nutshell, Canadian courts should respect a forum selection clause selecting another jurisdiction and should stay the local proceeding unless there is strong cause for not doing so. Bastarache J. made it clear that although the strong cause test shared some features with the *forum non conveniens* test, they are not the same test, and the presence of a forum selection clause warrants a different test.

Regrettably, some lower courts treat the strong cause test as a gloss on the *forum non conveniens* analysis they would undertake in the absence of a forum selection clause (and others simply conflate the two tests). In jurisdictions that have adopted the *Court Jurisdiction and Proceedings Transfer Act*[26] (of which B.C. is one), matters are confused further since the CJPTA is treated as codifying the conflicts of law rules for a local court taking jurisdiction. The fact that forum selection clause are only expressly dealt with in s. 10 of the CJPTA (dealing with territorial competence) and are not referred to in s. 11 (the *forum non conveniens* provision) feeds the notion that B.C. courts are entitled to engage in a full *forum non conveniens* analysis even in the face of an exclusive forum clause by which the parties have selected another jurisdiction.

The Choice of Court Convention effectively ousts any *forum non conveniens* analysis and, in my view, its implementation in Canada should reduce jurisdictional wrangles and the spectre of parallel proceedings in many commercial disputes arising out of well-drafted contracts with forum selection clauses.

If court resolution of disputes under an agreement is a better option for your client than arbitration, make sure that the choice of forum clause is just that, an exclusive choice of forum clause, rather than a clause by which the parties merely attorn to the courts of a particular jurisdiction.[27]

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[25] *Z.I. Pompey Industrie v. ECU-Line N.V.*, 2003 SCC 27, [2003] 1 S.C.R. 450.
[26] S.B.C. 2003, c. 28.
[27] See the discussion of the difference between these two concepts in *B.C. Rail Partnership v. Standard Car Truck Co.*, 2003 BCCA 597 and *Tecnet Canada Inc. v. Unisys Canada Inc.*, 2006 BCSC 1321.

Bottom line: Until the law is clarified by ratification and implementation of the Choice of Court Convention in Canada and other significant jurisdictions, parties cannot rest assured that their choice of forum clause will be respected by Canadian courts or foreign courts.

Your client still may be advised to insert an exclusive forum selection clause as a means of minimizing the risk of multiple proceedings and to discourage courts of jurisdictions other than the one selected from taking jurisdiction. Picking a forum, of course, should be preceded by an analysis of the procedural and practical advantages of various potential fora.

Time of the Essence Clauses

It is always worth revisiting the rationale for, and effectiveness of, specific types of boilerplate clauses.

A time is of the essence clause is invariably part of the boilerplate in commercial agreements, chiefly because of differences between the common law and equity: in the former, time was always of the essence, in the latter time was only of the essence if the parties had expressly or impliedly so agreed. To avoid any suggestion that time is not of the essence, a standard time of the essence clause is therefore included by cautious solicitors.

What is the purpose of such a clause? Wherever a contract stipulates time limits for certain events or performance obligations, failure to meet the time limits by one party will permit the other to rescind the contract if time is stated to be of the essence. It is time of the essence clause that gives the innocent party the right to treat the failure to meet the time limit as a breach of condition.

Time of the essence clauses operate somewhat independently of the principles of contract interpretation. The meaning of such clauses does not really turn on the parties' intention; rather

inclusion of such a clause triggers a set of well-developed rules that modify its strict application.[28]

First, to take advantage of a breach of a time of the essence clause, the person invoking it has to be ready willing and able to perform himself or herself. If that party is also in breach of its obligations, time ceases to be of the essence.

Second, if neither party is ready, willing and able to perform at the stipulated time, one of the parties can "reinstate" time of the essence by giving reasonable notice of a new time limit for performance (which must be reasonable).
Theoretically, courts may imply a stipulation that time is of the essence into a contract or into a particular contractual provision if the nature of the property involved or the circumstances of the case call for such an interpretation.[29] However, as a recent B.C. case illustrates, that is very unlikely to happen.

In *Husky Crane Service Inc. v. Danco Equipment Inc.*,[30] the contract in question was for the installation of a used crane on a truck (which in turn was to be used in Husky's trucking and crane services business). The contract was formed when Danco sent a quotation letter to Husky, which was revised based on discussions between the parties. In the quotation letter, Danco deliberately avoided guaranteeing completion by a specific date and instead gave a general time frame.

Husky took the position in the litigation that by way of a work order it delivered to Danco, the parties agreed to a specific completion date for the work (which Danco did not meet). The Court considered all the circumstances, including the fact that the vehicle was intended for use in the northern B.C. oilfields, where it was off-season, and the fact that the contract was for an installation of a used crane on a used truck, in relation to which both parties ought to have been

[28] Geoff R. Hall, *Canadian Contractual Interpretation Law* (Markham, Ont.: LexisNexis, 2007) at 282-3.
[29] *Sail Labrador Ltd. v. Challenge One (The)*, [1999] 1 S.C.R. 265 at para. 54.
[30] 2009 BCSC 906. *Husky Crane* fits into a long line of B.C. cases in which the courts have rejected the urgings of a party to imply a time is of the essence term into a contract.

aware that unexpected problems could arise. The Court concluded that by agreeing to an earlier completion date on the work order, Danco was not agreeing to be bound by that date to the exclusion of the qualifications and uncertainties expressed in the quotation letter and that it was not agreeing expressly or impliedly to make time of the essence.

Can a court find that time is of the essence in relation to a specific time-limited performance obligation even where the parties do not use those words? The answer is "yes", although the language has to quite explicitly give the innocent party the right to elect to terminate the contract if the time limit is not met.

The contract in question in *1159465 Alberta Ltd. v. Adwood Manufacturing Ltd*.[31] included a "back-out" provision, which read as follows:

> The date of the purchase of the Purchased Assets (the "closing") shall be the later of April 8, 2005, 30 days after the acceptance of this Offer by the Vendor, or such later date as the parties may agree. Notwithstanding the above, or any other provision of this Agreement, if the Closing does not take place within 60 days from the date of this signing of this Offer, the Vendor may terminate this agreement.

The Alberta court acknowledged that time is not presumed to be of the essence in commercial contracts. However, it concluded that the back-out provision, by its wording, did exactly what a boilerplate time of the essence provision would do; as such, it was by definition a time of the essence clause.

Commercial contracts can include numerous provisions that stipulate for performance or action by a specific date or time. In many cases, it will not make sense to have the time is of the essence regime apply by default to each and every time stipulation (by way of a boilerplate clause). Consider therefore, either including time of the essence language in only the provisions where that regime is intended to apply or having the boilerplate provide that except in relation to a list of performance obligations, time is *not* of the essence.

[31] 2010 ABQB 133.

Bottom line: Time of the essence clauses are not surplusage; they serve an important function in commercial transactions. There will rarely be a good reason not to include a time of the essence clause. However, solicitors should consider crafting them so the time of the essence regime triggered by such a clause is only applicable to obligations that the parties intend to be treated as conditions and giving rise to a right to terminate on breach. While the words "time of the essence" are not the only words capable of bringing about the desired result, a clause that does not use those words must make the consequence of not meeting the time limit clear (a right of termination in the innocent party) for it to be treated as making time of the essence.

Economic Duress

Economic duress, where established, results in a contract or a contract modification being voidable, with restitution of money and property paid under the contract being available once the contract is avoided.

While the doctrine does not give rise to a drafting issue *per se*, it is most often pleaded in the context of commercial transactions and therefore solicitors working in this area need to understand its parameters. In particular, when extracting a hard bargain for a client, solicitors need to be alive to the possibility of a subsequent attack on the contract (or on a modification of the contract) based on economic duress.

I think of economic duress as the commercial cousin to unconscionability in the consumer context. You might be surprised to learn that the doctrine of economic duress is referenced in over 40 decisions in Canadian courts since the beginning of 2008.

One of the difficulties courts have struggled with is drawing the line between what constitutes acceptable hard bargaining in a commercial context and conduct that crosses the line so as to constitute an improper threat giving rise to economic duress.

The English courts developed the concept of "overborne will" whereby duress was made out where there was coercion of the will so as to vitiate consent. The test articulated by the Privy Council set out four indicia of coercion of the will:[32]

> Duress, whatever form it takes, is a coercion of the will so as to vitiate consent. ... [I]n a contractual situation commercial pressure is not enough. There must be present some factor ... which could in law be regarded as a coercion of [the] will [of the person alleging duress] so as to vitiate his [or her] consent... . In determining whether there was a coercion of will such that there was no true consent, it is material to enquire whether the person alleged to have been coerced did or did not protest; whether, at the time he [or she] was allegedly coerced into making the contract, he [or she] did or did not have an alternative course open to him [or her] such as an adequate legal remedy; whether he [or she] was independently advised; and whether after entering the contract he [or she] took steps to avoid it. All these matters are ... relevant in determining whether [the person alleging duress] acted voluntarily or not.

The English courts subsequently appear to have modified this test, by shifting the focus somewhat from a subjective inquiry into the wronged party's "coerced will" to an objective inquiry into the legitimacy or illegitimacy of the pressure applied.[33] The party alleging economic duress still must still demonstrate pressure brought to bear by the other party, the practical effect of which is the absence of choice.

Some might say that any difference between these two approaches is illusory or semantic but there is an argument that the new English test is easier to make out (and has moved us further afield from the origins of the law of duress in actual threats of physical harm). From a common sense perspective, it will be difficult for a commercial entity, especially one with legal advice, to demonstrate its will was overborne. It is more practical for such an entity to focus the attention of the court on what the other party did and characterizing it as illegimate pressure.

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[32] *Pao On v. Lau Yiu Long,* [1980] A.C. 614 at 635 (J.C.P.C.).
[33] See, for example, *Universe Tankships Inc. of Monrovia v. International Transport Workers Federation (The Universe Sentinel)*, [1983] 1 A.C. 366 at 400 (H.L.).

The Supreme Court of Canada has not weighed in. A 2008 decision of the New Brunswick Court of Appeal, *Greater Fredericton Airport Authority Inc. v. NAV Canada*[34] contains a useful review of the history of the law of duress. Robertson J.A. was critical of the adoption in Canada of the English law, and in particular of the criterion of "illegitimate pressure" and took the view that the critical factor in an assessment of whether there had been economic duress was whether the victim had any practical alternative but to capitulate to the demand for the contract change.[35]

The New Brunswick Court decided to articulate its own version of the test for economic duress, which is quite complicated, and which appears to shift the focus back to "coerced will". The Court was careful to limit its new test to scenarios where the issue was a variation to an existing contract and noted that concepts such as unconscionablity, undue influence and unequal bargaining power were distinct legal concepts relevant to contract formation that should not infuse the concept of economic duress in this context. With economic duress, then, relative sophistication of the parties may not be particularly relevant:

> Subject to the above observations, a finding of economic duress is dependent initially on two conditions precedent. First, the promise (the contractual variation) must be extracted as a result of the exercise of "pressure", whether characterized as a "demand" or a "threat". Second, the exercise of that pressure must have been such that the coerced party had no practical alternative but to agree to the coercer's demand to vary the terms of the underlying contract. However, even if those two conditions precedent are satisfied, a finding of economic duress does not automatically follow. Once these two threshold requirements are met, the legal analysis must focus on the ultimate question: whether the coerced party "consented" to the variation. To make that determination three factors should be examined: (1) whether the promise was supported by consideration; (2) whether the coerced party made the promise "under protest" or "without prejudice"; and (3) if not, whether the coerced party took reasonable steps to disaffirm the promise as soon as practicable. Admittedly, the last two factors are more likely to have a bearing on the ultimate outcome of a case than the first. As well, note that under this general framework, no reference is made to the supposed victim having "independent legal advice" or to the "good faith conduct" on the part of the supposed coercer. I shall also deal with these matters separately. For the moment, I am going to focus on the framework outlined above.[36]

[34] 2008 NBCA 28, (2008), 290 D.L.R. (4th) 405.
[35] At paragraphs 47 - 51.
[36] At paragraph 53.

The New Brunswick Court's restatement of the test has only been referred to in passing by courts in other provinces, so it is too early to tell if it will become any kind of a standard as the test to be applied for economic duress where an existing contract is varied.

A review of recent Ontario cases suggests that judges in that province favour the modified English test, focussing on the illegitimacy of the pressure brought to bear, but still requiring that the victim's consent be effectively vitiated.[37]

What is the law in B.C.? The two most recent appellate decisions on economic duress in this province are 20 and 16 years old. One involved actual threats of violence to the person.[38] In the other, the Court of Appeal twice endorsed the approach of two different trial judges who had applied the original English test (in dealing with different pieces of an interlocking set of contracts and pleas of economic duress).[39]

There are a number of B.C. cases in which the doctrine was raised by a party over the past two years. The judges in these cases appear to endorse the original English test for economic duress. In *Luxor Food & Beverage Inc. v. Country Style Food Service Inc.*,[40] the plaintiff was unsuccessful because it failed to register any protest at the time the transaction was completed and because the Court found it had practical alternatives to capitulating to the pressure from the other party and had sought out legal advice. In *Schneider v. Mid Mountain Ventures Ltd.,*[41] the defendant signed the contract in question under protest but the court found it had real alternatives and was not under duress.

Whatever version of the test one applies, and whether the focus is on that party's overborne will or the illegitimacy of the pressure brought to bear by the other side, if the innocent party did not

[37] *Darlind Construction Inc. v. Rooflifters*, LLC, 2009 CanLII 55319 (Ont. S.C.); *Taber v. Paris Boutique & Bridal Inc*., 2010 ONCA 157; *Process Automation Inc. v. Norstream Intertec Inc.*, 2010 ONSC 3987.
[38] *Byle v. Byle* (1990), 65 D.L.R. (4th) 641 (B.C.C.A.).
[39] *Canadian Energy Services Ltd. v. Gotaverken Energy Systems Ltd.* (1990), 42 C.L.R. 50 (B.C.C.A.) and *Gotaverken Energy Systems Ltd. v. Cariboo Pulp & Paper Co.*, [1994] B.C.J. 1545 (C.A.).
[40] 2008 BCSC 1433.
[41] 2010 BCSC 400.

protest at the time and, rather than taking early steps to disaffirm contract or contract modification, acted so as to adopt it, it is unlikely to succeed with a plea of economic duress. Bottom line: Where a contract or contract modification arises out of circumstances where one party has the other over a barrel in some sense, it may later be attacked as being the product of economic duress. When acting for the pressured party, and where that party has concluded it has no choice but to capitulate, it will be important to document the nature of the pressure and the lack of practical alternatives for the client and to have the client formally protest and take steps thereafter, if feasible, to avoid the contract. The fact that you were involved advising the client will be a factor the court may weigh in determining whether there was economic duress but will not preclude such a finding on the right facts.

Pre-incorporation Contracts

There is nothing particularly new about the law relating to enforcement of pre-incorporation contracts. However, the wary practitioner (especially those of us who went to law school a few decades ago) must ensure that he or she understands the extent to which the common law principles have been modified in corporate statutes and the attendant risks to the individuals entering into the contract on behalf of a yet-to-be formed corporation.

Prior to legislative reform, the common law wrestled with legal concepts that did not fit well with commercial practice. If an individual sought to enter into a contract on behalf of a corporation not yet in existence, the contract could not be binding on the later formed corporation, since contract law does not allow for a contract with a non-existent person. If the parties intended the contract to bind the corporation, there would rarely be evidence that they also intended the individual to be bound. The other contracting party, who usually had negotiated the contract in good faith, was therefore without recourse against the later formed corporation or the individual who negotiated the contract when strict legal theory was applied.

The common law resorted to various legal finesses to address what appeared to be an unjust and problematic result. In some cases, the courts found that the intention of the parties was always to

make the individual, not some corporation not yet existing, the contracting party. B.C. courts also employed the device of finding the contract enforceable against the later formed corporation on the basis it adopted the pre-incorporation contract, thereby entering into a contract on identical terms.

Modern corporate legislation attempts to regularize these concepts and outcomes. The legislation makes it more difficult for what the common law referred to as to as the "promoter" (referred to as the "facilitator" in the B.C. legislation) to avoid liability under a pre-incorporation contract. It is important to be aware that B.C. *Business Corporations Act*[42] takes a somewhat different approach than *Canada Business Corporations Act*,[43] and Acts modelled on the CBCA.

The corporate statutes provide that the corporation, once it has come into existence, can adopt the contract by any act or conduct signifying its intention to be bound, and that the corporation is thereby bound by and entitled to the benefits of the pre-incorporation contract as if the new company had been incorporated at the date of the pre-incorporation contract and had been a party to it.

The case law interpreting the corporate statutes confirms that the courts will take a broad view of conduct that will amount to adoption of the contract by the corporation and will reject an argument that there has to be some sort of formal adoption by way of internal corporate process or external notice.[44]

Under the CBCA model, person who enters into, or purports to enter into, a written contract in the name of or on behalf of a corporation before it comes into existence is *prima facie* both personally bound by the contract and entitled to its benefits.[45]
The person who purported to act in the name of or on behalf of the corporation ceases to be bound by or entitled to the benefits of the contract when the corporation adopts the contract[46]

[42] S.B.C. 2002, c. 57, s. 20
[43] R.S.C. 1985, c. 44, s. 14.
[44] See, for example, *Gurdev Holdings Ltd. v. Schmidt*, 2009 BCSC 551.
[45] CBCA, s. 14(1).

unless the court otherwise orders under a provision permitting applications to the court to be made by a party to the contract.[47] However, the promoter can bullet-proof himself further by obtaining an express exemption from liability from the other contracting party. In that case, the court's jurisdiction to make an order respecting the nature and extent of the obligations and liability under the contract of the corporation and the person who entered into, or purported to enter into, the contract in the name of or on behalf of the corporation is ousted.[48]

The B.C. regime is more complicated. Rather than deeming the promoter/facilitator to be liable on the pre-incorporation contract (unless and until it is adopted by the corporation), the B.C. Act makes the facilitator liable on the basis of a statutory warranty that the company will come into existence within a reasonable period of time and will adopt the pre-incorporation contract within a reasonable period of time.[49] The statutory measure of damages for breach of the warranty is the same as if: a) the company existed when the purported contract was entered into; 2) the person who entered into the purported contract in the name of or on behalf of the company had no authority to do so; and 3) the company refused to ratify the purported contract.[50] From a practical perspective, there may be no real difference between the risk, as promoter, of being liable as a contracting party under the CBCA model and the risk under the BC Act of being liable for damages based on the deemed statutory warranty. However, the B.C. Act may in some ways simplify matters –the other contracting party cannot seek specific performance or other remedies to compel the facilitator to carry out performance obligations under the contract and, conversely, the facilitator has no rights to any benefits under the contract.

The B.C. Act permits the parties to agree in writing that the facilitator will not be liable for the pre-incorporation contract pursuant to the statutory warranty in circumstances where the corporation does not come into existence or, on coming into existence does not adopt the contract.[51]

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[46] CBCA, s. 14(2).
[47] CBCA, s. 14(3).
[48] CBCA, s. 14(4).
[49] BCBCA, s. 20(2).
[50] BCBCA, s. 20(2)(c).
[51] BCBCA, s. 20(8).

However, whereas the CBCA makes it clear that an express written exemption of the promoter from liability for the pre-incorporation contract ousts the jurisdiction of the court to assign liability to that person pursuant to its statutory discretion, the B.C. statute is ambiguous. In my view, there is at least a hypothetical argument that in circumstances where the company adopts the contract, it is still open to the facilitator or any party to the pre-incorporation contract (including the company) to ask the court to set the obligations of the new company and the facilitator under the pre-incorporation contract as joint or joint and several or to apportion liability.[52]

Bottom line: If you are acting for the facilitator (promoter), ensure that you obtain an express written exemption of that person from liability. Such a provision should stipulate that the person is not liable on the pre-incorporation contract whether or not the corporation is later formed and whether or not such later formed corporation adopts the contract. If the applicable legislation is the B.C. Act, you will want to add a stipulation that the person is exempt from liability under the statutory warranty in s. 20(2).

If you are acting for other parties who are duped into signing a contract with a non-existent corporation, there are significant remedies available to them even if the corporation never comes into existence or, when incorporated, refuses to adopt the pre-incorporation contract. Better still, where the corporation does adopt the contract, you may still be entitled to enforce the contract against the facilitator.

Illegal Contracts

The law in relation to illegal contracts can be divided into two broad categories: contracts that are contrary to public policy at common law and contracts that conflict with a statutory scheme (which I will refer to as statutory illegality).

[52] Under BCBCA s. 20(6) and (7).

I am only going to deal with the second category.

It is not difficult to advise clients where the statute in question expressly states that breach of a particular provision will result in a contract being unenforceable or that a particular type of contract or contractual provision is unenforceable.

However, when statutory illegality is raised by a party seeking to resist enforcement of a contract, it is more often raised in the context of a statute that does not plainly determine the question of enforceability but instead prohibits specific conduct or delineates mandatory regulatory requirements. The party seeking out from under its contractual obligations argues that because the contract contemplated the prohibited conduct or was formed or operates in a manner inconsistent with the statutory scheme, it is illegal and unenforceable.

Commentators suggest that modern courts are increasingly less inclined to find a contract illegal on the basis that it conflicts with or is inconsistent with a statutory regime.[53] Instead, the courts, mindful of the importance of enforcing contracts as a valid policy objective in and of itself, consider whether enforcing the contract would be consistent with the policies underlying the legislation or, to the contrary, would subvert those policies and exercises its discretion to enforce or not enforce accordingly. As another means to the same end, courts are prepared to consider permitting a party to recover through a claim of unjust enrichment, as an alternative to enforcing an "illegal" contract.

Two recent cases illustrate the type of weighing process that the courts engage in when an illegal contract allegation is made.

In *Wojnarowski v. Bomar Alarms Ltd.*,[54] the plaintiffs sought repayment of monies advanced to the individual defendant, Becker, pursuant to three promissory notes. For tax avoidance reasons, the interest payments on the promissory notes were made, over a number of years, by means of

[53] McCamus, *supra* note 2 at 459-67; Angela Swan, *Canadian Contract Law*, 2nd ed. (Markham, Ont.: LexisNexis, 2009) at 876-9.
[54] 2010 ONSC 273.

cheques payable to fictitious payees and in varying amounts, so as to disguise their true nature. Becker raised this illegality (which he had previously participated in) as a basis for the Court finding that the promissory notes were unenforceable. The Court foreshadowed where it was going with a Denning-esque opening sentence:

> In this action, the parties sought to shed the cloak of criminality that they wore comfortably for more than a decade, only to find the vestments of the virtuous to be ill-fitting.

The trial judge held that promissory notes, in which the parties, using fictitious payees, conspire not to declare the interest as income, are illegal. He concluded as follows at paragraphs 69 and 70:

> Should an attempt be made to strike a balance between eschewing the enforcement of illegal contracts and the countervailing concern of protecting against the inequity of an unjust enrichment (by, perhaps, severing the interest and principal provisions of the promissory notes, with the former being illegal and unenforceable and the latter legal and enforceable)? Is it necessary to unduly anguish over balancing the interests of a collection of criminals?
>
> Where parties enter into a contract that, unwittingly, contains an illegal provision, severance of that provision might be the proper course –if severance is possible. However, where parties conspire to enter into a contract that knowingly contains an illegal provision, and actively perpetuate that conspiracy for more than a decade, it would be offensive to public conscience if they were permitted access to the courts for the purpose of enforcing any part of the contract.

In *Dong v. Tong*,[55] Mr. Tong and his company leased a vehicle to Mrs. Dong. The vehicle in question had been leased by the defendants from a car dealership. Mrs. Dong testified that while the document she signed was headed "Sub-lease", she did not understand what that meant and did not know that the defendants were lessees of the car rather than owners. When the car dealership repossessed the car from the defendants, Mrs. Dong learned that the defendants were not licensed to sell or lease vehicles under the *Motor Dealer Act*. Mrs. Dong brought a claim in Provincial Court to recover the payments she made under the sub-lease before the car was seized.

[55] 2009 BCPC 133.

Bowden P.C.J. (as he then was) concluded as follows at paragraphs 22 and 23:

> In my view the requirement in the *Motor Dealer Act* is intended to protect those persons who may acquire a motor vehicle from a person or corporation [that] is not registered under that statute and who may engage in the sale or other disposition of a motor vehicle in a way that is detrimental to the purchaser or, in this case, the lessee. The requirement of registration in this regulatory statute and penalties for non-compliance are necessary to try and prevent unqualified and, perhaps, unscrupulous persons from engaging in the sale or other disposition of motor vehicles. In my view the registration requirement is designed to try and prevent just the kind of transaction that has taken place between the Claimant and the Defendants.
>
> While it is arguable that the Defendants should not retain any moneys paid under their agreement with the Claimant, the Claimant agreed that they should be entitled to keep the amounts paid as monthly rent until such time as she learned that Langley would be repossessing her vehicle. It seems that at least until November of 2007 the Defendants paid the required lease payments to Langley Chrysler so that the Claimant was not exposed to the care being repossessed until that time. Accordingly, the Claimant's claim for 18 months of payments during the time she possessed the vehicle is dismissed.

Mrs. Dong did recoup her $12,000 downpayment.

If a contract is illegal, all is not lost for the party seeking to enforce it if severance of the "illegal" content is possible. A well-drafted severance clause should be included in the boilerplate to make this result more likely. I discuss the doctrine of severance at length in my 2006 paper.

Based on my unscientific survey of the case digests, the types of statutory provisions most often pleaded as giving rise to illegality of contract are the *Criminal Code* prohibition against criminal rates of interest and mandatory requirements of planning and land title statutes. Where the illegality is a criminal rate of interest, severance is possible and usual. Severing the illegal part of the contract may not be an option where the entire contract runs afoul of rules relating to subdivision approval or statutory rules for creating a specific type of interest in land.

Bottom line: Absent an express statutory provision deeming non-compliant contracts to be unenforceable, it is not easy to predict when a contract, some aspect of which is contrary to or inconsistent with an applicable statute, will be found to be illegal and unenforceable as a consequence. Obviously you need to be familiar with the statutory regimes applicable to the parties to or subject-matter of a given agreement so as to avoid inadvertently creating a potential argument of statutory illegality down the road by drafting provisions that conflict with a relevant statutory regime

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