CONTRACT LAW UPDATE – DEVELOPMENTS OF NOTE 2015

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I have been preparing this annual review of contract law cases relevant to commercial practice since 2009. Last year (2014) was an exceptional year because the Supreme Court of Canada ("SCC") issued several blockbuster decisions influencing contract law. My paper last year was published in two instalments, with the second instalment dealing exclusively with the SCC decision in *Bhasin v. Hrynew*.

I have attached as an appendix a list of topics covered in prior updates. Those updates are all available on Lawson Lundell LLP's website under my profile (www.lawsonlundell.com/team-Lisa-Peters.html).

We find ourselves in a world where many contract law principles have been settled or clarified by SCC jurisprudence over the last decade. To refresh your memory, some of the key SCC decisions (and their subject matters as they pertain to contract law) are:

- *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53: Confirmed that a question of contract interpretation is a question of mixed fact and law and that the surrounding circumstances (or factual matrix) are to be considered in every contract interpretation exercise, not just where there is an ambiguity.

- *Bhasin v. Hrynew* ("*Bhasin*"), 2014 SCC 71: Articulated the new duty of honesty in contractual performance (not to lie or mislead the other party about one's contractual performance) and mapped out an overarching organizing principle of good faith.

- *Payette v. Guay*, 2013 SCC 45: Confirmed that restrictive covenants in commercial contracts (particularly where there was no imbalance of bargaining power and the parties had professional advisors) are not as rigorously scrutinized as restrictive covenants in employment contracts.

- *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)* ("*Tercon*"), 2010 SCC 4: Enunciated a three-part test for assessing whether a party can escape the effect of an exclusion clause (or similar exculpatory clause).

- *Shafron v. KRG Insurance Brokers (Western) Inc.*, 2009 SCC 6: Clarified that notional severance is not an appropriate mechanism to cure a defective restrictive covenant.

- *Jedfro Investments (U.S.A.) Ltd. v. Jacyk*, 2007 SCC 55: Explained that the fact parties have ignored an agreement or treated it as abandoned will not result in the agreement

being discharged unless it can be shown that the parties, by their conduct, agreed to a new contract in substitution for the old.

- *Transport North American Express Inc. v. New Solutions Financial Corp*., 2004 SCC 7: Propounded a technique of "notional severance" (a method of reading down more liberal than the traditional "blue-pencil approach") for severing illegal provisions in contracts, particularly contract provisions that provide for a criminal interest rate.

- *Hamilton v. Open Window Bakery Ltd*., 2004 SCC 9: Clarified how damages for breach of contract are assessed in a scenario where a defendant who wrongfully repudiated a contract had alternative modes of performing. In this scenario, the performance mode adopted (and on which damages are based) is the mode least profitable to the plaintiff and least burdensome to the defendant.

- *Semlhago v. Parmadevan*, [1996] 2 S.C.R. 415 and *Southcott Estates Inc. v. Toronto Catholic District School Board*, 2012 SCC 51: Clarified when specific performance is available as a remedy and the interaction of the duty to mitigate with a claim for specific performance.

- *London Drugs Ltd. v. Kuehne & Nagel International Ltd*., [1992] 3 S.C.R. 288 and *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108: Articulated the "third party beneficiary" or principled exception to the doctrine of privity.

From the perspective of commercial certainty, this abundance of SCC guidance is a good thing. From the perspective of this writer, it has made it more difficult to find cases foreshadowing or illustrating significant changes in contract law as it applies to commercial transactions.

But that does not mean there is nothing to talk about. As always, I reviewed decisions handed down since I wrote last year's paper, looking for cases dealing with contract law principles relevant to commercial solicitors and commercial litigators. The cases I chose do not necessarily change the law; some simply serve as a springboard for discussing pre-existing principles or doctrines.

This year, I track how lower courts have applied some of the SCC cases listed above (*Bhasin* and *Tercon* in particular).[1] I revisit the question of whether there is a duty of good faith negotiation. I discuss 2015's SCC case dealing with a commercial contracting issue (interaction between confidentiality clauses and settlement privilege). I introduce some new topics: automatic renewal clauses and continuing breach.[2]

Bhasin v. Hrynew **– The Aftermath**

I reviewed the decisions citing *Bhasin* with two questions in mind:

[1] A chart tracking the topics covered in my annual papers since 2009 is attached.

[2] I would like to thank Nabila Pirani, articled student, for her help in reviewing this year's cases and Meg Gaily for her assistance in editing.

1. Would there be many (or any) successful claims under the new duty of honesty in contractual performance?

2. Would lower courts use the "organizing principle" of good faith performance to create new doctrines, by finding a duty of good faith in factual circumstances other than those already identified in pre-*Bhasin* jurisprudence?

The answer to the first question is a qualified yes. The answer to the second question is no. I will discuss the cases leading me to those conclusions below.

It is important to know that certain appellate decisions have raised questions about the impact of *Bhasin* on the law of implied terms, a subject I will discuss below under a separate heading after commenting on the more general impact of *Bhasin* over the past year.

The new duty of honesty in contractual performance

While parties pleaded the new duty of honesty in contractual performance in a number of cases, most failed to make out a breach of the duty on the facts – they could not point to any lies or misleading statements made by their counterparty in their contractual performance .[3]

There are a few cases in which a plaintiff was successful. In those cases, however, the result could be explained on a legal theory other than breach of the duty of honesty.

Gaudet v. Dugas, 2015 NBQB 59, involved a contract under which Mr. and Mrs. Gaudet purchased a commercial fishing business from Mr. and Mrs. Dugas, including federal fishing licences. The most valuable licence was a snow crab licence. In what follows, I will refer to this licence simply as the "licence".

At the time the sale closed, Mr. Gaudet did not qualify to hold title to the licence. It was agreed that Mr. Dugas would hold it in trust pending an eventual transfer. Three years later, on the pretext that the Department of Fisheries and Oceans was going to revoke the licence and that it would not be possible to transfer it, Mr. Dugas unilaterally terminated the trust agreement, re-appropriated the licence and resumed fishing himself. The Gaudets sued. Mr. Dugas offered to pay them $2.1 million within 30 days to settle the matter and a consent order was executed, which included that term. Mr. Dugas then proceeded to declare bankruptcy, which allowed him to keep the licence, and the original purchase price under the contract with the Gaudets, while paying them cents on the dollar through the trustee in bankruptcy. The Gaudets then brought an action seeking to set the consent order aside (along with other relief).

The basis asserted for setting aside the consent order was Mr. Dugas's bad faith. Mr. Justice Ouellette held that Mr. Dugas failed to meet the requirement to act honestly in the performance of a contract, citing *Bhasin*. He found that Mr. Dugas never intended to perform the contract and to pay the settlement amount of $2.1 million; rather, his goal was to recover the licence in order to profit from the considerable increase in its market value.

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[3] See, for example, *Chuang v. Toyota Canada Inc*., 2015 ONSC 885, *Burquitlam Care Society v. Fraser Health Authority*, 2015 BCSC 1343; *Badger Daylighting Kindersley Ltd. v. Badger Daylighting Inc*., 2015 ABQB 55; *Tender Choice Foods Inc. v. Planet Energy (Ontario) Corp*., 2015 ONSC 817.

The trial judge found that by terminating the trust agreement under which he held the licence and failing to transfer the licence, Mr. Dugas breached his fiduciary duty. Since Mr. Dugas was clothed as a fiduciary in relation to the licences, his lack of candour about his plan for going bankrupt was arguably a breach of fiduciary duty as well and the case might have been decided on that basis alone.

The Court declared the consent order to be void *ab initio*. Mr. Justice Ouellette ordered specific performance of the trust agreement (conveyance of the licence to the Gaudets) and awarded damages for breach of fiduciary duty by way of an accounting of the profits earned by Mr. Dugas fishing with the licence.

Combined Air Mechanical Services v. Computer Room Services Corp., 2015 ONSC 610, involved the bid tendering process in a construction context. Combined Air was an approved tenderer on a design/build project of HVAC systems for the computer systems of Hydro One. Combined Air agreed to work with the defendant ("CRSC") to develop a single tender, with CRSC as prime contractor/tenderer naming Combined Air as its mechanical subcontractor. Combined Air then withdrew as a primary tenderer. Combined Air's price for the mechanical work was included in CRSC's bid, which also referred to the expertise of the project and service manager of Combined Air. CRSC's bid was accepted but it subcontracted mechanical services for the project to another company. Combined Air sued CRSC.

Combined Air relied on the principles set out *in R. v. Ron Engineering & Construction (Eastern) Ltd.*, [1981] 1 S.C.R. 111, to found an argument that there was a "Contract A" between the plaintiff and defendant. Justice Lederman applied those principles and found that there was a contract that arose when CRSC included Combined Air's bid (price) as part of CRSC's tender to Hydro One. Implicitly, he appears to have been of the view that CRSC was obligated to use Combined Air as its subcontractor when it won the tender. Accordingly, it may not have been strictly necessary to consider the duty of honesty in contractual performance from *Bhasin*. Nonetheless, it was breach of that duty that Justice Lederman focussed on. He held that CRSC breached its duty of honesty by including information about Combined Air in the bid (such as its project manager's profile) to impress Hydro One, and when CRSC used Combined Air's pricing knowing that it had no intention of using Combined Air as the mechanical sub-contractor (CRSC intended to keep Combined Air in reserve to do the work if it failed to find another mechanical sub-contractor at a lower price).

He awarded Combined Air its lost profit in the amount of $505,420.00.

I will discuss a third case, which dealt with good faith performance in the context of pre-contractual negotiations, under the heading "Is There a Duty of Good Faith Negotiation?" below.

<u>The organizing principle from *Bhasin*</u>

Post-*Bhasin*, while counsel often have chosen to allege a more generic contractual duty of good faith in a range of factual circumstances, drawing on the SCC's articulation of an overarching organizing principle, the decisions over the last year show the courts (in particular the Ontario Superior Court) reining in overly enthusiastic attempts to make *Bhasin* stand for more than it does.

In *Data & Scientific Inc. v. Oracle Corp*., 2015 ONSC 4178, an express clause in a standard form agreement stated that its renewal was at the defendant's ("Oracle's") sole discretion upon the network user applying for renewal on line. The plaintiff had been a member of the Oracle Partner Network for 20 years, but when it applied for a renewal of its contract in 2014, Oracle declined to renew. The plaintiff sued, claiming damages for an alleged failure to give reasonable notice of non-renewal. It argued that Oracle was obliged to exercise its discretionary renewal power reasonably. Oracle brought a summary judgment application.

In this case it was the defendant who sought to rely on *Bhasin*. Oracle submitted that *Bhasin* decided the general principle that the obligation to exercise discretionary contractual powers reasonably does not ever apply in contract renewal situation.

Justice Belobaba, in a passage picked up in subsequent cases, rejected this proposition but also summarized what *Bhasin* did and didn't do:

> [10]…In *Bhasin,* an obviously important development in the continuing modernization of Canadian contract law, the Court in essence, did two things: one, it recognized that the 'situational' and 'relational' examples or pockets of a judicially recognized good faith doctrine were aspects of a broader organizing principle of good faith – "that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily;" and two, the Court decided on the facts before it that it was time to recognize a new duty - "a general duty of honesty in contractual performance."
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> [11] The Court made clear that this new duty of honesty in contractual performance flowed "directly from" and was an "aspect" (albeit "one of the most widely recognized aspects") of the general organizing principle of good faith. In other words, the pre-existing situational and relational aspects or pockets of implied good faith (such as the obligation to exercise discretionary contractual powers reasonably) were not eliminated but were simply realigned under a broad organizing principle of good faith. And the newly established duty of honesty in contractual performance was applied on the facts in *Bhasin* to confirm that the defendant Can-Am breached this duty by misleading the plaintiff and acting dishonestly in numerous ways leading up to and including the non-renewal of their agreement. […]
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> [15] I am therefore not persuaded that *Bhasin* stands for the broadly worded proposition that is being advanced by the defendants. The Supreme Court has not (yet) decided that the long-standing requirement that discretionary contractual power must be exercised reasonably can never apply in contract renewal situations where, as here, the contractual agreement bestows a "sole discretion" non-renewal power and requires no notice of any kind.
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> [16] I also note that in its reasons for judgment, the Court reminds the reader that the list of situations and relationships that can attract good faith obligations "is not closed" and that "the application of the organizing principle of good faith to particular situations should be developed where the existing law

> is found to be wanting ...” The Court notes that good faith can be invoked in “widely varying contexts” and this calls for “a highly context-specific understanding of what honesty and reasonableness in performance require so as to give appropriate consideration to the legitimate interests of both contracting parties.” For example, continues the Court, “the general organizing principle of good faith would likely have different implications in the context of a long-term contract of mutual co-operation that it would in a more transactional exchange.” In my view, these comments apply to the facts herein.

In *Empire Communities Ltd. v. Ontario*, 2015 ONSC 4355, Justice Myers quotes from Justice Belobaba’s reasons in *Data & Scientific Inc. v. Oracle Corp* and set out his views of what *Bhasin* did and did not do.

What it did:

- “…rationalized, renamed, and provided an overall framework for understanding several pre-existing aspects of duties of good faith that have been recognized by the law.”

- Added a new duty not to lie to one’s contractual counterparty.

What it did not:

- Eliminate the pre-existing law of latent defects or the contractual interpretation principles set out in *Sattva Capital Corp. v. Creston Moly Corp*.

- Create a freestanding, ill-defined, and potential arbitrary duty of good faith against which to measure all aspects of contractual performance.

Another Ontario Justice (Justice Dunphy) stated that,[4] “*Bhasin* is no authority for unbridled creativity in the creation from whole cloth of obligations in a contractual context which the parties have not provided for or have addressed in a fashion which one party regrets in hindsight.”

And in *Reserve Properties Limited v. 2174689 Ontario Inc*., 2015 ONSC 3469, Myers J., after holding that there is no duty to remind a party of its contractual obligations (especially sophisticated parties), noted that “*Bhasin* is a very measured case which makes little incremental change to the common law.”[5]

There were also decisions in which courts confirmed circumstances in which a specific good faith duty of performance had already been recognized and which were mentioned by the SCC when discussing the organizing principle in *Bhasin*. For example, in *Styles v. Alberta Investment Management Corp*, 2015 ABQB 621, the Court confirmed the common law duty of reasonable exercise of discretionary contractual powers under the rubric of the general organizing principle

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[4] *Addison Chevrolet Buick GMC Limited v. General Motors of Canada Limited*, 2015 ONSC 3404 at para. 116, leave to appeal refused, 2015 CarswellOnt 16573 (Div. Ct.).
[5] At para. 22.

Bottom line: The new duty of honesty in contractual performance has provided an alternative cause of action in cases that might previously have only proceeded under the banner of breach of fiduciary duty or misrepresentation. However, to succeed on such a plea, the plaintiff must be able to prove that the defendant lied to or actively misled them in terms of their contract performance. The organizing principle discussed in *Bhasin* has not, to this point, served as a springboard for new duties of good faith.

Terms Implied on Grounds of Business Efficacy – Has *Bhasin* Changed Anything Here?

There was a flurry of cases over the last year considering when a term should be implied into a contract on the basis of business efficacy. Two of them underscore some of the confusion that still prevails as to whether a duty of good faith can be implied as a contractual term post-*Bhasin*. All of them serve as a useful reminder of the circumstances when terms will be implied into a contract and the nature of the evidence a party seeking to have a term implied on the grounds of business efficacy must lead.

The test for implying terms

The three circumstances in which terms may be implied into a contract were confirmed by the SCC in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd*. ("MJB"), [1999] 1 S.C.R. 619 at para. 27:

> (1) based on custom or usage; (2) as the legal incidents of a particular class or kind of contract; or (3) based on the presumed intention of the parties where the implied term must be necessary "to give business efficacy to a contract or as otherwise meeting the 'officious bystander' test as a term which the parties would say, if questioned, that they had obviously assumed" [citation omitted].

It is #3 that was the focus of the cases discussed here.

Appellate decisions on implying terms on business efficacy grounds

In *Moulton Contracting Ltd. v. British Columbia* ("*Moulton Contracting*")[6] the trial judge implied a term into timber sale licences that the Province was not aware of any First Nations expressing dissatisfaction with the consultation undertaken by the Province, save as disclosed to the plaintiff. He did so on the following basis:

> [290] The need to engage in meaningful consultation with aboriginal groups is fundamental to questions of land use in territory covered by Treaty 8. If adequate consultation were not to take place, the legitimacy of the "taking up" under the Treaty would stand to be challenged, and a party given license by the Crown to use land would inevitably run the risk of conflict. The Crown must be taken to be aware of this risk in any given situation, and a party engaging in negotiations with the Crown for license to use Crown land must be entitled to assume that the Crown has taken adequate steps to discharge its obligation. The commercial

[6] 2013 BCSC 2348 and 2014 BCSC 993, rev'd 2015 BCCA 89, leave to appeal refused, 2015 CarswellBC 3021 (S.C.C.).

> reality of dealing with land subject to aboriginal claims justifies and necessitates such expectations being recognized as forming implied terms of a contract with the Crown…[7]

The B.C. Court of Appeal held that the trial judge erred in implying a term on the basis of the "commercial reality" from the point of view of parties that contract with the Province more generally. The Court stressed that for a term to be implied on business efficacy grounds, the term must be necessary to make the contract as the parties intended; in other words, it must be established that without the term the contract, as intended by the parties, would not be effective. Therefore, the Court held, the trial judge erred in not considering the effect of other clauses in the timber licences, which were inconsistent with a conclusion that the parties intended for the Province to have a duty to inform Moulton of information relevant to its ability to avail itself of its rights under the licences.

I confess to having some difficulty understanding the Court's treatment and application of *Bhasin* in this case. Madam Justice Levine states[8] that "*Bhasin* clarifies that good faith is not an implied term, but is an organizing principle that manifests in particular doctrines, such as the duty of honest contractual performance." She then cites a passage from a decision of the Ontario Court of Appeal,[9] where that Court said that Mr. Justice Cromwell, in *Bhasin*, "clarified that the duty of good faith should not be thought of as an implied term."

Is the Court of Appeal saying that *Bhasin* stands for the proposition that a good faith obligation can never be implied as a contractual term under one of the three circumstances identified in earlier jurisprudence (based on custom or usage; as the legal incidents of a particular class or kind of contract; or based on the presumed intention of the parties where the implied term must be necessary "to give business efficacy to a contract")?

I do not read *Bhasin* as standing for such a proposition. Mr. Justice Cromwell did not say that a good faith obligation can never be implied as a term in a contract. Rather, he articulated a new contractual doctrine and an overarching organizing principle. In his review of the pre-existing law on good faith, he noted that good faith obligations are implied as a matter of law to address power imbalances in certain classes of contract and are also implied as a matter of fact to give effect to the intentions of the parties. So, for example, courts continue to imply duties of good faith in contracts of employment.

The B.C. Court of Appeal in *Moulton Contracting* may be saying that the duty of honesty in contractual performance recognized in *Bhasin* is a doctrine, not an implied term. That is, of course, what the SCC said. And it may be that the Court viewed the plaintiff as seeking to support the trial judge's implication of a term as an application of the new doctrine and found that the plaintiff failed to make out a breach of the duty of honesty in contractual performance on the facts. Alternatively, the Court may have been reacting to the proposition that an implied good faith obligation arises automatically in the context of contracts with the Crown.

There are two Ontario Court of Appeal cases that feed this discussion.

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[7] In the 2013 decision.
[8] At para. 67.
[9] *High Tower Homes Corporation v. Stevens*, 2014 ONCA 911.

High Tower Homes Corporation v. Stevens, 2014 ONCA 911, is the Ontario Court of Appeal decision cited by the B.C. Court of Appeal in *Moulton Contracting*. However, when that decision is read as a whole, it seems to me that the Ontario Court was not suggesting that a good faith obligation could never be implied into a contract. Rather, the Court was saying that such a term could not be implied on the particular facts of that case, both in light of an entire agreement clause and because to imply a term would be inconsistent with the express terms of the parties' agreement.

In that case, the Ontario Court of Appeal refused to overturn the decision of the trial judge not to imply terms into an agreement of purchase and sale of residential real estate. The vendor in that case was mistaken as to the terms of an agreement of purchase and sale. It was critical to the vendor to sell two adjacent properties together for tax planning purposes. The purchaser initially submitted offers for both properties, but in the course of a series of offers and counter-offers, the purchaser revised the text of the clause under the heading "Condition for the Sale of Adjacent Property" to provide that the sale of property A was not conditional on the sale of property B. This change was not blacklined and the vendor missed it. The vendor accepted this counter-offer.

The purchaser purported to waive conditions in the agreement stated to be for its exclusive benefit. The contract required that such waiver be by notice in writing to the vendor personally by a specific date (and in the absence of waiver, it stated that the agreement would become null and void). The only timely notice given by the purchaser was to the vendor's solicitor. When the vendor realized that the counter-offer no longer tied the purchaser to purchasing both properties, his lawyer wrote to the purchaser stating the contract was at an end because the notice of waiver of conditions had not been delivered to the vendor personally in the set time period. The purchaser sued for specific performance and damages for breach of contract in the alternative. On a motion for summary judgment, the motion judge found that the agreement was unenforceable due to the purchaser's non-compliance with the notice requirement. He held that the entire agreement clause precluded implication of terms to the contrary and was a complete answer to the purchaser's argument that the vendor had waived the requirement that notice be given by personal delivery.

On appeal, the purchaser argued: a) that a term that notice waiving the conditions in favour of the purchaser could be given by fax to the vendor's solicitor and by leaving a copy at the property should be implied as necessary to give business efficacy to the agreement; and b) the vendor waived the personal delivery notice requirement.

This case is not about implying a duty of good faith at all. It is about implying a term as to alternative forms of notice into the contract of purchase and sale on the basis of business efficacy. It would appear that counsel for the purchaser cited an earlier decision of the Court (*CivicLife.com Inc. v. Canada (Attorney General)* (2006), 215 O.A.C. 43) to support an argument that such a term could be implied in the face of an entire agreement clause.

CivicLife was a case about good faith. The Ontario Court of Appeal concluded that *CivicLife*, read in light of the SCC decision in *Bhasin*, should be read as a case about acting in good faith in contractual dealings, rather than as a case providing for a general ability to imply terms – whatever their nature – notwithstanding an entire agreement clause.

The Court of Appeal declined to imply a term in light of the entire agreement clause but also because to imply it would be inconsistent with the express notice provisions in the agreement.

In *Energy Fundamentals Group Inc. v. Veresen Inc*., 2015 ONCA 514 ("*Energy Fundamentals*"), the trial judge implied a term requiring one party to a letter agreement that contained an option to provide the other party (who had the right to exercise the option) with financial information, specifically the optionor's calculation of the option exercise price and information on the current value of an equity stake of up to 20% in the project in question.

The project that gave rise to the option was the "Jordan Cove Energy Project", which was a limited partnership for the development of a liquid natural gas terminal on the coast of Oregon.

The plaintiff (EFG) is an investment bank that had introduced Veresen to the Project. EFG provided certain services under a non-binding letter agreement, which recorded its understanding that it would be compensated with a right to invest in the Project once it was acquired by Veresen. When Veresen acquired the Project, the parties executed a two-and-a half page letter agreement (which was obviously not comprehensive). The letter agreement provided that EFG was to provide assistance to Veresen's exercise of due diligence in the development of the Project. It gave EFG an option to acquire up to a 20% interest in the Project, contingent on a successful financing.

Litigation ensued when Veresen took the position that the option no longer existed because the originally contemplated LNG facility had been changed into an LNG export operation. The application judge rejected that proposition and that issue was not the subject of the appeal. The appeal was from the order of the application judge implying a term that Veresen supply to EFG sufficient information to confirm Veresen's calculation of the option exercise price and the value of EFG's potential equity stake.

The application judge implied those terms on the ground of "business efficacy". He found that it was "clear beyond peradventure" that a potential 20% investor in the Project would require access to financial documents before making an investment that could amount to several hundred million dollars and that the obligation to disclose the valuation information was a necessary incident to the existence of the option right itself as without it, the option right would be no right at all.

Veresen argued on appeal that the application judge should not have implied these terms because:

- The parties were sophisticated;
- EFG chose not to bargain for a contractual right to disclosure even though it had done so in another context; and
- The judge gave insufficient weight to the evidence of a Veresen executive who said the company would never have agreed to such undefined disclosure terms.

The Ontario Court of Appeal held that the issue of implication of contractual terms raises questions of mixed law and fact, but noted that the conclusion of the application judge was

largely factual and entitled to deference. The Court of Appeal upheld the application judge's finding that no reasonable person would have embarked on an exercise of the option without disclosure, which in turn supported the finding of the necessity of the implied term for purposes of business efficacy.

Veresen also argued that the application judge's reference to good faith and *Bhasin* confounded the requirement of good faith performance of a contract with the test for implying contractual terms. The Ontario Court of Appeal held that the allusions to good faith did not undermine the judge's factual conclusions as to necessity and business efficacy – it was on the basis of the latter that the term was implied. Again, the term that was implied was not a term as to good faith performance or conduct; it was a term requiring disclosure of information.

Is there a difference between BC and Ontario in terms of the test for implying terms on business efficacy grounds?

The Ontario Court of Appeal in *Energy Fundamentals* concluded that:

- The analysis of whether to imply a term must be done on an objective basis, but having regard to the specific parties and specific contractual context.

- Implication of a contractual term does not require a finding that a party actually thought about a term or expressly agreed to it. Terms may be implied to fill gaps to which the parties did not turn their minds.

- A court will not imply a term that contradicts the express language of the contract or that is unreasonable.

The Ontario Court's articulation of the test for implying a term on business efficacy grounds is slightly different, therefore, than the articulation by the B.C. Court. In *Moulton Contracting*, the B.C. Court of Appeal stressed that it is not a question of implying a term because it is reasonable or logical. On this the two appellate courts agree. But the B.C. Court seems to go further when it says "the intention of parties is not what reasonable parties would intend but rather what the actual parties in the actual circumstances of the contract intended".[10] This language suggests a primarily subjective test rather than an assessment done on an objective basis, having regard to the specific parties and specific contractual context.

So, do we have a test for assessing whether a term should be implied on business efficacy grounds in B.C. that focusses more on the subjective intentions of the parties? On balance, I think not. Rather, the two appellate courts simply adopted different ways of summarizing what the SCC stated in *MJB*:[11]

> As mentioned, LeDain J. stated in *Canadian Pacific Hotels Ltd.*, *supra*, that a contractual term may be implied on the basis of presumed intentions of the parties where necessary to give business efficacy to the contract or where it meets the "officious bystander" test. It is unclear whether these are to be understood as two

[10] At para. 58.
[11] At para. 29.

> separate tests but I need not determine that here. What is important in both formulations is a focus on the intentions of the actual parties. A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of reasonable parties. This is why the implication of the term must have a certain degree of obviousness to it, and why, if there is evidence of a contrary intention, on the part of either party, an implied term may not be found on this basis.

Bottom line: Going forward, you likely will have to fit your facts within one of three categories from *MJB* to have a term implied. Though *Moulton Contracting* might be read as suggesting that a good faith obligation can never be implied as a term, the better view is that this decision, along with *Bhasin*, stands for the proposition that a good faith obligation may be implied only if the basis for implication of a term is made out in the particular case on the particular facts (*i.e.*, because it falls within one of the three circumstances set out in *MJB*).

Under the "business efficacy" prong there is some dissonance in terms of how subjective or objective the analysis for implying the term should be. The B.C. and Ontario Courts of Appeal express the test somewhat differently. A cautious barrister can fall back on the articulation of the test by the SCC in *MJB*.

Is There a Duty of Pre-contractual Good Faith Negotiation?

I posed this question previously in my 2013 and 2009 updates.

A number of the cases I have been tracking that raised the question of whether such a stand-alone duty could arise (as an implied term or otherwise) were resolved without a trial on the merits:

- *SCM Insurance Services v. Medisys Corporate Health LP*, 2014 ONSC 2632
- *Molson Canada 2005 v. Miller Brewing Co.*, 2013 ONSC 2758

There are, of course, specific contexts where duties of good faith negotiation have been found to arise due to the nature of the contract and contracting parties, *e.g.*, collective bargaining and contracts with First Nations.[12]

There are three cases worth noting on the issue of good faith negotiation: one in which there was an express term imposing such an obligation; another where a party sought to rely on *Bhasin* as the basis for imposing a post-contractual duty to negotiate a payment plan in relation to existing loan agreements; and a third where the court applied the duty of honesty in contractual performance to pre-contract negotiations for an employment contract.

[12] For a Quebec law view on a duty to negotiate in good faith in a commercial context, see *Singh c. Kohli*, 2015 QCCA 1135.

Express term requiring good faith negotiation

In *0856464 B.C. Ltd. v. TimberWest Forest Corp*., 2014 BCSC 2433,[13] Mr. Justice Sigurdson had to consider an express term in the timber harvesting contracts between the parties that required them to negotiate each year in good faith in order to agree upon rates. Where such a clause is express, the questions that arise relate to its interpretation and application (as opposed to existence of the good faith obligation in the first place).

The facts of this case are very complex. One of the challenges for the trial judge was the fact that the parties had not defined what good faith meant and had not set out any standard against which a party's conduct in negotiations might be measured. He concluded that the question of whether the defendants breached the duty involved a very context-specific, factually-driven analysis. He held that the TimberWest defendants (collectively, "TimberWest") failed to negotiate annual logging rates in good faith as required by the clause, which resulted in the unlawful termination of the contracts by the defendants when no agreement on rates was reached.

Although the finding that TimberWest breached its duty to negotiate rates in good faith is fact-specific, the case is noteworthy because it identifies conduct that amounts to bad faith negotiation (albeit in the particular circumstances).

Mr. Justice Sigurdson found that TimberWest had an objective, when negotiating with the plaintiffs, to bring the contracts to an end to advance its goal of putting pressure on the union to agree to the right to further subdivide future logging operations. The right to contract out a woodlands operation to private contractors had been given to TimberWest in the context of a resolution of collective bargaining with its unions in 2004. However, it was not permitted to further subdivide the operations beyond the large chunks dealt with in its master collective agreement without the union's consent. By the time of negotiation of the 2008 rates for the timber harvesting contracts, TimberWest was keen on achieving the right to subdivide its harvesting contracts into smaller segments, which it felt would be more profitable. When its labour relations strategy to secure subdivision with consent of the union was unsuccessful, it developed a strategy to put pressure on the union by termination of contracts with private contractors over rate disputes.

At the time of the rate negotiations between the plaintiffs and TimberWest, the parties had performed three years of a five-year contract. TimberWest could only terminate the contract if it failed to reach a rate agreement after negotiating in good faith. The plaintiffs had made substantial investments on the strength of the contracts. The only real protection the plaintiffs had was the requirement that the parties negotiate the annual rates in good faith. TimberWest argued that since the rates it offered were market rates (or at least perceived by TimberWest to be market rates) that should be the end of any bad faith assertion. Mr. Justice Sigurdson disagreed. He found that the good faith obligation required the parties, at least, not to act in a manner that would eviscerate the underlying objective of the agreements, which was continued logging for the balance of the five-year term.

[13] I understand that the judgment has been appealed.

He concluded, in part:[14]

> …I have concluded on all of the evidence, however, that the dominant motivation of the defendant in its rate negotiations was the execution of its subdivision strategy. I find that the defendant's motivation and objective in the short 2008 rate negotiations was to bring the contracts to an end because of the strategic importance of being able to put pressure on the union to achieve subdivision. The defendant's witnesses were not deceitful but I find that in all of the circumstances TimberWest acted not in good faith because their conduct was not reasonable given the history of the parties contractual relationship and was not honest given that rather than pursuing a course of conduct that was in its best interests in continuing the agreement, it was pursuing a conflicting strategy which strategy required eviscerating the agreement to succeed. While it may be possible to ride both horses at the same time, it is difficult, and here I find that the defendant was unable to accomplish that.
>
> Its conduct as a whole supports that conclusion and the fact that arguments could be made to support a contention that the rates were market rates does not justify their conduct. In my view, if the defendant did not approach the 2008 rate negotiations with the strategy of terminating the contract over a rate dispute, and negotiated the rates in good faith with the objective of continuing the balance of the five-year term, I find that there would have been quite a different result.

The Court awarded damages of $2.75 million, based on a calculation rooted in the position the plaintiffs would have been in had the contracts been performed over the remaining two years of their five-year term. Mr. Justice Sigurdson rejected the nominal damages that TimberWest argued for (although the damages were subject to a set-off of just over $1 million).

Good faith negotiation obligation does not arise out of *Bhasin*

In *Royal Bank of Canada v. 4445211 Manitoba Ltd*., 2015 SKQB 261, the bank sued the numbered company and individual guarantors to recover monies owed on a line of credit and a demand loan. In the statement of defence, the defendants pleaded details of various negotiations with the bank and alleged that the bank did not act in good faith in not agreeing to rewrite the terms of the loans and in not working out an arrangement that would permit payment over time.

The bank applied to strike out the statement of defence on the basis it disclosed no reasonable defence and that it was frivolous, vexatious and an abuse of process. Mr. Justice Danyliuk granted the application on both grounds, stating in part:

> [38] Here, there is no express pleading that there was an intentional lie conveyed by some representative of the plaintiff to one or more of the defendants...

[14] At paras. 308 and 309.

> [39] Further, *Bhasin* applies to a party's performance of the contractual terms. It is not pled that it was a term of either loan agreement or any of the guarantees that the plaintiff would re-negotiate the terms of those agreements in a certain way, or at all. From a plain reading of this pleading, as constructed by the defendants, one cannot discern from where any *Bhasin* duty would emanate. That duty is not free-floating, applicable to every transaction. It is a duty pertaining to the proper performance of commercial contracts. There is nothing in this defence to allege that the putative *Bhasin* breach of the plaintiff is related to any extant contract as between the parties.
>
> [40] Lying, or otherwise intentionally misleading, the party opposite in a contract is at the core of this new duty. Without an express pleading to support such an allegation of breach of this duty, the pleading is insufficient and fails to disclose a viable defence. Even assuming everything the defendants put in their statement of defence is true, a *Bhasin* breach does not arise and cannot be shown. It was (and is) the defendants' duty to plead sufficient material facts. They have not done so here.

Good faith negotiation obligation does arise out of *Bhasin* (at least in an employment law context)

In *Antunes v. Limen Structures Ltd*., 2015 ONSC 2163, the plaintiff alleged that he was induced to enter into an employment contract with the defendant as a senior VP of operations by misrepresentations about the company's financial status and the value of the shares offered as part of the employment package. The company offered Antunes a salary of $150,000 plus 5% of the shares of the company (with increases in both these forms of compensation promised after the first year of employment). The company's principal (Lima) represented it as being valued at $10 million, such that the shares Antunes was to receive would be worth $500,000 (the "Financial Representations").

Antunes started work with the company, but on commencing work was not involved in project management, and was instead assigned the task of processing delay claims. After just over five months' employment, Antunes was terminated without notice. He sued for wrongful dismissal, but also claimed for breach of contract and negligent misrepresentation.

Justice Brown found that Antunes had been wrongfully dismissed and awarded eight months' salary. But she also found that Antunes was entitled to recover $500,000 for the defendant's failure to issue shares under the contract of employment. This amount of damages was premised upon Lima's representation of the company's value at the time of the contract representations.

I view this as a misrepresentation case. Indeed, the trial judge found that the Financial Representations were made in the negotiations and that Antunes relied upon them when accepting the offer of employment. However, Justice Brown cited *Bhasin* and the duty of honesty in contract performance. She held that the defendant did not deal with the

plaintiff honestly in the contractual negotiations. Accordingly, one could view this case as one where the duty of honesty was applied to pre-contractual negotiations.

Bottom line: Pre-*Bhasin*, judicial recognition of a general stand-alone duty of good faith negotiations seemed unlikely. Post-*Bhasin*, it is even less likely. Courts may find such a duty to exist in specific contexts (in addition to those already recognized) where there is unequal bargaining power or a fiduciary relationship (borne out by the employment law case discussed above).

We may also see more cases interpreting express clauses imposing such a duty. The decision in TimberWest illustrates how complex those cases can be to litigate since absent a contractual definition of "good faith" (and perhaps even with one), what amounts to good or bad faith negotiation is contextual, resulting in a need to review the history of the parties' relationship.

Application of *Tercon* principles

While over five years have elapsed since this SCC decision and its articulation of a three-part test for assessing the enforceability of exculpatory clauses, there are still developments in the law in terms of the scope and application of the *Tercon* test.

Professionals limiting liability

In October, the B.C. Court of Appeal issued reasons for judgment in *Felty v. Ernst & Young LLP*, 2015 BCCA 445. I discussed the trial judgment in my 2013 update, citing it as an illustration of how hard it seems to be to successfully argue that a limitation of liability clause, or other exclusion clause, is contrary to public policy. The limitation of liability clause in this case epitomizes the trend towards professional service providers (accountants, engineers, architects, *etc*.) insisting upon clauses that limit their liability to the contract fees paid to them or their insurance coverage.

The limitation of liability provision at issue was contained in an engagement agreement between a multi-national accounting firm and a law firm (on a client's behalf) and limited the accounting firm's liability in negligence and an innocent third party's damages to "an amount equal to the fees paid for the services rendered".

Ms. Felty argued that the desirability of holding professional advisors to a high standard of diligence constituted an overriding public policy that justified the exercise of the court's power to refuse to enforce the exclusion clause.

She noted the provision in the *Legal Profession Act*,[15] which prohibits lawyers from limiting their liability for negligence (there is no equivalent provision in the *Chartered Professional Accountants Act*), pointed out that the advice she received was tax advice that could have been given as easily by a law firm, and asserted that it was unfair to allow accounting firms to limit their liability when law firms cannot. She pointed to a provision in the Agreement whereby E&Y represented that its professional liability insurance exceeded the requirements imposed by the CA institutes across Canada. She contended that the relationship between her and E&Y was

[15] S.B.C. 1998, c. 9, s. 65(3).

a fiduciary one and that the risk of negligence should be allocated to the professional in the relationship.

None of these arguments persuaded the Court of Appeal to overturn the finding below that the limitation of liability clause was enforceable under the *Tercon* test.

Madam Justice Newbury authored the reasons. Her key findings were:

- The public policy in favour of holding professionals to a high degree of diligence is not a sufficiently overriding or powerful public objective to justify the Court declining to enforce the limitation of liability clause.

- The existence of a fiduciary relationship does not alter this conclusion.

- The Court's discretion to decline to enforce such clauses on public policy grounds is confined to cases that are compelling or overriding. The Court reiterated the examples given in *Tercon* – extreme conduct such as a manufacturer's adulteration of baby formula with a toxic compound, or the contemptuous or reckless supply of defective plastic resin which the supplier knew would be used to fabricate natural gas, and referred to cases of statutory illegality (citing the Court's decision last year in *Niedermeyer v. Charlton*, 2014 BCCA 165).

Does *Tercon* apply to covenants to insure?

In *DLG & Associates Ltd. v. Minto Properties Inc*., 2014 ONSC 7287, rev'd in part, 2015 ONCA 705, counsel for the plaintiff, a tenant under a commercial lease, argued that the covenant to insure in the lease[16] was an exculpatory provision subject to the *Tercon* three-part test and that application of that test should result in the covenant being unenforceable.

The plaintiff's claim was for breach of contract and alleged fraudulent or negligent misrepresentations by the landlord as to the state of the plumbing in the premises. Shortly after the plaintiff began operating a restaurant on the premises, a sewer backup caused by a backward surge in the main line accepting drainage from the rented premises caused extensive damage to the restaurant. The backup was caused by a drainage pipe that did not meet building code standards. A second backup occurred, after which the restaurant was permanently closed.

The landlord brought an application to have the Amended Statement of Claim struck and the plaintiff's action dismissed, relying primarily on the submission that the tenant's claims were precluded by the covenant to insure.

Justice Perell noted that it might not be strictly necessary for him to address the *Tercon* argument in that it was not plain and obvious that the landlord could rely on the covenant to insure to exculpate it from liability for fraudulent misrepresentation. However, he went on to apply *Tercon* and concluded that the covenant was enforceable. He struck the claims for breach of

[16] The tenant covenanted to obtain all risks property insurance, which specifically included insurance for sewer backups.

contract, negligence and negligent misrepresentation, but granted leave for the tenant to amend to plead fraudulent misrepresentation.

The Ontario Court of Appeal dismissed the appeal. However, it specifically commented on the question of whether a covenant to insure is an exclusion clause subject to the *Tercon* test. It held that it was not. The clause, it stated, did not exclude the landlord from liability it would otherwise carry but for the clause. Instead, the role of a covenant to insure is to assign risk for certain losses by requiring the tenant to obtain insurance for those losses.

Entire agreement clauses in employment contracts

There was also an interesting trial level decision out of Ontario this year in which the judge found that an entire agreement clause in an employment agreement was unenforceable because it was unconscionable and contrary to public policy.

In *Kielb v. National Money Mart Company*, 2015 ONSC 3790, the plaintiff was hired as Vice President and Division General Counsel of the defendant in December 2008. When he was dismissed without cause in April 2010, he brought a wrongful dismissal action. The contentious issue being litigated was Mr. Kielb's entitlement to a bonus (the "Key Management Bonus" or "KMB").

Mr. Kielb gave evidence about the bonus program and his entitlement under it being a key inducement for him taking the job, which offered a base salary below his expectations. He testified as to what he was told about the KMB and his entitlements under it by the company's representative in their contract negotiations.

The employment agreement that was provided to Mr. Kielb after the negotiations contained two key clauses. The first dealt expressly with the bonus plan and included language by which Mr. Kielb waived entitlement to the KMB if he was terminated, for cause or not, and the bonus was not payable within the notice period. The second was a boilerplate entire agreement clause.

Citing wrongful dismissal jurisprudence, the trial judge concluded that he had to first consider whether the KMB was part of the overall compensation the plaintiff was entitled to. He held that the defendant, through its representative, held out the KMB as an important and integral part of the plaintiff's overall compensation package in an effort to obtain his services.

The company argued that because of the entire agreement clause, the representations made could not be taken into account by the court. In the face of this submission, Justice Akhtar assessed the enforceability of the entire agreement clause under the *Tercon* test. He held that it was unenforceable under all three prongs (in the alternative): 1) in his view, the parties did not intend the pre-contractual negotiations to be captured by the clause; 2) it was unconscionable, in that the plaintiff was given a short fuse to accept a "take it or leave it" offer and on the basis that the company abused its stronger informational position to entice the plaintiff into consenting to an improvident clause; and 3) it was contrary to public policy.

On the third point, he stated that it, "ill serves the public interest to permit companies and their recruitment agencies to orally promise automatic financial benefits and bonuses in order to

secure prospective employment candidates and then eliminate those benefits without a clear and timely warning."[17]

Mr. Kielb won the battle, but not the war. Justice Akhtar found that the clause limiting the availability of the bonus on termination of employment was enforceable under *Tercon.*

This application and interpretation of the *Tercon* test to the entire agreement clause in this case is surprising on a number of levels. It will be interesting to see whether other courts embrace the proposition that an entire agreement clause in an employment agreement is contrary to public policy. As noted in the discussion above of good faith negotiations, employment contracts are a special class of contract to which different rules apply.

Bottom line: There appears to be little judicial appetite for expanding the scope of what would result in an exculpatory clause being unenforceable on public policy grounds outside of situations where an exculpatory clause is inconsistent with mandatory legislation or where the conduct to which the clause might apply is of the egregious type identified in *Tercon*. According to the Ontario Court of Appeal, the enforceability of covenants to insure in commercial leases is not to be assessed using the *Tercon* test.

Interaction between Confidentiality Clauses and Settlement Privilege

There is only one significant SCC case in this year's crop: *Union Carbide Canada Inc. v. Bombardier Inc*., 2014 SCC 35. In this case, the Court considered the interaction between a confidentiality clause in a mediation agreement and the law of settlement privilege.

The Court makes it clear that the common law of settlement privilege forms part of the civil law of Quebec (where the case originated from); thus, although the case has Quebec origins, the principles enunciated are generally applicable in Canada.

Mediation agreements will invariably contain some form of confidentiality clause. In this case, the clause provided:

> 2. Anything which transpires in the Mediation will be confidential. In this regard, and without limitation:
>
> (a) Nothing which transpires in the Mediation will be alleged, referred to or sought to be put into evidence in any proceeding;
>
> (b) No statement made or document produced in the Mediation will become subject to discovery, compellable as evidence or admissible into evidence in any proceeding, as a result of having been made or produced in the Mediation; however, nothing will prohibit a party from using, in judicial or other proceedings, a document which has been divulged in the course of the Mediation and which it would otherwise be entitled to produce;

[17] At para. 28.

(c) The recollections, documents and work product of the Mediator will be confidential and not subject to disclosure or compellable as evidence in any proceeding.

The parties (Dow Chemical and Bombardier) had engaged in mediation of a decades-long dispute over the fitness of gas tanks produced by Dow Chemical and used on personal watercraft (Sea-Doos) manufactured by Bombardier, which was the subject matter of an action in the Quebec Superior Court. The day after the mediation concluded, Dow Chemical submitted a settlement offer, which was accepted by Bombardier. Two days later, counsel for Dow Chemical stated that his client considered the settlement to be a global amount (*i.e.*, covering existing and future claims in any jurisdiction relating to the gas tanks). Counsel for Bombardier then took the position that the settlement was in relation to the specific claim made in the Quebec action only.

When it was clear that the parties had very different views about the scope of the settlement, Bombardier filed a motion for homologation.[18] Dow Chemical applied to strike the portions of the pleadings that referred to events that had taken place during the mediation on the basis that in referring to them, Bombardier was in breach of the confidentiality clause.

The critical question for the SCC was this: whether a confidentiality clause in a private mediation contract can override the exception to the common law settlement privilege that enables parties to produce evidence of privileged communications in order to prove the existence or the scope of a settlement.

Dow Chemical made a commercial certainty pitch: courts should give effect to contract terms freely entered into. The Court generally agreed with this proposition, finding that it is open to parties to contract out of common law rules, including the exception to settlement privilege. However, it held that in the particular circumstances of the case, the parties had not done so.

In the view of Mr. Justice Wagner, the following factors militated against finding that the parties had intended to oust the common law rule:

- The contract was a standard form document provided by the mediator – neither party had input into it and they were asked to sign it on the eve of the mediation.

- There was no evidence that the parties thought they were deviating from the settlement privilege that usually applies to mediation (which includes the exception) when they signed the agreement.

In his view, it was unreasonable and illogical to assume that parties who had agreed to mediation for the purpose of reaching a settlement would renounce their right to prove the terms of the settlement.

Bottom line: Parties can agree to oust common law rules, including rules relating to privilege, but if they intend to do so, they must make that intention explicit.

[18] In civil law, judicial approval of certain acts or agreements to render them more readily enforceable.

It may be trickier to agree to oust common law rules codified in legislation– but that is a topic for another day.

Be alive to the fact that confidentiality and privilege are different things, and that neither guarantees that sensitive information will not be disclosed in court because both are subject to exceptions.

Automatic Renewal Clauses

An automatic renewal clause typically provides for renewal of a contract for a set period of time, without any action by either party, unless a party gives written notice of termination some period before the end of the original term.

These clauses are often found in contracts for the rental of chattels or licensing agreements and are often paired with a liquidated damages clause.

Automatic renewal clauses are sometimes tarred with the same brush as negative option billing. The latter has been outlawed in some jurisdictions (Ontario, for example). So how have automatic renewal clauses fared when challenged as unenforceable?

In a 2015 decision, the Manitoba Court of Queen's Bench held that such clauses are enforceable.

The plaintiffs in *DirectCash ATM Processing Partnership v. Rockwood Motor Inn*, 2015 MBQB 15, were suppliers of automatic teller machines and Interac banking services. A numbered company, whose two shareholders were a married couple ("Rockwood"), operated the Rockwood Motor Inn in Stonewall, Manitoba. Rockwood purchased, and had installed on its premises, an ATM. It entered into a processing agreement with DirectCash whereby the latter processed the transactions made on the ATM. The agreement had a five-year term (the "Initial Term"), and contained a clause whereby it was automatically renewed for two five-year periods unless Rockwood notified DirectCash in writing three months before the end of the Initial , or any renewal term, of its intent to terminate the agreement.

Rockwood failed to give any notice of termination, but disconnected the ATM at the end of the Initial Term. DirectCash took the position that the agreement was automatically renewed and that Rockwood was liable for the profit DirectCash would have received over the five-year renewal term pursuant to a liquidated damages clause.

Rockwood defended on the basis that the automatic renewal term was an onerous term that was not brought to its attention (relying on *Tilden Rent-A-Car v. Clendenning*,[19] a case that even boomers will have read in law school). It also argued that the liquidated damages clause constituted an unenforceable penalty.

Both arguments were rejected by the trial judge. On the argument that the automatic renewal clause was onerous, he noted that Rockwood had received a copy of the agreement and that there was evidence that one of the principals of the company was aware of the clause. He concluded, "Although the automatic renewal clause may seem onerous or unfair in hindsight, it is what was

[19] (1978), 18 O.R. (2d) 601 (C.A.).

agreed to by Rockwood and DirectCash. There is a need for certainty and security in commerce. Parties to agreements must be able to expect that they will be enforced as agreed."[20] DirectCash recovered the net profit it would have earned over the renewal term.

A recent B.C. Provincial Court decision provides an interesting contrast. In *Pacific Vending Ltd. v. Fraser Valley Playgrounds Inc*., 2015 BCPC 250, the automatic renewal clause was in an agreement for the supply of amusement machines. The defendant was the operator of a playground facility that offered games for children. Under the agreement, the claimant agreed to supply coin-operated amusement machines for the defendant's business, with the parties agreeing to share the revenue.

The agreement was in the claimant's standard form. It set an initial term of two years and stipulated that it would continue for an additional period of one year and so on from year to year until written notice of termination was received no less than sixty days prior to the end of any term. At the end of the initial term (end of April 2014), the parties carried on under the agreement. However, disputes over servicing of the machines arose and in June 2014, the defendant wrote to the claimant and demanded that it remove the machines. The defendant later said it would bring in bailiffs to remove the machines if the claimant did not do so. The claimant ultimately picked up the machines on September 2nd. The claimant then sued for damages, calculated based on the remaining term of the contract (240 days).

Judge Skilnick found in favour of the defendant, but only by strictly construing the automatic renewal clause. He spent some time discussing *Tilden Rent-A-Car v. Clendenning* and articulated a duty on the part of the claimant to bring the existence of the automatic renewal clause to the defendant's attention, but did not take the next step of finding the clause to be thereby unenforceable. Instead, he found the clause to be ambiguous and held that the claimant was only entitled to 60-days-worth of damages.

Tilden Rent-A-Car Co. v. Clendenning is still cited on a fairly regular basis by Canadian courts, but it is difficult to find a case where it was actually applied and an onerous clause was found thereby to be unenforceable. A large part of the role that case played in prior decades has arguably been subsumed by *Tercon*: clauses attacked as onerous are often limitation of liability and exclusion clauses, and the enforceability of those types of clauses are now governed by the three-part test in *Tercon*. When dealing with consumers, or unsophisticated parties, enforcement of such clauses will be aided where you bring them to the attention of the counterparty.

Bottom line: There is nothing inherently wrong with automatic renewal clauses. Generally speaking, they will be enforced. Where such a clause is paired with a limitation of liability clause, a party can seek to at least have the latter declared unenforceable under the *Tercon* test, although as we have seen, commercial parties are very unlikely to succeed under that test.

Continuing Breach

The choices available to an innocent party when their counterparty anticipatorily breaches (and thereby repudiates) a contract appear simple: 1) accept the repudiation and sue for damages; or 2) affirm the contract and wait for the date for performance. Election between these options is

[20] At para. 26.

often described as a strictly one-time event to be made at a particular point in time, with no option for re-election.

However, where the breach is a "continuing breach", the innocent party will have the option of re-electing and accepting the repudiation at a later date, after initially affirming the contract. The tricky question is, "What constitutes a continuing breach?".

The B.C. Court of Appeal had an opportunity to revisit that question recently in *Dosanjh v. Liang*, 2015 BCCA 18.

Mr. Dosanjh entered into a contract of purchase and sale to purchase a residential property from Ms. Liang. Ms. Liang had retained a realtor who listed the property on Craigslist initially. The decision to list was made somewhat impulsively by Ms. Liang, after learning that her tenants had been using it for a grow operation. The property was listed for $629,000. Mr. Dosanjh saw the listing on Craigslist, obtained the address and viewed it from the outside. He made an offer to purchase and the parties reached agreement on August 27th at a price of $605,000 with an October 1st closing date. There were three subject conditions, all for the sole benefit of Mr. Dosanjh.

On August 29th, Ms. Liang experienced seller's remorse. Her realtor contacted Mr. Dosanjh by email with the news that Ms. Liang would not proceed with the contract, explaining that Ms. Liang felt pressure and duress at the time of the sale and was now being treated for anxiety.

Mr. Dosanjh tried to contact Ms. Liang's realtor by phone and ultimately responded by email, noting that he had not observed Ms. Liang to be under any stress and that he wanted to remove the conditions and complete the purchase.

The MLS listing generated considerable interest in the property and Ms. Liang increased the asking price to $669,000. On September 6th, Mr. Dosanjh sent an email removing subjects and indicating that once the seller signed the subject removal, he would send the deposit due at that point. Mr. Dosanjh followed up with a fax on September 8th that contained the addendum to the contract removing the subjects and indicating that he was ready, willing and able to complete on October 1st.

Neither Ms. Liang nor her realtor responded. Mr. Dosanjh attempted to drop off a deposit cheque in early September, but the realtor was away. Mr. Dosanjh then tried to courier the cheque for the deposit to the realtor's office, but it was closed.

On September 15th, Mr. Dosanjh's realtor wrote to Ms. Liang and her realtor confirming this series of events. In that letter, Mr. Dosanjh took the position that he was accepting Ms. Liang's repudiation. Ms. Liang did not respond to this letter. Neither party took any steps to close the transaction on October 1st.

The trial judge found that Ms. Liang had repudiated the contract. Ms. Liang argued that if she had repudiated, Mr. Dosanjh had affirmed the contract, and was not later entitled to accept the repudiation. The trial judge found that Mr. Dosanjh had not affirmed the contract, but was rather "assessing the circumstances, considering his options, attempting to resolve the situation, and trying to ensure that he did what he had to do to complete the Contract". Therefore, she

reasoned, he had not made an election as at September 15 and was entitled on that date to accept Ms. Liang's repudiation.

One of the issues on appeal was whether Mr. Dosanjh had "unequivocally and irrevocably" affirmed the contract in late August/early September and was therefore barred from accepting Ms. Liang's repudiation on September 15th.

On appeal, Mr. Justice Groberman noted that the proposition that an election, once made, is irrevocable requires some qualification to ensure that it is not inappropriately applied in cases of repeated or continuing repudiation.

While accepting the proposition that there must be clear evidence for a court to find that the innocent party has affirmed a contract, he elaborated on how the evidence should be assessed as follows:

> [37] I accept that, where a party has repudiated a contract, the opposite party is entitled to a reasonable period of time in which to decide whether to affirm the contract or accept the repudiation. I also accept that, at least until that reasonable period of time has elapsed, a court should be slow to treat equivocal statements or acts as affirmations of the contract. The court's solicitude toward the innocent party, however, must not extend to ignoring unequivocal acts or statements of affirmation made by a party that is aware of its legal rights.

He went on to address the question of whether that affirmation was "irrevocable". He confirmed that ordinarily, the election whether to affirm or accept the repudiation is a one-time event. However, he qualified that proposition:

> [42] That does not mean, however, that a party that repudiates a contract is free to commit fundamental breaches without fear that the contract will be terminated, nor does it mean that a party guilty of a fundamental breach may continue to refuse to perform with impunity. Each time a party commits an act amounting to a repudiation, the opposite party is entitled to elect to affirm the contract or accept the repudiation. The fact that the innocent party has previously affirmed a contract does not disentitle it from accepting a new repudiation of it by the guilty party.
>
> [43] Equally, a party that has affirmed a contract after a repudiation by the other party may, if the repudiation is continuing, choose to accept it and treat the contract as at an end.

He found that in the circumstances, there was a continuing breach. Mr. Dosanjh and his lawyer made multiple attempts to communicate with Ms. Liang and her realtor to ascertain whether she would complete. Ms. Liang was unresponsive, as was her realtor. This ongoing conduct communicated to Mr. Dosanjh that she would not complete.

Mr. Justice Groberman concluded:

> [46] In all the circumstances, it is my view that Ms. Liang's repudiation of the contract was not a single incident, but rather a continuing fundamental breach of contract. Mr. Dosanjh was, in the circumstances, entitled to affirm the contract after the initial repudiation on August 29, 2011, and then later, in response to Ms. Liang's continued repudiation, to treat the contract as at an end.

I note the Court's use of the term "fundamental breach." Some courts have abandoned this terminology entirely (referring instead to serious breaches or breaches going to the root of the contract), perhaps taking the view that the SCC in *Tercon* rejected its use. In fact, the SCC in *Tercon* was only eschewing use of the term in the context of assessing the enforceability of exculpatory clauses.

However, in another recent case, the SCC suggested using the term "substantial breach" to describe a breach amounting to repudiation in the context of a constructive dismissal allegation:[21]

> In *Farber*, Gonthier J. identified such a change as a "fundamental breach". The term "fundamental breach" has taken on a specific meaning in the context of exclusionary or exculpatory clauses: see, e.g., *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, [citation omitted].To avoid confusion, I will therefore use the term "substantial breach" to refer to breaches of this nature. The standard nevertheless remains unchanged — a finding of constructive dismissal requires that the employer's acts and conduct "evince an intention no longer to be bound by the contract": [citations omitted].

Other examples of conduct that may constitute a continuing breach or repudiation are canvassed in an earlier decision of the B.C. Court of Appeal, *Doman Forest Products Ltd. v. GMAC Commercial Credit Corp.- Canada*, 2007 BCCA 88. They include:[22]

- Failure to keep a premises or thing in repair
- Continued exclusion of a party from possession of premises in breach of agreement
- A tenant's ongoing violation of a use clause in a lease
- Failure of a landlord to remedy leaks that prevent a tenant from successfully operating a business
- Refusal to allow a party to enter onto land to remove trees under an agreement
- Failure to respond to demands of performance (by making required instalment payments) in the context of a shipbuilding contracts

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[21] *Potter v. New Brunswick Legal Aid Services Commission*, 2015 SCC 10 at para. 35.

[22] At paras. 97-107.

The decision in *Doman* underscores the need for a party alleging continuing repudiation to show that they continued to perform their obligations, or at least were in a position to do so, and to lead evidence of a continuing or repeated refusal by the breaching party to perform.

Mr. Justice Lowry stated, in part:[23]

> If, having affirmed an agreement in the face of it having been repudiated, and then having taken the benefit of the repudiating party's performance, the innocent party is to be heard to say at some later time there has been a continuing breach entitling that party to accept the repudiation, it can only be where there is no question that the repudiating party has in fact refused at the time of acceptance to perform. There must, at the very least, be a clear manifest refusal to perform, subsequent to an affirmation of the agreement, which is accepted with reasonable promptness. The party purporting to have accepted the repudiation bears the constitutes the repudiation. The burden will become more onerous with the passage of time between affirmation and subsequent purported acceptance.

He also found that silence in response to a request for performance could suffice as a "continuing repudiation".

Bottom line: While an election to accept a repudiation or affirm the contract ordinarily will be a one-time event, the innocent party may have a right to re-elect if he or she can demonstrate that the breach was ongoing or continuing. Silence in the face of inquiry by the innocent party about whether the party that repudiated intends to perform or not may amount to a continuing repudiation.

[23] At para. 113.

CONTRACT LAW – DEVELOPMENTS OF NOTE
SUMMARY OF TOPICS

HEADINGS	2014	2013	2012	2011	2010	2009
Links to Contract Law Paper by Year		http://www.lawsonlundell.com/media/news/396_2013%20developments%20in%20contract%20law%20paper%20_in%20house%20and%20website%20version%20as%20at%20October%2031_.pdf	http://www.lawsonlundell.com/media/news/323_ContractLawUpdate2012.pdf	http://www.lawsonlundell.com/media/news/76_ContractLawUpdateDevelopmentsofNote2011LisaPeters.pdf	http://www.lawsonlundell.com/media/news/101_Contract%20Law%20Update.pdf	http://www.lawsonlundell.com/media/news/147_ContractLawUpdate.pdf
Acceptance by Conduct			X			
Arbitration Clauses	X	X		X	X	
Best Effort Clauses				X		
Binding Effect and Enurement Clauses		X				
Buy/Sell Clauses				X		
Choice of Court (Forum Selection) Clauses	X				X	
Conditions Precedent		X				
Contract Termination						X
Contracting with First Nations under the *Indian Act*		X				
Duty of Good Faith	X	X				X
Duty of Honesty in Contractual Performance	X					
Efficient breach	X					
Economic Duress					X	
Electronic Transactions and Computer Contracts			X			

HEADINGS	2014	2013	2012	2011	2010	2009
Links to Contract Law Paper by Year		http://www.lawsonlundell.com/media/news/396_2013%20developments%20in%20contract%20law%20paper%20_in%20house%20and%20website%20version%20as%20at%20October%2031_.pdf	http://www.lawsonlundell.com/media/news/323_ContractLawUpdate2012.pdf	http://www.lawsonlundell.com/media/news/76_ContractLawUpdateDevelopmentsofNote2011LisaPeters.pdf	http://www.lawsonlundell.com/media/news/101_Contract%20Law%20Update.pdf	http://www.lawsonlundell.com/media/news/147_ContractLawUpdate.pdf
Equitable Mistake				X		
Exculpatory Clauses and Limitation of Liability Clauses	X	X	X	X		X
Frustration and *Force Majeure*						X
Fundamental Breach (*Tercon)*					X	
Illegal Contracts					X	
Implied Terms			X			
Legislative Developments of Note			X	X		X
Liquidated Damages Clauses			X			
Pre-Incorporation Contracts					X	
Privity of Contract			X	X		X
Restrictive covenants	X					
Severability						X
Standard of Review on Contract Issues	X					
Statutory Illegality			X			
Specific Performance		X				
Time of the Essence Clauses					X	
Unconscionability in Commercial Transactions				X		

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