CONTRACT LAW UPDATE: DEVELOPMENTS OF NOTE (2018)

(Updated to May 22, 2019)

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By Lisa A. Peters, Q.C.

For over a decade, I have combed over the previous year's contract law decisions, looking for cases that have changed the law or which illustrate core principles relevant to commercial solicitors and barristers, and reported on them in this paper.

In this annual update, I will share with you what I (and the student who assisted me) found.[1] At the end of each topic is a short summary of the take-away for those in a hurry. A chart of the topics covered in previous years' papers is attached as an appendix; prior papers are available on the Lawson Lundell website.

This year's topics are:

- No consideration required for contract variations! The impact of *Rosas v. Toca*.
- The modified "strong cause test" for enforceability of forum selection clauses in consumer contracts articulated in *Douez v. Facebook Inc*.[2] – how has it been applied?
- Forum selection clauses and arbitration clauses: "One of these things is not like the other".
- The *Tercon*[3] test for enforceability of exclusion clauses revisited (again).
- Frustration of contract – a refresher.
- Excluding the statutory warranties under the *International Sale of Goods Act.*
- This year's boilerplate commentary: contractual references to legislative provisions.
- Smart contracts update.

[1] I am indebted to Eman Jeddy, law student at the University of Ottawa, who pored over many cases and gave sound advice on what my readers would be interested in. A substantial portion of the section on smart contracts was penned by Eman.
[2] 2017 SCC 33 (hereafter, "*Douez*").
[3] *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways),* 2010 SCC 4 ("*Tercon*").

No Need for Fresh Consideration to Vary Contractual Terms – *Rosas v. Toca*

A major substantive change to the law of contract is rare. But this year, the B.C. Court of Appeal decided the time was ripe for a change to the law of consideration.

Most of you are probably familiar with the facts in *Rosas v. Toca*.[4]

In January of 2007, Ms. Rosas loaned $600,000 of her lottery winnings[5] to her friend Ms. Toca and her husband so that they could buy a house. The loan was to be repaid without interest in one year's time. In ensuing years, Ms. Toca kept asking for an extension and Ms. Rosas kept acceding to her requests. In July of 2014, Ms. Rosas commenced a civil action in debt.

The obvious problem for Ms. Rosas was the tolling of the limitation period. She argued at trial that the parties entered into multiple forbearance agreements on a yearly basis and that each year, Ms. Toca promised to pay the next year. The trial judge found that without any additional consideration, these forbearance agreements were unenforceable and that the claim was accordingly statute barred.

The Court of Appeal considered and rejected arguments based on, *inter alia*, contract interpretation, resulting trust and estoppel, before moving on to the main event: were the extensions to the repayment date enforceable so as to negate the limitations defence?

Chief Justice Bauman dispensed with the argument that by way of the extensions, the old contract was rescinded and a new one arose; in his view, there were no findings of fact to support this position. He rejected the proposition that a request for forbearance in relation to a debt is consideration for the forbearance itself, holding that a promise to forbear, alone, cannot create a binding contractual obligation. After a review of authorities, he concluded that the current state of the law was that there must be good consideration to make a promise to forbear enforceable.

Bauman C.J.B.C. then embarked on an in-depth review of the state of the law on consideration and, in particular, whether it had evolved here in Canada but also in other Commonwealth jurisdictions.

As many of you may remember from law school, Canadian common law jurisdictions, including B.C., have followed the so-called pre-existing duty rule, said to originate in the English decision of *Stilk v. Myrick*.[6] Under that rule, a promise to do something by a

[4] 2018 BCCA 191.
[5] She won $4.163 million.
[6] (1809), 170 E.R. 1168 (K.B.).

party already obligated to do that thing under contract is not enforceable without additional consideration. In Ontario, the case cited for this proposition is *Gilbert Steel Ltd. v. University Construction Ltd.*;[7] that case has been frequently cited in other jurisdictions as well.

As outlined in the judgment in *Rosas v. Toca*, Canadian courts have also required debtors to provide fresh consideration in addition to their existing obligations under loan agreements in order to render a promise to forbear enforceable.

While these propositions reflected the current state of the law at the time of the decision in *Rosas v. Toca*, Chief Justice Bauman tracked inroads into that law in Canada and elsewhere.

One of the decisions Chief Justice Bauman considered at length in his review was that of the New Brunswick Court of Appeal in *NAV Canada v. Greater Fredericton Airport Authority Inc.* ("*NAV Canada*").[8] The NBCA had gone boldly where Chief Justice Bauman planned to go, refining the doctrine of consideration by holding that a variation to an existing contract, unsupported by consideration, is enforceable if not procured under economic duress. As the Chief Justice notes, that case is difficult to reconcile with the later decision of that same Court in *Kennedy v. Clark*,[9] where the Court distinguished *NAV Canada*, holding that a disclaimer of liability for misrepresentations in the sale of a yacht was unenforceable for lack of consideration.

Appellate courts in other Canadian jurisdictions evinced interest in the issue after *NAV Canada* was decided, without deciding to follow suit.[10]

Ultimately, Chief Justice Bauman found support in the jurisprudence and commentary for reform of the law. The critical passage in the Reasons reads as follows:[11]

> The time has come to reform the doctrine of consideration as it applies in this context, and modify the pre-existing duty rule, as so many commentators and several courts have suggested. When parties to a contract agree to vary its terms, the variation should be enforceable without fresh consideration, absent duress, unconscionability, or other public policy concerns, which would render an otherwise valid term unenforceable. A variation supported by valid consideration may continue

[7] (1976), 12 O.R. (2d) 19 (C.A.).
[8] 2008 NBCA 28.
[9] 2009 NBCA 60.
[10] See, for example, *Matchim v. BGI Atlantic Inc.*, 2010 NLCA 9, leave to appeal refused, 2010 CarswellNfld 217 (S.C.C.); and *Richcraft Homes Ltd. v. Urbandale Corporation*, 2016 ONCA 622.
[11] At paras. 4 and 183.

> to be enforceable for that reason, but a lack of fresh consideration will no longer be determinative. In this way the legitimate expectations of the parties can be protected. To do otherwise would be to let the doctrine of consideration work an injustice. […]

This is not a comparative law paper and I have not conducted an exhaustive review of the law in other Commonwealth countries. However, I note the following:

- This reform to the law of consideration goes further than the evolution of the law in England. As Chief Justice Bauman notes, in *Williams v. Roffey Bros*,[12] the English Court of Appeal adapted the doctrine of consideration to encompass the situation where one party receives a "practical benefit" in exchange for a promise, thus avoiding the rule that a pre-existing duty cannot constitute consideration. On the facts of that case, the Court found that a practical benefit from the provision of services already owed under contract can constitute valid consideration for a promise to pay an additional sum for those services.[13] Admittedly, the question of what will constitute a sufficient "practical benefit" is hard to apply in practice.[14]

- The English courts have refused to apply the "practical benefit" approach in the context of debt claims, holding that an agreement to accept part payment or payment by instalments of a pre-existing debt is not binding (applying the venerable decision in *Foakes v. Beer,*[15] which stands for the proposition that part payment alone cannot constitute full settlement of a debt and cannot be consideration for a new agreement that prevents the creditor from collecting the balance of the debt).[16] The English courts have extended the practical benefits approach to unilateral variation agreements to reduce rent.[17] In *Rosas v. Toca*, the

[12] [1991] 1 Q.B. 1 (C.A.).

[13] In that case, the parties had an existing contract under which Roffey Bros. had engaged Williams as a subcontractor to provide carpentry work on a number of flats the former was refurbishing. When it became apparent that the initial contract price was too low and Williams might not complete the work on time, Roffey Bros. promised an additional lump sum for each flat that was completed. The practical benefits amounting to consideration for the variation were said to be: Williams continuing with the contracted for carpentry work; Roffey Bros. would avoid the trouble and expense of finding a replacement carpenter; Roffey Bros. would avoid being penalized for late completion under the head refurbishment contact; and Roffey Bros. would have a more formalized scheme for payment.

[14] One author has described "practical benefits" as the flow-on benefits hoped to be gained by the promisor through the promisee completing its side of the original bargain: Marcus Roberts, "The Formation of Variation Contracts in New Zealand: Consideration and Estoppel" (2016) 47(2) Victoria of University of Wellington Law Review 327.

[15] (1884), 9 App. Cas. 605 (H.L.).

[16] *Re Selectmove Ltd.*, [1995] 1 W.L.R. 474 (Eng. C.A.).

[17] *MWB Business Exchange Ltd. v. Rock Advertising Ltd.*, [2016] EWCA Civ. 553.

Chief Justice posits that *Foakes v. Beer* "does not appear to have been expressly adopted in B.C." and then states that s. 43 of the *Law and Equity Act*[18] abrogates that rule. I am not sure about the first proposition: it would depend, in part, on whether the law as expressed in *Foakes v. Beer* was already part of received English common law as at November 19, 1858[19] and was not subsequently modified by B.C. common law. As to the second proposition, s. 43 does appear to abrogate that rule, at least in B.C. The situation in other provinces, including Ontario, appears to be rather complex.[20] In short, we should not assume that the law is similar elsewhere.

- As described by commentators, the law in New Zealand is unsettled on this issue.[21] In *Anton's Trawling Co. Ltd. v. Smith*,[22] the New Zealand Court of Appeal did not commit to either the practical benefit approach from *Williams v. Roffey Bros*. or an approach where no consideration is required for a variation absent duress, stating that whichever of those two options was chosen, the result on the facts before it would be the same. In *Teats v. Willcocks*,[23] the Court stated that the "position is not yet settled" and then ruled that a benefit in practice was sufficient to support a variation agreement before going on to say that it was "attracted" to the idea that "no consideration at all may be required provided the variation is agreed voluntarily and without illegitimate pressure."

- In Australia, consideration is still required for a variation, but "practical benefits" à la *Williams v. Roffey Bros*. will suffice.[24] However, unlike the situation in England, where the practical benefits approach does not apply in the context of part payment of debt claims, the Australian courts have applied *Williams v. Roffey* to a

[18] Section 43 is entitled "Rule in *Cumber v. Wane* abrogated" and reads: "Part performance of an obligation either before or after a breach of it, when expressly accepted by the creditor in satisfaction or rendered under an agreement for that purpose, though without any new consideration, must be held to extinguish the obligation."

[19] Per s. 2 of the *Law and Equity Act*. The rule in *Foakes v. Beer* does seems to have originated earlier, in *Pinnel's case* (1602), 5 Co. Rep. 117a (Common Pleas) and *Cumber v. Wane* (1721), 1 Stra. 426 (K.B.).

[20] See M.H. Ogilvie, "Part Payment of a Debt and a Proposal for Final Settlement of the Law: *Process Automation Inc. v. Norstream Intertec Inc*." (2012) 90 Can. Bar. Rev. 199.

[21] Roberts, *supra* note 14. In a later paper, "*NAV Canada*: A Review After a Decade of Uncertainty" (2012) 60 Can. Bus. L.J. 202, Roberts takes the view that the law in New Zealand is coalescing on the position that consideration is not needed for variation agreements.

[22] [2003] N.Z.L.R. 23 (C.A.).

[23] [2014] 3 N.Z.L.R. 129 (C.A.).

[24] Marcus Roberts, "Variation contracts in Australia and New Zealand: whither consideration?' (2017) 17:2 Oxford University Commonwealth L.J. 238.

part payment fact pattern, finding no conceptual difference between a promise to pay more and a promise to accept less.[25]

- Chief Justice Bauman refers to the U.S. *Uniform Commercial Code*, §2-209, noting that this provision only applies to the sale of goods context. He also cites the *Restatement (Second) of Contracts* as "rejecting" the pre-existing duty rule.[26] While the Restatements are highly regarded secondary sources (compilations of the common law), they are not a primary source of law. It is my understanding that contract law varies from state to state; one would have to research whether a particular state's law matches what the American Law Institute has crystallized in a Restatement to determine how that state deals with the pre-existing duty rule.

What has happened elsewhere in Canada since the decision came down? *Rosas v. Toca* has been followed in Alberta[27] and in the Tax Court of Canada.[28]

It will be interesting to see whether the other provinces' courts follow suit. Ultimately, the issue might have to go to the SCC for a consistent pan-Canadian approach to be articulated.

Some might ask why, if consideration is no longer required for a contract variation, should it continue to be required for the original contract? That topic is beyond the scope of this paper, but has been, and will no doubt continue to be, the subject of academic musings going forward.

Bottom line: If the contract is governed by the law of a province other than B.C., you will still want to ensure that there is consideration for any variation of it. If you are a transactional lawyer, you may find yourself having to explain this case to English and other foreign lawyers in the context of transactions governed by B.C. law, since, as noted above, the law is not uniform on this issue in other jurisdictions.

Parties seeking to avoid obligations under a contract variation governed by B.C. law will have to shift their focus to unconscionability, duress and public policy arguments, none of which are likely to have any traction in a commercial context. Of course, a party alleging a contract variation will still have to prove it.

[25] *Musumeci v. Winadell Pty Ltd.* (1994), 34 N.S.W.L.R. 723 (S.C.). For more details of the Australian position see Roberts, *supra* note 24.
[26] At para. 128.
[27] *Servus Credit Union v Sulyok*, 2018 ABQB 860.
[28] *De Vries v. The Queen*, 2018 TCC 166.

Forum Selection Clauses and the Modified Enforceability Test from *Douez*

In last year's paper I discussed this decision of the Supreme Court of Canada ("SCC"). I also co-authored an analysis of the case with Professor Elizabeth Edinger of the Allard School of Law published in the Advocate.[29]

While I will not repeat much of that analysis here, I will remind you that the Court split 3-1-3. Three of the justices (who I refer to as the KWG Panel) articulated a modified strong cause test for assessing the forum selection clause before them, which was in an online contract of adhesion that Ms. Douez was subject to as a condition of using Facebook. Madam Justice Abella did not expressly weigh in on this modified test, instead focussing on the first step in the existing *Z.I.Pompey* test[30] and finding the forum selection clause to be unconscionable and unenforceable based on that doctrine and public policy grounds.

The three-justice dissent applied the longstanding strong cause test from *Z.I. Pompey* and found the forum selection clause to be enforceable.

The majority of the Court treats application of the *Z.I. Pompey* strong cause test (or modified test) and the *forum non conveniens* analysis as distinct steps. However, as I will discuss below, there is some cross-pollination of factors between the two steps.

Over a year has passed since the reasons in *Douez* were pronounced, allowing us to see what lower courts have decided vis-à-vis the applicability of the modified strong cause test. If one were seeking to limit the scope of the modified strong cause test, one could point to the fact that *Douez* involved an online contract of adhesion with a counterparty that was a large corporation with implications for privacy rights (which are quasi-constitutional in nature).

In the smattering of relevant cases, the modified strong cause test, while applied somewhat narrowly, has not been strictly limited to the *Douez* fact pattern.

In a recent B.C. case, the modified strong cause test was applied to a forum selection clause in a contract between an individual in B.C. who purchased a pre-fabricated steel outbuilding and a commercial entity based in Ontario. The plaintiff was able to establish strong cause why he should not be required to litigate his claim in Ontario.[31]

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[29] (2018) 76 Adv. 345.

[30] Articulated in *Z.I. Pompey Industrie v. ECU-Line N.V.*, 2003 SCC 27. Under this two-part test, the party relying on the clause must establish that it is valid, clear and enforceable and applies in the circumstances. Then, the party asking the court to take jurisdiction must establish strong cause for not giving effect to the forum selection clause.

[31] *Schuppener v. Pioneer Steel Manufacturers Limited*, 2019 BCSC 425.

There is also a developing body of law in which courts have drawn an analogy between consumer contracts and employment contracts when considering forum selection clauses.

In *Cain v. Pfizer Canada Inc.*,[32] an Ontario Master had to consider the application of *Douez* to a forum selection clause in Pfizer's Long-Term Incentive Plan ("LTIP") under which the plaintiff claimed entitlement to stock options and restricted share units after he was dismissed from employment. Pfizer sought a stay of that action, relying on a forum selection clause in an acknowledgement and consent signed by Cain in relation to his participation in the LTIP, which named the courts of New York state as having exclusive jurisdiction.

Master Sugunasiri held that the forum selection clause did not apply to Cain's wrongful dismissal claim. She concluded that there was a material dispute as to whether the entitlements under the LTIP were part of Cain's employment compensation, which dispute should not be resolved in the stay motion. On the record before the Court, she found that Pfizer had not demonstrated a clear, valid and enforceable forum selection clause that governed Cain's entitlement to LTIP benefits.

But in the alternative, she found that Cain had made out strong cause, effectively applying the modified test from *Douez*. She stated, in part:[33]

> …I would be remiss in failing to take into consideration the fact that Pfizer Canada and Mr. Cain are in a relationship of unequal bargaining power that is inherent to the employer-employee relationship, and that the terms of the LTIP, including the forum selection clause, were not a product of negotiations between two equal parties, but rather a contract of "adhesion" that employees like Mr. Cain had no choice but to agree to if they are to opt in the LTIP.
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> While the discussion of contracts of adhesion an [*sic*] inequality of bargaining power are discussed in Facebook in the context of consumers participating in social media, many of the court's comments are applicable here…In cases involving unequal bargains between consumers and multi-billion dollar corporations, forum selection clauses are given less weight.
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> Employment cases fall closer to consumer cases than bill of lading cases.

In *Nowak v. Biocomposites Inc.*,[34] Nowak was employed by the defendant as its only B.C. salesperson. He signed a service agreement that contained a forum selection clause

[32] 2018 ONSC 297.
[33] At paras. 83-5.

under which he agreed to submit to the exclusive jurisdiction of the courts located in New Hanover County, North Carolina.

Nowak sued for wrongful dismissal in B.C. The defendant applied for a stay. Mr. Justice Smith found the forum selection clause to be unenforceable as inconsistent with the *Employment Standards Act*.[35] But he went on to find that the plaintiff "appeared" to have shown strong cause why it should not be enforced, focussing on inequality of bargaining power and public policy à la the KWG Panel in *Douez*.

He stated, in part:[36]

> Although *Douez* did not deal with an employment contract, I find that the circumstances of the employment contract in this case are much closer to those of a consumer contract than to a commercial case involving sophisticated parties of equal bargaining power. […]
>
> For reasons similar to those referred to in *Cain,* I would, if necessary, hold that the inequality of bargaining power at the time of the service agreement along with the juridical disadvantage, expense and inconvenience imposed on Mr. Nowak, justify a refusal of the Court to uphold the forum selection clause.[…] The effect of the forum selection and choice of law clauses in this case is to deny a British Columbia resident who performed his duties in British Columbia the legal protection he is entitled to both under the common law and the specific legislation of this province. As such, I find that their enforcement on the facts of this case would be contrary to public policy.

While counsel have attempted to extend the reach of the modified strong cause test from *Douez* into the commercial context, courts have consistently applied *Z.I. Pompey* in such cases, either expressly or impliedly ruling that the modified test is not applicable.

Trial courts have stated, *inter alia*:[37]

> "This is not a case like *Douez v Facebook*, 2017 SCC 33 (CanLII), where the grossly unequal bargaining power in a consumer transaction provided a strong reason not to enforce a forum selection clause."[38]

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[34] 2018 BCSC 785.
[35] R.S.B.C. 1996, c. 113.
[36] At paras. 41-45.
[37] See also *2Source Manufacturing Inc. v. United Technologies Corporation*, 2017 ONSC 4409 at footnote 5 and *WCL Capital Group Inc. v. Google LLC*, 2019 ONSC 947.
[38] *Qunata Services, Inc. v. Rokstad Power Corporation*, 2017 BCSC 1858 at para 13.

> "*Douez* does not assist the Numbered Company. This Subconsultant Agreement was a freely negotiated business transaction between experienced commercial undertakings. Article 18.3 [the forum selection clause] was not an adhesive term derived from grossly uneven bargaining power."[39]
>
> "This is not a contract akin to that considered…[in *Douez*]…The contract before me is a commercial contract not a consumer contract. Opportunity existed (though not taken) for the Plaintiff to seek to negotiate its terms."[40]

Aside from the modified strong cause test articulated by the KWG majority, *Douez* is also recognized as the case in which the SCC made it clear that the assessment of the applicability and enforceability of a forum selection clause is a distinct step from application of the *forum non conveniens* test.

A useful review of how to apply the two tests in sequence, and an explanation of why the strong cause test is not relevant to a non-exclusive forum selection clause, is found in *Romanchuk v. Jemi Fibre Corp*.[41] The two main takeaways from that case:

- If the forum selection clause is non-exclusive, you move directly to *forum non conveniens*.
- With exclusive forum selection clauses, you only move to *forum non conveniens* if strong cause is established. Some of the same factors that were relevant to the strong cause test such as the location of witnesses, the enforceability of an eventual judgment and comparative convenience and expense are also relevant to the *forum non conveniens* analysis, but the burden shifts to the party opposing the local court's jurisdiction.

Bottom line: The modified strong cause test from *Douez* has been extended into the realm of employment contracts, at least in *dicta*. Clients including forum selection clauses in employment-related contracts should be advised that they may be vulnerable under this test.

However, aside from that incremental creep, the test has been limited to the consumer context. The enforceability of forum selection clauses in commercial contracts is still assessed under the original strong cause test from *Z.I. Pompey*.

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[39] *3289444 Nova Scotia Limited v. R.W. Armstrong & Associates Inc.*, 2018 NSCA 26 at para. 72.
[40] *Guest Tek Interactive Entertainment Ltd. v. PricewaterhouseCoopers LLP*, 2017 ABQB 567 at paras. 7 and 10.
[41] 2018 SKQB 46. See *Forbes Energy Group Inc. v. Parian Energy Rad Gas*, 2019 ONCA 372 for a similar analysis in a non-CJPTA jurisdiction.

The Strong Cause Test and Arbitration Clauses

In last year's paper, I discussed a decision of the Ontario Court of Appeal in which the Court, surprisingly, applied the strong cause test from *Z.I. Pompey* to an arbitration clause.[42] As I outlined in my analysis, the two types of clauses are underpinned by different policy imperatives, there is a statutory overlay to arbitration clauses (the domestic and international arbitration statutes), and there is a distinct body of law describing how the applicability and validity of arbitration clauses is assessed.[43]

In a 2018 decision, an Ontario Superior Court Justice, while not citing *Novatrax*, made a point of distinguishing between the two types of clauses and the basis on which a court may refuse to enforce them.

In *Heller v. Uber Technologies Inc.*,[44] Mr. Justice Perell stayed a proposed class action on the basis that the agreement between the proposed representative plaintiff and Uber contained an arbitration clause.

Mr. Heller relied on *Douez* to argue that because he had no bargaining power in his dealings with Uber, as the contract was a contract of adhesion, the agreement was unenforceable. Mr. Justice Perell stated in part:

> [76] The rule from *Z.I. Pompey Industries* is that a forum selection clause should be enforced unless there is "strong cause" not to enforce it. The effect of such a clause is to reverse the onus of proof, which normally requires the moving party defendant to justify staying the plaintiff's action, to place a burden on the plaintiff to show why a stay should not be granted. A majority of the Supreme Court [in *Douez*] held that the context of a consumer contract, as opposed to a commercial agreement, may provide strong reasons not to enforce a forum selection clause having regard to such circumstances as unequal bargaining power, the importance of adjudicating privacy rights, the comparative convenience and expense of litigating in another jurisdiction, public policy concerns, and the interests of justice. Thus, a majority in the Supreme Court held that forum selection clauses in consumer contracts require a special and

[42] *Novatrax International Inc. v. Hägele Landtechnik GmbH*, 2016 ONCA 771.
[43] Other commentators have weighed in on this decision, agreeing with my conclusion that the Court applied the wrong analysis: see Edward C. Chiasson and Kalie N. McCrystal, "*Novatrax:* right result, wrong reason" (2017) 35 Advocates' Soc. No. 4, 12-17; John S. Kelly, "The *Novatrax* Decision: Court of Appeal confuses an international arbitration clause with a forum selection clause and incorrectly stays an Ontario action" (Fall 2017) 26 Can Arbit. And Med. J. No. 1, 8-11 and William Horton, "Court got it wrong in *Novatrax*" (Dec. 2016 3 Lawyers Wkly. No. 30, 13.
[44] 2018 ONSC 718.

> different treatment than how a forum selection clause will be treated in a commercial contract.
>
> [77] The case at bar, however, is not about a discretionary court jurisdiction where there is a forum selection clause to refuse to stay proceedings where a strong cause might justify refusing a stay; rather, it is about a very strong legislative direction under the *Arbitration Act, 1991* or the *International Commercial Arbitration Act, 2017* and numerous cases that hold that courts should only refuse a reference to arbitration if it is clear that the dispute falls outside the arbitration agreement.

Mr. Justice Perell's ruling was overturned by the Ontario Court of Appeal, which found that the arbitration clause in question was unconscionable and an illegal contracting out of that Province's *Employment Standards Act, 2000*.[45]

The appellate court took a subtly different approach than the approach it took in *Novatrax*. Mr. Justice Nordheimer, at several places in the Reasons, acknowledges that the clause under consideration is an arbitration clause rather than a forum selection clause and that the strong cause test was developed in the context of the latter type of clause.

However, the Court merged concepts from the two contexts when applying s. 7(2) of the *Arbitration Act, 1991* (a provision that allows the court to refuse to stay a proceeding based on an arbitration clause where the arbitration agreement in question is invalid).

Under the Court's reasoning, if the arbitration clause was unconscionable, it was invalid, and the Court could and should refuse to stay the court action brought in the face of the clause. In assessing whether the clause was unconscionable, the Court held as follows:

> [63] …While I recognize that the clause in question in *Douez* was a forum selection clause, I see no reason in principle why the same approach ought not to be taken to the Arbitration Clause in this case. I say that because the Arbitration Clause here is not, strictly speaking, simply an arbitration provision. It is also a forum selection provision and it is a choice of laws provision. It covers much more than just the method through which disputes will be resolved. It establishes both a foreign forum for the adjudication and a foreign law that will be applied in that adjudication. Consequently, the Arbitration Clause should be subject to a broader

[45] 2019 ONCA 1, leave to appeal granted, 2019 CanLII 45261 (S.C.C.).

> analysis when it comes to the issue of validity, especially in a situation where it is part of a contract of adhesion.
>
> [64] The majority in *Douez* set out the approach to determining whether to enforce such a clause. The majority applied a two-step approach. At the first step, the party relying on the clause must establish that the clause is valid, clear, and enforceable, and that it applies to the cause of action before the court (para. 28). In this step, the court applies the principles of contract law to determine the validity of the clause, including issues such as unconscionability, undue influence, and fraud.
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> [65] If the clause is found to be valid, then, at the second step, the onus shifts to the opposing party who must demonstrate strong reasons why the court should not enforce the forum selection clause and stay the action. At this stage, the court must consider all the circumstances including the "convenience of the parties, fairness between the parties and the interests of justice" (para. 29).
>
> [66] Although, in my view, the two step approach taken in *Douez* has application to this case, that approach has to be adjusted to take into account the statutory requirements that flow from the *Arbitration Act, 1991*. One of those requirements is found in s. 7(2) which clearly places the onus on the person, who seeks to avoid the mandatory stay, to establish that the arbitration provision in issue is invalid. So in this case, the onus falls on the appellant to establish unconscionability and thus invalidity. It is not Uber's onus to establish validity.
>
> [67] Another requirement is that, because the exception in s. 7(2) requires a finding of invalidity, there does not appear to be any room for the second step of the analysis in *Douez* to apply. That is, if the appellant cannot establish that the Arbitration Clause is invalid, the *Arbitration Act, 1991* would not allow for a separate finding that the Arbitration Clause is unenforceable for other reasons. Indeed, the majority in *Douez* appears to proceed on the basis that the forum selection clause was valid but, nonetheless, the majority would not enforce it for the reasons they gave. That latter remedy is not provided for under the *Arbitration Act, 1991* as a mechanism to avoid the mandatory stay.

I am puzzled, as I was when *Novatrax* came out, by this importation of the strong cause test into the arbitration clause context. It is doubly puzzling that the Court here purported to adopt a two-step test only to then concede that there was no scope for the second step applying given the express provisions of the *Arbitration Act, 1991*.

The B.C. Court of Appeal in *Sum Trade Corp. v. Agricom International Inc.*,[46] reminds us of the accepted approach to applicability arguments made on a stay application in relation to an arbitration clause in an international agreement. In that case, the parties had entered into three agreements under which Agricom sold lentils to Sum Trade. Each of the contracts contained an annotation: "Trade Rule Info: GAFTA 88, Incoterms 2010" (the "Annotation"). GAFTA is a standard form contract drawn by the Grain and Feed Trade Association that contains a mandatory arbitration clause requiring disputes to be determined under the GAFTA Arbitration Rules and expressly prohibiting parties or persons claiming under them from bringing a civil action.

Sum Trade notified Agricom that lentils delivered in 2017 did not meet the contract specifications and sought to return the lentils for a refund. Agricom took the position that the Annotation had the effect of incorporating the GAFTA 88 dispute resolution process. Sum Trade chose to commence a civil action in the B.C. Supreme Court. Agricom applied to stay the action.

The chamber judge stayed the action, describing his role as determining whether there was an arguable case that the parties had agreed to submit disputes arising under the relevant contracts to arbitration. He identified s. 8 of the *International Commercial Act*[47] as setting out the prerequisites to the court granting a stay. He held that contests about the arbitrator's jurisdiction should be resolved first by the arbitrator unless the challenge is based solely on a question of law, or, if a question of mixed fact and law, the question of fact requires only a superficial consideration of the documentary evidence on the record.

The chambers judge found that the applicable "arguable case" standard had been met; he could find no reason for the Annotation other than to incorporate the GAFTA terms. Sum Trade argued that the reference to Incoterms 2010 (rules describing the tasks, costs and risks involved in the delivery of goods) was inconsistent with incorporation of the GAFTA provisions. The chambers judge held that each party had put forward an arguable case on their respective positions on this issue.

The chambers judge's approach and characterization of the issues was endorsed by the Court of Appeal. It rejected the proposition that a respondent must prove the existence of an arbitration agreement, on the balance of probabilities, before it can apply for a stay.

The Court of Appeal rejected the proposition that that the question of whether an arbitration clause was incorporated into the contacts was a question of law best decided

[46] 2018 BCCA 379.
[47] R.S.B.C. 1996, c. 233.

by the courts. Rather, it held that this was an inherently fact-specific question, and therefore a question of mixed fact and law.

It held that all the prerequisites in s. 8 are to be assessed on the arguable case standard. The standard applies not just to cases involving a dispute about the validity of an arbitration clause but also cases involving a dispute about applicability of such a clause. The standard also applies to issues raised as to whether the agreement is null and void, inoperative or incapable of being performed (under s. 8(2)).

It held that there is no distinction in principle to be made between cases where a litigant says it is not a party to an arbitration agreement and a case where a litigant says the contract to which it is a party does not incorporate an arbitration agreement. Both cases raise questions of scope and applicability of an arbitration agreement are appropriate questions for the arbitral tribunal.

Bottom line: Despite last year's ONCA decision in *Novatrax*, courts in other provinces have distinguished between the test to be applied where a party challenges a forum selection clause vs. an arbitration clause. The situation in Ontario is less clear. The ONCA decision in *Heller v. Uber Technologies Inc*. at least acknowledges the difference between the two types of clauses but comes close to equating them by relying on *Douez* and describing the arbitration clause as "not simply an arbitration provision." The Court acknowledges that the test for whether a stay will issue is found in the relevant arbitration statute and also recognizes that the statute provides for who bears the onus of proof, so perhaps its blending of concepts (by drawing from *Douez* when assessing unconscionability) will have no significant practical effect going forward.

***Tercon* Revisited (Again)**

Tercon, of course, is the 2010 decision of the SCC which articulated a three-part test for determining the enforceability of an exclusion clause[48] in a contract.

When applied in the commercial contracting context, the test makes it difficult for a contracting party to persuade a court to find such a clause unenforceable.

I wrote about the case in 2010, tracked its progeny each year from 2011 to 2015 and touched on it again last year in the context of enforceability of "no suit" clauses.

Over the past year, there were four notable cases considering the *Tercon* test. All four cases considered the "contrary to public policy" prong of the test. In one, the plaintiff sought to rely on the "unconscionability prong" despite the commercial context.

[48] As noted in my past papers, the *Tercon* test has been applied to a wide range of clauses including limitation of liability, entire agreement and no suit clauses, and releases.

Mega Reporting Inc. v. Yukon (Government of)[49] involved an RFP issued by the Government of Yukon for court transcription services. The RFP included a clause purporting to waive Yukon's liability for any costs associated with unfairness in the RFP process, other than for costs of preparing a bid or those awarded pursuant to a Bid Challenge Process.

Mega was the unsuccessful bidder and had issues with the way the RFP process unfolded. It sued the Government, alleging breach of its duty to fairly review Mega's RFP response.

At trial, Madam Justice Bielby noted that the tendering process was subject to both a regulation and a government directive imposing duties on Yukon in relation to fairness, openness and transparency and accountability in the tendering process. She took the view that the waiver clause contained in the RFP was aimed directly at annulling the effect of the legislation. She found that enforcing the waiver would be contrary to public policy, in that it would permit Yukon to continue to represent to the public that it engages only in fair, accountable, open and transparent procurement processes without suffering any consequences for failing to do so.

On appeal, the Yukon Court of Appeal held that the trial judge erred by not considering the high threshold necessary to establish that public policy outweighs the countervailing interest in enforcing contractual bargains. She weighed the public interest in maintaining the right to contract freely against the public interest in ensuring a fair, accountable, open and transparent bid process and found the latter interest should prevail. This, said the Court of Appeal, was an error. She was required to conclude that the harm to the public was "substantially uncontestable" such that there was an overriding public policy that should negate the public interest in enforcing contractual bargains.

Chief Justice Bauman stated in part:

> [35] However, in the case at bar, the obligations to conduct a bidding process fairly and transparently are as much for the benefit of those tendering, and the public at large, as they are for bidders like Mega. The government does not adopt statutes or regulations on tendering solely out of concern to protect vulnerable bidders, but also to provide clear guidance so that parties can effectively bid and the process can be sufficiently competitive, ensuring that taxpayers receive value for their money. Yet the government, one of the parties whose interests the procurement principles are ostensibly supposed to advance, and who in

[49] 2018 YKCA 10, leave to appeal refused, 2019 CarswellYukon 42 (S.C.C.).

> fact adopted them in the first place, has come to the conclusion that the public policy interest motivating those principles should not override their ability to protect themselves from liability. Why should the Court step in now and tell that party that they misunderstand their interests or that they are improperly weighing the impact that enforcement of the exclusion clause will have on the competitiveness and efficiency of future RFPs? Surely that cannot be a "substantially incontestable" public policy consideration in the circumstances.
>
> [36] While Mega's interests also factor into the rationale behind the procurement principles, as Binnie J. observed in *Tercon*, "[a] contractor who does not think it is in its business interest to bid on the terms offered is free to decline to participate ... So long as contractors are willing to bid on such terms, I do not think it is the court's job to rescue them from the consequences of their decision to do so" (at para. 141). (emphasis added).

In short, even where a government entity is the contracting party and has statutory and other duties with which it should comply, it is entitled to protect the public purse by way of exclusion clauses and limitation of liability clauses, and such clauses will be enforced against counterparties unless they can show substantially uncontestable harm to the public resulting from that enforcement.

In *Precision Drilling Canada Limited Partnership v. Yangarra Resources Ltd.*,[50] the majority of the Alberta Court of Appeal set aside a summary judgment on a claim for fees under a drilling contract[51] on the basis the case was unsuited for summary judgment. The defendant resisted the claim on multiple grounds, including by alleging fraudulent misrepresentation.

The Court assumed, for the purpose of its analysis, that an allocation of risk and limitation of liability clause excluded liability for fraud (as the chambers judge had found) and considered whether such an exclusion would be contrary to public policy under the third prong of the *Tercon* test.

Yangarra suffered a significant loss when a Precision employee mistakenly mixed sulfamic acid instead of caustic potash into drilling mud. Over the course of two days drilling, Precision advised Yangarra that the drilling mud was in order when it knew or ought to have known it was not. On the afternoon of the second day, the drill string and bit became stuck. It was assumed for the purpose of the summary judgment application that this was because of the sulfamic acid.

[50] 2017 ABCA 378.

[51] The standard form contract entered into is described by the Court as a "knock for knock" or "no fault" contract.

The well was ultimately abandoned, with $300,000 worth of Yangarra's equipment in it. A replacement well cost roughly $2 million.

A Master of the Court granted summary judgment to Precision, concluding that the exclusion clause was not contrary to public policy, noting that Yangarra's argument, if accepted, would amount to a ban prohibiting members of industry associations from entering into bilateral no-fault arrangements.[52]

That ruling was upheld by Mr. Justice Wilson.[53] He commented on the decision of the B.C. Court of Appeal in *Roy v. 1216393 Ontario Inc.*,[54] where the wrongdoer who committed fraud during the currency of the contract was found to not be entitled to "hide behind" an exclusion clause, in the context of considering the arguments of the parties that the exclusion clause covered (or did not) cover fraudulent conduct. He noted that the Master's comments on this issue where *obiter*, in that he wasn't satisfied that fraud or fraudulent misrepresentation had been made out.

In the Court of Appeal, Precision sought to distinguish *Roy v. 1216393 Ontario Inc.* on the basis of the no-fault nature of the contract at issue and the sophistication of the parties. The Court of Appeal took the view that those were arguments to be assessed on the evidence at trial.

It noted in part:

> [45] We note that Binnie, J. in *Tercon* (whose dissent with respect to the approach to assessing the validity of exclusion clauses was adopted by the majority) also stressed that "all of the circumstances should be examined very carefully by the court" in assessing any misconduct. Here, we have serious allegations of fraud against a sophisticated business entity that promised to conduct its risky and potentially dangerous work in a good and workmanlike manner. All we can say, without deciding the matter, is that if the appellant's allegations of fraud are substantiated, it is not clear to us that public policy would not be triggered to prevent Precision from the benefit of the contract's exclusion clauses.

The Court of Appeal allowed the Appeal and set aside the summary judgment.

[52] 2015 ABQB 433 and 2015 ABQB 649.
[53] 2016 ABQB 365.
[54] 2014 BCCA 429. In that case, the BCCA rejected the finding of the trial judge that to be contrary to public policy, conduct must "approach criminal behaviour or egregious fraud".

Assuming the matter proceeds to trial, the judgment should provide more guidance on when a "no fault" contract purporting to exclude liability for even fraudulent conduct will be unenforceable under the third prong of *Tercon*.

The Ontario Court of Appeal considered the third prong of the *Tercon* test as it applied to a consumer contract in *Gendron v. Doug C. Thompson Ltd. (Thompson Fuels)*.[55] Some might say that if there was ever a fact pattern to which the public policy basis for invalidating an exclusion should apply, this was it.

Mr. Gendron purchased 700 litres of fuel oil in December of 2008 that was delivered to oil tanks in his basement. One of the tanks began to leak almost immediately. Ultimately hundreds of litres of oil drained through a crack between the basement wall and floor. It soaked the soil under the house and also made its way into a drainage system and onwards into a nearby lake.

Over $2 million in remediation work was required. Mr. Gendron's house was demolished. Mr. Gendron sued Thompson Fuels (which was both his fuel supplier and service technician), the administrative authority responsible for fuel safety and the manufacturer of the oil tanks ("Granby"). He settled with Granby shortly after the trial began.

The applicable regulatory scheme imposed inspection obligations on fuel suppliers and obligations to shut off fuel systems in certain circumstances. Despite having made service calls to the Gendron home in 2006 and 2007, Thompson Fuels was found to have not complied with its inspection obligations (it claimed to have carried out an inspection but could produce no record thereof). The trial judge ruled that it should have shut off the system when it performed its service calls because it could not inspect the non-outlet end of the tanks and this was a non-immediate hazard that had to be corrected before it could deliver fuel.

The Customer Service Agreement between Mr. Gendron and Thompson Fuels contained an exclusion clause under which Thompson Fuels was stated not to be responsible for the inspection or maintenance of any fuel oil tank on the premises. The trial judge, applying the *Tercon* test, found that the exclusion clause did not apply on the facts: the clause purported to exclude liability for Thompson Fuel's failure to perform obligations imposed by the contract, but the obligation to perform an inspection was imposed by the relevant Regulation. He also held that it would be contrary to public policy to allow a fuel distributor to use an exclusionary clause in a consumer contract to escape liability for failing to perform obligations imposed by law as a precondition to supplying fuel to that consumer. He noted, however, that if a comprehensive inspection had been carried

[55] 2019 ONCA 293, aff'ing 2017 ONSC 4009.

out as required by law, the exclusion clause might have been effective to exclude liability for negligent performance by Thompson Fuels of its contractual obligations.

On appeal, the Ontario Court of Appeal stated as follows:

> [61] In addition, I agree with the trial judge's analysis of the third *Tercon* enquiry. Thompson Fuels' argument that the exclusionary clause applies because this is a civil action and not a regulatory proceeding is without merit. The trial judge found civil liability on the part of Thompson Fuel on the basis of repeated regulatory violations. The trial judge was correct to conclude that it would be contrary to public policy to permit a fuel distributor to escape its legal obligation to conduct a comprehensive inspection as a precondition for supplying fuel to a customer.

In *Medialinx Printing Ltd. v. United Parcel Service Canada Ltd.*,[56] the plaintiff contracted with the defendant to ship its customers' materials. As part of the agreement, the plaintiff was licensed to use the UPS shipping system and add a profit mark-up of 0.7% on each shipment. The plaintiff alleged that a UPS technician mistaken deleted the mark-up, which resulted in a two-year loss of shipping profits, and brought an action to recover the loss. The defendant sought dismissal of the claim based on an exclusion clause in the contract.[57]

MediaLinx argued that public policy precluded a party from immunizing itself from liability for failure to perform under a contract. The Court cited earlier authority to the effect that if this was all it took to make out an overriding public policy concern, no contractual exclusion clauses would ever be enforceable.

MediaLinx also tried to rely on the second prong in the *Tercon* test, alleging that the clause was unconscionable, despite the commercial nature of the parties' relationship.

The Court listed the factors that precluded a finding the clause was unconscionable:

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[56] 2018 ONSC 2946.

[57] The exclusion clause, all in caps, read: THE LICENSED PROGRAM IS PROVIDED TO CUSTOMER AND LICENSED ON AN "AS IS" BASIS. THERE ARE NO EXPRESS OR IMPLIED WARRANTIES OR CONDITIONS WHATSOEVER, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES OR CONDITIONS OF MERCHANTABLE QUALITY OR FITNESS FOR A PARTICULAR PURPOSE, WHETHER ARISING BY LAW OR BY STATUTE OR FROM COURSE OF DEALING OR USAGE OF TRADE. UPS ITS AGENTS AND SUPPLIERS SHALL IN NO EVENT BE LIABLE TO CUSTOMER FOR ANY DAMAGES, INCLUDING ANY INDIRECT, INCIDENTAL, OR CONSEQUENTIAL DAMAGES, LOST PROFITS OR DAMAGED DATA, LOST SAVINGS OR OTHER SUCH DAMAGES ARISING OUT OF THE POSSIBILITY OF SUCH DAMAGES, REGARDLESS OF THE FORM OR CAUSE OF ACTION, WHETHER IN CONTRACT OR IN TORT, INCLUDING NEGLIGENCE OR FOR ANY CLAIM BY ANY OTHER PERSON OR ENTITY.

- The clause was not unconscionable on its terms; while it excluded liability for lost profits, including for breach of contract and negligence, it did not encompass wrongful or intentional conduct by UPS employees.
- The clause was not so obscured as to escape attention.
- There was no evidence that MediaLinx had attempted to negotiate terms (and was unsuccessful in doing so). It could have gone to a competitor of UPS.
- There was evidence that MediaLinx, in fact, negotiated for other benefits under other agreements.
- The clause was not commercially unreasonable in the context of providing proprietary software for free.

Bottom line: When contracting, governments, like other parties, can employ exclusion clauses if it is deemed to be in the public interest to do so. Pointing to inconsistency with a broader government policy as the basis for an argument that the clause is contrary to public policy will be an unsuccessful strategy unless enforcement of the clause would cause substantially uncontestable harm to the public.

Where an exclusion clause purports to exclude liability for fraudulent conduct, there is a basis to argue the clause should not be enforced on public policy grounds. However, the result will be contextual: if the *Yangarra* case goes to trial, we will have judicial consideration of the enforceability of such a clause in an industry standard no-fault contract. When a party seeks to exclude liability for failure to perform mandatory regulatory duties, the exclusion clause in question will likely be unenforceable.

Frustration of Contract

There were no game-changing cases on this topic over the past year, but since I had not written on this doctrine since 2009, I decided it was worth reviewing some recent cases.

Frustration is one of those last-resort arguments made by a party who wants to get out from under a contractual obligation. Because of the high threshold set out in the case law, it is a rarely a successful argument.

The leading SCC decision is still *Naylor Group Inc. v. Ellis-Don Construction Ltd*.[58] As the Court stated there:[59]

> Frustration occurs when a situation has arisen for which the parties made no provision in the contract and performance of the contract becomes "a thing radically different from that which was undertaken by the contract."

[58] 2001 SCC 58.
[59] At para. 53.

A recent topical example arose in *Wilkie v. Jeong*,[60] where the alleged frustrating event was the foreign buyer tax imposed in B.C. by way of an amendment to the *Property Transfer Tax Act* (the "Act").[61]

Ms. Jeong ("Jeong") entered into a contract of purchase and sale to buy a house in North Vancouver from Ms. Wilkie ("Wilkie") on June 16, 2016. Jeong paid a deposit of $180,000, with a completion date set for October 17, 2016. On July 25, 2016, the Act was amended to impose an additional tax of 15% of the fair market value of the purchaser's share of the property purchased where the buyer was a foreign entity (including a foreign national). The new tax applied to purchases completed on or after the coming into force of the Act

Neither buyer nor seller had anticipated the tax. Jeong refused to close on the purchase and was sued by Wilkie for breach of contract. Jeong defended on the basis the contract was frustrated by the imposition of the tax, which required her to pay eight times more tax than anticipated, and sought relief from forfeiture in the alternative.

The parties agreed on a two element test for frustration, which is the five-part test enunciated by the B.C. Court of Appeal in *K.B.K. No. 138 Ventures Ltd. v. Canada Safeway Ltd.*,[62] boiled down to two:

1. A qualifying supervening event (one for which the contract makes no provision, is not the fault of either party, was not self-induced, and was not foreseeable);

2. That caused a radical change in the nature of a fundamental contractual obligation.

Mr. Justice Warren held that the imposition of the tax was a supervening event that qualified under the first element of the test. However, he held that it did not radically change the nature of Jeong's contractual obligation. The fundamental purpose of the contract was the exchange of land for a purchase price and that purpose and the nature of the contract did not change on the imposition of the tax. Imposition of the tax made contract performance more onerous for Jeong who, on the evidence, could not afford to pay it, but that fact was not germane.

The Court also declined to grant relief from forfeiture.

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[60] 2017 BCSC 2131. For some Ontario cases where purchasers of real estate raised a frustration defence and failed, see *Barg v. Sebastian*, 2018 ONSC 6226 and *Paradise Homes North West Inc v. Sidhu*, 2019 ONSC 1600.
[61] R.S.B.C. 1996, c. 378.
[62] 2000 BCCA 295.

For another recent example of a contracting party failing to demonstrate a radical change in the nature of a fundamental contractual obligation, see *2284064 Ontario Inc. v. Shunock*.[63] In that case, the grantor of a right to purchase in relation to a planned redevelopment of land assembled in Toronto argued that the contract was frustrated when it could not persuade an adjacent large landowner ("Norsham") to participate in the project, meaning that a only a small development project was possible on the three pieces of property it had acquired (including Shunock's property). A review of the documents revealed that refusal by Norsham to participate had been foreseen by the developer. Accordingly, there was no qualifying supervening event amounting to frustration. Further, the developer did not establish that smaller redevelopment could not provide for the main floor commercial space contemplated by the right to purchase.[64]

Another recent case serves to remind us of the role of legislation addressing frustrated contracts.

Eleven of the common law jurisdictions have such a statute,[65] containing provisions for adjustment of rights and liabilities under a frustrated contract, where the parties have not otherwise dealt with the consequences if the contract is frustrated by way of a contract provision.[66]

In *Grimsley v. Roe*,[67] the defendant purchased a guiding and hunting business from an individual named Campsall. As part of the sale, Roe assumed Campsall's liability to Grimsley under a loan and contracted to pay 70% of the profits from the business to Grimsley until the loan was repaid. The business was not successful. Grimsley sued Roe, his wife and company, seeking, *inter alia*, an order for the sale of Roe's interest in various assets. One of the defences raised by Roe was frustration; he alleged that extensive clear-cut logging in the guiding territory removed the cover for big game, making hunting difficult.

The trial judge rejected the defence of frustration on a number of grounds, including that the logging was foreseeable and that not the entire area of the guiding territory was affected.

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[63] 2017 ONSC 7146.

[64] See also *Sachdeva v.Cheng*, 2018 BCSC 1388, where the filing of a caveat and certificate of pending litigation against title was not a supervening event amounting to frustration as it was foreseeable.

[65] Alberta, B.C., Saskatchewan, Manitoba, Ontario, New Brunswick, Newfoundland and Labrador, P.E.I., Northwest Territories, Nunavut and Yukon.

[66] The statutes also deal with severance of parts of contracts that are wholly performed when the rest of the contract is frustrated.

[67] 2018 BCSC 985.

In *obiter*, Mr. Justice Saunders went on to consider the application of s. 5 of the B.C. *Frustrated Contract Act*,[68] in the context of the defendants seeking an order relieving them of the burden of repaying the loan. It reads as follows:

> 5(1) In this section, "benefit" means something done in the fulfillment of contractual obligations, whether or not the person for whose benefit it was done received the benefit.
>
> (2) Subject to section 6,[69] every party to a contract to which this Act applies is entitled to restitution from the other party or parties to the contract for benefits created by the party's performance or part performance of the contract.
>
> (3) Every party to a contract to which this Act applies is relieved from fulfilling obligations under the contract that were required to be performed before the frustration or avoidance but were not performed, except insofar as some other party to the contract has become entitled to damages for consequential loss as a result of the failure to fulfill those obligations.
>
> (4) If the circumstances giving rise to the frustration or avoidance cause a total or partial loss in value of a benefit to a party required to make restitution under subsection (2), that loss must be apportioned equally between the party required to make restitution and the party to whom the restitution is required to be made.

Mr. Justice Saunders held that had the loan contract been frustrated, the defendants would have to account for the value of the benefits they received under s. 5(2) from Grimsley's performance of his contractual obligations. In consideration of a $50,000 payment and their assumption of the loan obligation, Grimsely consented to them acquiring the guiding certificate and related territory, which items had a market value notwithstanding the business' poor returns.

And to the extent the diminution in value of the asset was caused by the logging, s. 5(4) required that this loss be apportioned equally between the plaintiff and defendants.

Bottom line: A contract will not be frustrated simply because performance under it has been made more onerous. The alleged frustrating event must be truly unforeseen and

[68] R.S.B.C. 1996, c. 166.

[69] Section 6 sets out the circumstances in which the statutory adjustment regime in section 5 does not apply, *e.g.,* when parties have allocated the risk of loss in value expressly.

unforeseeable; changes in the business landscape that increase cost or change the scope of a contract will not generally qualify.

Even where frustration is established, the party relying on the doctrine will have to account for benefits received under the contract and potentially will be subject to the apportionment regime under the relevant statute.

Excluding Statutory Warranties in the *International Sale of Goods Act*

The United Nations *Convention on Contracts for the International Sale of Goods* (the "Convention")[70] has been implemented in every province and territory. It has also been ratified by 89 states internationally, which states account for a major proportion of world trade.

The objective of the Convention is the adoption of uniform rules that govern contracts for the international sale of goods and take into account the different social, economic and legal systems prevailing.

Obviously, many transactions involving the sale of goods are cross border, making the implementing statutes relevant to commercial solicitors.

Article 1 of the Convention states as follows:

> (1) This Convention applies to contracts of sale of goods between parties whose places of business are in different States:
>
> (a) when the States are Contracting States; or
>
> (b) when the rules of private international law lead to the application of the law of a Contracting State.
>
> (2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.
>
> (3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention.

[70] S. Treaty Doc. 98-9 (1983); 1489 UNTS 3.

You also need to be aware of the limitations on the scope of the Convention in Articles 2 through 4. Note that the Convention governs only the formation of the contract of sale and the rights and obligations arising from such a contract.

To apply Articles 1 through 4, you need to understand the principles of private international law on choice of law in contract.

In a recent Ontario case, the Court of Appeal of that province explained that the question of the proper law of the contract is a threshold issue. In the absence of an express choice of law clause, litigants (and the court) will have to assess whether there is an implied choice of law and, if not, determine the proper law on consideration of the connecting factors identified in the case law.[71]

In *Bassett & Walker International Inc. v. Soleau International BVBA*,[72] an Ecuadorian seller sold shrimp to an Ontario-based buyer and shipped it via an Ecuadorian line for delivery to port in Mexico, where it was to clear customs. Some of the relevant documents contained a choice of law clause stipulating that Belgian law applied to disputes arising out of "the contract". Others contained no choice of law clause. A motions judge granted the seller's motion for summary judgment for payment of the sale price. The buyer appealed. The parties apparently assumed that Ontario law applied and no issue as to the proper law was raised on the motion.

The Court of Appeal remitted the matter for a new hearing, stating in part:

> [4] It is unclear as to how the issue of the appellant's alleged liability for the outstanding purchase price for the shrimp could be determined without first ascertaining the proper law of the contract – in particular, whether the *International Sale of Goods Act*, R.S.O. 1990, c. I.10 and the *United Nations Convention on Contracts for the International Sales of Goods*, set out in the Schedule to the Act, apply in the circumstances of this case and, if so, to what effect.
>
> [5] We note that Ontario, Belgium, Mexico and Ecuador have all ratified and acceded to the Convention. The Convention applies to contracts of the sale of goods – with certain exemptions – where, as here, the parties have places of business in different contracting states.

[71] For an explanation of these fundamental conflict of laws principles, see Janet Walker, *Canadian Conflict of Laws*, loose-leaf ed. (Toronto: Butterworths, 2005--).
[72] 2017 ONCA 886.

Because conflict of law principles result in the law expressly chosen by the parties to apply to most contract law issues,[73] parties can provide some certainty by including a choice of law clause. But in doing so, of course, they will have to consider whether the jurisdiction they choose has ratified the Convention and, if so, whether the parties want the Convention to apply as part of the expressly chosen law. The Convention expressly permits parties to contract out of its application.[74]

Why would parties choose to exclude the Convention? Sometimes it is because they do not want to be subject to the sale of goods warranties set out in it or to the provisions dealing with the passing of risk. Other times I suspect it is because the Convention is lengthy and detailed and parties are more comfortable with negotiating their own terms.

There is obviously no substitute for reviewing the Convention to assess whether it suits the parties. It contains provisions dealing with, *inter alia*, formation of contract; interpretation; offer and acceptance; breach; modification and termination; breach; obligations of buyer and seller; passing of risk; and remedies.[75]

A recent B.C. case illustrates the risk to a seller who thinks it is only offering limited warranties, but fails to explicitly exclude application of the Convention.[76] In *Pattison Outdoor Advertising Limited Partnership v. Zon LED LLC*,[77] the plaintiff ("Pattison") purchased almost $5 million worth of LED lighting fixtures for its outdoor billboards from the defendant ("Zon"). Zon is incorporated under the laws of Michigan.

The contract between the parties contained a "Special Limited Warranty", which limited Zon's liability for removal and installation costs incurred by Pattison within one year from shipment for the repair or replacement of defective units to a maximum of U.S. $75 per unit plus one-way transportation.

The units were defective. Their failure was not cured by Zon despite extensive efforts. An expert retained by Pattison concluded that because of numerous fundamental defects with the design of the fixtures, they were unfit for their intended purpose of illuminating outdoor billboards.

[73] Again, if you are not clear on which questions the proper law of the contract applies to, see Walker, *supra* note 70.
[74] Article 6 provides: "The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions."
[75] There are several text books dealing specifically with the Convention that also provide drafting tips.
[76] See also *Houweling Nurseries Oxnard v. Saskatoon Boiler Mfg. Co.,* 2011 SKQB 112.
[77] 2018 BCSC 555.

Pattison argued, successfully, that the Special Limited Warranty did not exclude statutory warranties.[78] The trial judge found that the implied warranties in the Convention (as implemented by the *International Sale of Goods Act*[79]) applied. He went on to find that the seller had committed a fundamental breach under Article 25 of the Convention entitling Pattison to avoid the contract and obtain judgment for the entire price paid.

Bottom line: Parties to international contracts for the sale of goods must address their minds to whether they wish to exclude application of some or all of the Convention (and craft their own regime, including warranties, rules as to passing of risk, obligations of parties, *etc*.). It will not be enough to deal with a subject matter covered by the Convention in a manner inconsistent with the Convention; rather, you must exclude its application explicitly. Litigation counsel seeking to get their client out from under limited warranties should consider whether it can be argued that the Convention has not been properly excluded, and therefore applies.

Contractual References to Legislation

When parties refer to legislative provisions in their contract, a question can arise as to whether they meant the reference to be static or ambulatory. Enactments, of course, are frequently amended.

There is very little law on point. The leading decision is a decision of the B.C. Supreme Court from 1997, where the Court held that the reference will be taken to refer to the provision as it existed at the date of the agreement, subject to the intention of the parties being otherwise as determined on the application of principles of contract interpretation.

In *Saunders v. Cathton Holdings Ltd.*,[80] the issue was whether holders of Class B non-voting shares in WIC International Communications Ltd. were entitled to convert those shares to voting shares as described in conversion right provisions[81] in the company's articles by reason of a transaction between a WIC shareholder ("WBC") and Cathon that arose out of the settlement of litigation between them (under which a substantial block of voting shares was transferred to Cathon).

The definition of "Offer" in the articles included the phrase "person acting jointly or in concert with the Offeror (as such term is construed for purposes of the *Securities Act*

[78] It stated in part, "This warranty is exclusive in lieu of all other warranties whether written, oral, expressed or implied and shall constitute the sole and exclusive remedy of Buyer and liability of ZON."
[79] R.S.B.C. 1996, c. 236.
[80] (1996), 17 B.C.L.R. (3d) 29 (S.C.), aff'd (1997), 43 B.C.L.R. (3d) 129 (C.A.).
[81] Also referred to as coattail provisions.

(Ontario))". The live questions in the litigation pursued by the plaintiffs were whether WBC and Cathon were acting "jointly and in concert" so that their shares in WIC would be aggregated and whether the transaction between them would constitute an "Offer" triggering the conversion right. The trial judge had to consider whether the reference to the *Securities Act* was to the version in force when the articles of WIC became effective or the version at force at the time of the relevant transaction. The *Securities Act* in force at the first date had been repealed and replaced in 1990. The 1990 version brought about a substantial reworking of the legislation and added a definition of "acting jointly or in concert."

Chief Justice Esson phrased the question as whether the reference to the statute is static or ambulatory. Relying on decision of the Court of Appeal on point,[82] he held that absent any specific direction in the agreement that the reference is to the statute as it exists from time to time, the reference must be treated as static. He found nothing in the factual matrix to suggest that the reference to the statute was meant to be to the statute as it was amended over time. He stated that "[t]he context is that of a commercial document in which certainty of meaning is of paramount importance…[T]he parties could hardly be taken to have intended to put those rights at risk from the unforeseen vagaries of legislative amendment".[83]

Interestingly, the *Interpretation Acts* of several jurisdictions, including Canada, B.C., Alberta and Ontario,[84] specifically provide for an ambulatory approach where reference to an enactment is made in another enactment. On appeal, the plaintiffs made much of this, arguing that the Chief Justice, and the Court of Appeal in the decision he cited, erred in not adopting the *Interpretation Act* approach.

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[82] He cited the concurring judgment of Lambert J.A. in *Ref. re Canada Assistance Plan* (1990), 71 D.L.R. (4th) 99 at 116 (B.C.C.A.), where he stated:

> Agreements must be interpreted in accordance with the intention of the parties. But the ordinary rule of interpretation is that if reference is made in an agreement to something which could change, and no specific direction is given that the reference is to be considered as a reference to that thing as it exists from time to time, then the reference will be taken to be a reference to the thing as it existed at the time of the agreement.

This B.C.C.A. decision was overturned by the Supreme Court of Canada (at [1991] 2 S.C.R. 525) but not on this point.

[83] At para. 34.

[84] Subsections 32(2) and (3) of B.C.'s *Interpretation Act*, R.S.B.C. 1996, c. 32, provide:

> 32(2) If a domestic enactment is amended, a reference in an unrepealed enactment of British Columbia to the domestic enactment is to be construed, for a subsequent transaction, matter or thing, as a reference to the amended domestic enactment.
> 32(3) Subsection (2) applies whether the domestic enactment is amended before, at the same time as or after the coming into force of the enactment of British Columbia in which the reference to the domestic enactment appears.

The Court of Appeal saw no basis for concluding that the common law rules as to construction or interpretation of a document should follow the will of the legislature relating to enactments. It agreed with the trial judge that the reference to the *Securities Act* was static.

An Ontario case illustrates how the contract interpretation exercise can lead the court to conclude that the reference to legislation was intended to be ambulatory. In *Stevens v. Sifton Properties Ltd.*,[85] an employment contract dated January 7, 2008, contained the following provision:

> The Corporation may terminate your employment without cause at any time by providing you with notice or payment in lieu of notice, and/or severance pay, in accordance with the *Employment Standards Act* of Ontario.

The plaintiff argued that the statutory reference was to the 1990 version of the *Employment Standards Act*, rather than the *Employment Standards Act, 2000*, which was the Act in force at the time the parties entered into the contract. The argument was based on the omission of "2000", which was part of the name of the latter Act.

Justice Leach rejected this argument, stating:[86]

> In my opinion, the only sensible interpretation is that the reference to "the *Employment Standards Act* of Ontario" in paragraph 13 of the 2008 letter of employment was an intended reference to the province's employment standards legislation that would be applicable into the future, during the parties' contractual relationship, however long that lasted. In that regard, the relevant wording accordingly was a descriptive reference, rather than an attempt at specific citation of particular legislation.

Implicitly he found that the reference was intended to be ambulatory given the nature of the contract.

Parties can deal with the issue expressly in boilerplate making their intention manifest. For example:

> Any reference in this Agreement to all or any part of any statute or regulation shall, unless otherwise expressly stated, be a reference to that statute or regulation or the relevant part thereof, as amended, substituted, replaced or re-enacted from time to time.

[85] 2012 ONSC 5508.
[86] At para. 23.

Other precedents can be found in textbooks on boilerplate[87] and in CLE materials.

Bottom line: Each time you include a reference to legislation in a contract, you need to consider whether the parties intend that reference to be static or ambulatory. If you do not make their intention explicit, there is a risk that the reference will be interpreted as static based on the existing jurisprudence, which may run contrary to what the parties were trying to achieve. Counsel handling contract litigation should consider, where the contract references legislation, whether an ambulatory or static reference best serves their client's position and how to advocate for one or the other interpretation.

Smart Contract Update

Last year, I commented on the burgeoning literature on the topic of smart contracts, zeroing in on their potential to disrupt—and possibly reimagine—traditional contract law. My bottom line was that if smart contracts were more than a passing fad, then regulation was likely inevitable, as was accompanying litigation. Despite the lack of Canadian jurisprudence on smart contracts or any relevant legislation here in Canada, this past year has shown that smart contracts are more than a phase, and both public and private sector actors are preparing for their increased usage. What follows is a reminder of what smart contracts are, an update on how different jurisdictions are regulating them, and a preview of their future direction.

Smart contracts (also known as self-executing contracts, blockchain contracts, or digital contracts) are "simply computer programs that act as agreements where the terms and conditions of the agreement are preprogrammed into the computer code making it possible for a contract to self-execute and self-enforce itself."[88] The purpose of this technology is to allow a platform for two anonymous parties to trade and do business, usually over the internet, without the need for an intermediary—such as a banks, or insurance companies. In this way, smart contracts operate much like escrow. The underlying technology of smart contracts is blockchain, a decentralized online ledger that records transactions in "blocks".[89] Each block is stored in a linear chain, "cryptographically hashed, and time stamped" to ensure that the overall blockchain has not been tampered with—thus, removing the need for third-party verification.[90] Currently blockchain is primarily used to exchange cryptocurrencies; however, their application across industries is expected to grow. I will not deal here with the steps

[87] For example, Cynthia L. Elderkin and Julia S. Shin Doi, *Behind and Beyond Boilerplate: Drafting Commercial Agreements*, 3rd ed. (Toronto: Carswell, 2011).
[88] "Smart contracts explained: The ultimate guide to understanding blockchain smart contracts," online: <www.blockchaintechnologies.com/blockchain-smart-contracts>.
[89] Also referred to as digital ledger technology, or DLT.
[90] "Blockchain explained: The ultimate guide to understanding blockchain technology," online: <www.blockchaintechnologies.com/blockchain-technology>.

taken to accommodate regulatory environments to account for the use of blockchain; as I did last year, I will focus on smart contracts.

So is anything happening in relation to smart contracts in other jurisdictions?

The Law Commission in the U.K. recently announced a "scoping study to review the current English legal framework as it applies to smart contracts." The Commission specified that the goal of the study was to ensure that "English courts and law remain a competitive choice for business."[91]

In the U.S., Ohio, Arizona, and Tennessee have all passed legislation to legally recognize smart contracts. These legislative measures do not go much further that simply recognizing that a contract will not be denied "legal effect, validity, or enforceability" solely because it is executed as a smart contract; however, they nonetheless lend an air of legitimacy to smart contracts that did not exist before.[92] Other states have introduced bills with respect to smart contracts legislation, including California, New York, Illinois and Nebraska.

Interestingly, the U.S. Chamber of Digital Commerce released a Joint Statement in Response to Smart Contracts Legislation in April of 2018, taking the position that existing legislation dealing with electronic transactions[93] provided a sufficient foundation for the enforcement of smart contracts and that additional legislation would only serve to create inconsistent and redundant laws.[94] The Chamber is not opposed to the use of smart contracts; to the contrary, it has published a white paper discussing their use, which considers at length the issues arising.[95] It just does not think additional legislation is needed at this time.

Similarly, some experts warn against too much too soon. In a recent article published in the MIT Technology Review titled "States that are passing laws to govern 'smart contracts' have no idea what they're doing", author Matt Orcutt argues that without a uniform understanding of smart contracts, legislation designed to govern smart contracts could end up stifling their use. Further, he argues that without consistent understandings of terms like "blockchain," "smart contracts" or "executed" regulation

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[91] Law Commission of the United Kingdom, Annual Report 2017-18 (2018) at 18, online: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727386/6.4475_LC_Annual_Report_Accounts_201718_WEB.PDF.

[92] US, SB, 1662, *An Act to amend Tennessee Code Annotated, Title 12; Title 47; Title 48; Title 61 and Title 66, relative to electronic transactions*, Ten, 2018, s.2(c).

[93] Referring to the *Uniform Electronic Transactions Act*, enacted in the majority of states.

[94] "Joint Statement in Response to State Smart Contracts Legislation" (April 2018), online: US Chamber of Digital Commerce<digitalchamber.org/policy-positions/smart-contracts/Innovation>.

[95] Online: < https://digitalchamber.org/smart-contracts-whitepaper/>.

will lead to more confusion on how smart contracts fit in within the larger domain of contract law.[96]

The United Arab Emirates has arguably gone the furthest in its endorsement of smart contracts by establishing a "Court of Blockchain." According to a global law firm based in Dubai:

> "[The] plan to create a blockchain-based court [is] designed to streamline the judicial process, remove document duplications, and drive efficiencies. Future research announced will investigate handling disputes arising out of private and public blockchains and out of regulation and contractual terms encoded within smart contracts."[97]

Even without regulation, practical issues on how to treat smart contracts remain. Since a smart contract is simply lines of computer code, it may need to be accompanied by a "natural language" contract that reflects the parties' intentions and the meaning behind the code (sometimes referred to as an "external model"). The presence of two contracts—one reflecting the parties' intent, and one executing it—inherently creates interpretation issues as to which contract (and to what extent) governs the parties' relationship in the event of a dispute. Furthermore, despite their increased sophistication, there remains (for the moment) a ceiling on the utility of smart contracts. Traditional contracts, particularly complex-ones, often incorporate provisions that are subjective in nature—for example, a provision requiring parties to undertake their "reasonable commercial efforts" or provide "reasonable notice." Such provisions, under current technologies, are difficult to reduce to programmable code. In addition, conflict of laws issues arise when dealing with smart contracts. Applying principles as to jurisdiction and choice of law will be challenging in a digital environment.

Therefore, while smart contracts are becoming increasingly more commonplace, it will be a while (if ever) before they completely displace the role of traditional contracts, and sophisticated regulation governing their use is unlikely to come in place before then.

Bottom line: Smart contracts are more than a fad. While the technology and practice of using smart contracts is still in its nascent stage, their usage across industries such as finance, law, real estate, and energy, among others, is likely to increase. It is perhaps too early to predict the decline of the contract lawyer—on the contrary, in the interim, smart contracts create more issues than solutions and a number of jurisdictions appear eager

[96] Matt Orcutt, MIT Technology Review: States that are passing laws to govern "smart contracts" have no idea what they're doing" (29 March 2018), online: https://www.technologyreview.com/s/610718/states-that-are-passing-laws-to-govern-smart-contracts-have-no-idea-what-theyre-doing/.
[97] K&L Gates, "Court of the Blockchain Announced" (1 August 2018) online : <www.lexology.com/library/detail.aspx?g=1f7f8f20-6835-464d-b64a-314ebe8b0123> .

to take on the challenge. In the past, Canadian courts have chosen to modify existing principles to fit new models of contracting (see *Douez*) and the first "smart contract dispute" may well define the direction of this new dimension of law.

An Epilogue: Looking Ahead to Next Year's Paper

Before this year's paper is complete, I am always thinking about next year's topics.

In a recent decision of the B.C. Supreme Court, Mr. Justice Branch considered, without deciding, the issue of how a contractual limitation of liability affects third party proceedings for contribution and indemnity against one of the contracting parties.

In *Imperial Metals Corporation v. Knight Piésold Ltd.*,[98] the neat question posed was whether, if a defendant paid its contractual limit of liability to the plaintiff, this prevented third party proceedings brought by other defendants from continuing against it.

The issue was before the Court on a summary judgment application. Mr. Justice Branch concluded that the legal issue was novel, and that there was an array of other evidentiary and practical considerations that meant that it was not suitable for summary determination.

A trial is scheduled to commence in 2019; perhaps by next winter we will have a decision informing us on this interesting issue.

[98] 2018 BCSC 211.

CONTRACT LAW – DEVELOPMENTS OF NOTE
SUMMARY OF TOPICS

HEADINGS	2017	2016	2015	2014	2013	2012	2011	2010	2009
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Acceptance by Conduct						X			
Anti-oral Amendment Clauses		X							
Arbitration Clauses	X			X	X		X	X	
Automatic Renewal Clauses			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				
Continuing Breach of Contract		X	X						
Contract Interpretation		X							
Contract Termination									X
Confidentiality Clauses			X						
Contracting with First Nations under the *Indian Act*					X				
Discretionary Powers		X							
Duty of Good Faith		X	X	X	X				X
Duty of Honesty in Contractual Performance			X	X					

HEADINGS	2017	2016	2015	2014	2013	2012	2011	2010	2009
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Efficient breach				X					
Economic Duress								X	
Electronic Transactions and Computer Contracts						X			
Equitable Mistake							X		
Exculpatory Clauses and Limitation of Liability Clauses			X	X	X	X	X		X
Forum Selection Clauses	X								
Frustration and *Force Majeure*									X
Fundamental Breach (*Tercon)*								X	
Illegal Contracts								X	
Implied Terms			X			X			
Legislative Developments of Note						X	X		X
Liquidated Damages Clauses						X			
No Suit Clauses	X								
Options		X							
Pre-Incorporation Contracts								X	
Privity of Contract						X	X		X
Rectification	X								
Releases	X								
Rights of First Refusal		X							
Restrictive covenants				X					
Severability									X
Smart Contracts	X								
Standard of Review on Contract Issues				X					
Statutory Illegality						X			
Specific Performance					X				
Time of the Essence Clauses								X	

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Unconscionability in Commercial Transactions							X		