Contract Law Update:
Developments of Note

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This is a general overview of the subject matter and should not be relied upon as legal advice or opinion.
For specific legal advice on the information provided and related topics,
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I. Focus and Scope of this Paper

Solicitors who spend time and energy attempting to bulletproof transactional documents (the very task on which this course is focussed) may find it frustrating that they cannot always bulletproof them against judicial consideration.

Courts, on occasion, uphold the parties' bargain as expressed in carefully crafted language. The jurisprudence illustrates, however, that courts may also tinker with that language through the doctrines of severance and rectification, may imply additional obligations (such as the duty of good faith) into the agreement or may refuse to enforce certain provisions (such as liquidated damages clauses held to constitute penalties).

In this paper, I survey some of the jurisprudential contexts in which legal drafting has been scrutinized by the courts. I also address some areas of contract law of continuing interest to solicitors drafting commercial agreements because the law impacts on drafting choices they will make. Under each subject heading, I provide details of recent relevant cases; the facts and particular wording of contract clauses under consideration are significant to the outcome in any given case. However, at the end of each section, I provide an overview, entitled "Bottom Line", for those who want to skip to my views on how recent cases impact on commercial practice.

II. Enforceability of Boilerplate Clauses (Exculpatory Clauses)

Perhaps because of the state of the economy, there seems to have been a recent increase in litigation in which a party seeks to enforce (or get out from under) boilerplate terms such as entire agreement, exclusion and limitation of liability clauses. As we will see in the discussion below, the precision of the language chosen does have an impact on the result as can the character of the contracting parties.

Frequently litigated issues are whether an entire agreement or exclusion clause immunizes a party from liability for misrepresentations or fundamental breach of the agreement.

A. <u>Effect of Exculpatory Clauses on Misrepresentations</u>

1. *Fraudulent misrepresentations*

The Ontario Superior Court and the British Columbia Supreme Court have both recently confirmed that fraudulent misrepresentations made prior to an agreement being finalized cannot be neutralized by an entire agreement or exclusion clause: *1565831 Ontario Ltd. v. Klupt*, [2005] O.J. No. 4946 at para. 155 (S.C.J.), aff'd 2007 ONCA 440; *Sanghera v. Danger Figure Centre (Burnaby) Ltd.*, 2007 BCSC 1308 at para. 15.

2. *Negligent misrepresentations*

Whether or not an entire agreement clause or exclusion clause will prevail over a negligent misrepresentation is fact and clause dependent.

A recent decision of the B.C. Court of Appeal stands for the proposition that negligence need not be expressly referred to in an exclusion clause in order to exclude an action (and therefore liability) for negligent misrepresentation.

In *No. 2002 Taurus Ventures Ltd. v. Intrawest Corp.*, 2007 BCCA 228 ("*Taurus*"), the contract was for the purchase of a building lot on Whistler Mountain in a development called Kadenwood. The appellant, Intrawest, marketed Kadenwood as a "premier ski-in/ski-out" residential development that provided access to the lots by skiers on ski runs and ski trails. The contract did not provide for the construction of the ski runs and ski trails. The respondent, an experienced real estate developer and an active player in the Whistler real estate market, claimed that Intrawest represented that it would build and pay for both the ski runs and ski trails within a reasonable period of time following the purchase of the lot, and that it failed to do so. The respondent sued Intrawest for damages for, among other claims, negligent misrepresentation and breach of a collateral contract.

The contract included an "entire agreement clause":

> This Contract is the entire agreement between the parties and there are no other terms, conditions, representations, warranties or collateral agreements, express or implied, whether made by the Vendor, any agent, employee or representative of the Vendor or any other person. All of the terms, conditions, representations, and warranties contained in this Contract will survive closing and the transfer of the Property to the Purchaser.

Madam Justice Levine conducted an extensive review of the case law on the issue of entire agreement clauses. She concluded that that the cases clearly supported her view that parties may arrange their affairs to exclude liability in tort by including valid exclusion clauses in their contract (at para. 58) and that negligence need not be expressly referred to in an exclusion clause in order to exclude an action in negligence (at para. 59).

Madam Justice Levine concluded that the entire agreement clause prevailed because the parties were both sophisticated, commercial entities and the contract was not a standard adhesion contract. Madam Justice Levine stated that in these circumstances, where the contract was clearly intended to govern the relationship between the parties, it would not accord with commercial reality to give no effect to the entire agreement clause in determining whether the respondent could claim a tort remedy.

On the issue of whether a collateral contract was formed relating to the construction of the ski trails, Madam Justice Levine held that the trial judge had erred in concluding that there was no evidence of contractual intention and sent that issue back to trial.

In *Punto e Pasta Manufacturing Inc. v. Henderson Development (Canada) Ltd.*, 2009 BCSC 37, Mr. Justice Slade applied the principles enunciated in *Taurus* to another case of alleged negligent misrepresentation. The result in the case is markedly different from that in *Taurus*, however, because of the specific wording of the entire agreement clauses in question.

The dispute related to the lease of a unit in a large commercial development located in close proximity to the downtown eastside of Vancouver. The parties signed an Offer of Lease and a Lease, both of which contained entire agreement clauses. The trial judge held that the defendant's representations relating to the identity of other tenants, and the status of the defendant's plans to implement a food market, were negligent misrepresentations. The issue was whether the entire agreement clauses barred a claim for negligence. The Offer of Lease contained the following entire agreement clause:

> It is understood and agreed that there are no covenants, representations, agreements, warranties or conditions <u>in any way relating to the subject matter of this Offer to Lease</u>, whether expressed or implied, collateral or otherwise, either oral or written, except for those set forth in this Offer to Lease. Except as herein otherwise provided, no subsequent alteration, amendment, change or addition to this Offer to Lease shall be binding upon the Landlord or the Tenant unless reduced to writing and signed by each of them. This Offer to Lease shall be governed by and construed in accordance with the laws of the Province of British Columbia.
>
> [emphasis added]

The Lease itself contained the following clause:

> This Lease and any Offer to Lease pertaining to the Premises and executed and delivered by the Tenant and the Landlord, set forth all of the warranties, representations, covenants, promises, agreements, conditions and understandings between the parties <u>concerning the Premises and the Centre</u> and there are no warranties, representations, covenants, promises, agreements, conditions or understandings, either oral or written, express or implied, between them other than as set forth in this Lease, as modified pursuant to Section 19.6 or the said Offer to Lease. The provisions of the said Offer to Lease shall survive the execution and delivery of this Lease, provided that such provisions shall be deemed to be, and survive only as, covenants and not conditions and provided further that in the event of any conflict or contradiction between this Lease and the said Offer to Lease, the provisions of this Lease shall prevail.
>
> [emphasis added]

Mr. Justice Slade relied on two points from the Court of Appeal in *Taurus*: first, that an entire agreement clause need not explicitly exclude liability for negligence in order to have that effect; and second, where the contract was clearly intended to govern the relationship between the parties, it would not accord with commercial reality to not give effect to the entire agreement clause.

The trial judge found that there could be no doubt that both parties to the Offer to Lease and the Lease intended that it govern the relationship between the parties. However, he held that the entire agreement clause in the Offer to Lease only excluded reliance on any representations relating to its subject matter, which was the physical area to be leased. The representations that were found to be negligent did not relate to the premises. They related to the identity of other tenants, and the status of defendant's plans to implement the food market.

Similarly, the judge held that the entire agreement clause in the Lease covered only representations relating to the physical plant, comprised of the land, buildings, improvements, facilities and equipment. This was in contrast to the entire agreement clause in *Taurus,* which applied to the entire agreement between the parties.

Noting that exemption clauses are to be construed narrowly and against the interest of the drafter, Mr. Justice Slade held that the entire agreement clauses did not exempt the defendant from claims based on negligent misrepresentation in the circumstances.

Mr. Justice Slade buttressed this conclusion by noting that the plaintiff was a relatively unsophisticated businessman and that the plaintiff's attention was not directed to the entire agreement clauses, which were buried in the small print of a standard form contract.

In another recent decision of the British Columbia Supreme Court, an entire agreement clause was held to bar claims for both negligent misrepresentation and collateral contract. The judge in *0715257 B.C. Ltd. v. Longiaru*, 2008 BCSC 1281, considered an entire agreement clause included in a share purchase agreement for the acquisition of a flight school and three training aircraft. The plaintiffs asserted that the defendants had misrepresented the value of the three aircraft. The defendants submitted that the entire agreement clause expressly confined a consideration of the warranties, covenants, conditions or terms said to have been breached to those in the written contract, and excluded consideration of any evidence relating to pre-contractual discussions, negotiations or representations.

The entire agreement clause read as follows:

> This Agreement contains the whole agreement between the Vendors and Purchaser pertaining to the subject matter hereof and supersedes all prior agreements, understandings, negotiations and discussions between the parties and there are no representations, warranties, covenants, conditions or other terms other than expressly contained in this Agreement.

Mr. Justice Cullen first considered whether *Zippy Print v. Pawliuk*, [1995] 3 W.W.R. 324 (B.C.C.A), a case where an entire agreement clause was found not to bar a claim for negligent misrepresentation, was applicable to the facts. He concluded that case was distinguishable because in *Zippy Print,* the contract was a standard form contract of adhesion between a sophisticated commercial entity and an unsophisticated customer. In contrast, the share purchase agreement before him was made by two sophisticated parties and had been drafted by the solicitor for the plaintiffs, the very parties attempting to limit the use of the clause.

Mr. Justice Cullen further distinguished *Zippy Print* based on the argument that this was a case where the plaintiffs had no need to rely on the representations of the defendants because the plaintiffs had an opportunity to conduct a pre-contractual appraisal of the aircraft, while in *Zippy Print* the representations at issue related to matters within the exclusive knowledge or control of the defendants.

In concluding that the entire agreement clause barred the claim, whether it was made as a claim for negligent misrepresentation or collateral contract, the judge stated (at para. 102):

> This is not a case where the plaintiffs were limited in or deprived of the opportunity to obtain an appraisal of the aircraft. Nor is it a case where they signed a standard form contract or a contract prepared by the defendants. There was nothing to prevent the plaintiffs from confirming the market value of the aircraft through an appraisal, or having the defendants warrant the market value of the aircraft in the agreement expressly and explicitly. That they did not do either, and that in addition they included an entire agreement clause in an agreement which they drafted, weighs heavily against finding, on an objective basis, an intention of the parties to create contractual terms around the market value of the aircraft.

B. Limitation of Liability Clauses

The decision in *Agfaphoto Canada Inc. v. Overwaitea Food Group Ltd*., 2008 BCSC 1287, is an example of a recent decision in which a British Columbia court gave effect to a broadly worded limitation of liability clause.

The parties entered into an agreement under which Agfaphoto supplied Overwaitea with photofinishing minilabs for a number of its grocery stores in British Columbia and Alberta, and serviced the minilabs. Overwaitea agreed to purchase photofinishing paper and chemicals exclusively from Agfaphoto.

The relationship soured and Agfaphoto commenced an action claiming various amounts due under the Agreement in respect of minilabs, parts, and photofinishing products. Overwaitea responded with claims by way of set-off and counterclaim.

Madam Justice Holmes had to interpret a broadly drafted limitation of liability clause which Agfaphoto attempted to rely on to bar most of Overwaitea’s claims. The clause read:

> The Buyer agrees that in no event will the Seller or Seller’s affiliates be liable to the Buyer or anyone else for loss of profit, indirect, special, punitive or consequential damages arising out of any breach of the Agreement, or arising out of the sale, use or improper functioning of the Equipment, including, without limitation: Loss of profit, goodwill or revenue: business interruption: even where caused by the negligence of the Seller or that of its affiliates. In no case shall the Seller or Seller’s affiliates liability exceed the price paid to the Seller by the Buyer for the Equipment at issue.

Of particular contention was the placement of the emphasized "or" in the middle of the clause. Overwaitea argued that only the first portion of the clause -- up to the word "or" (which for emphasis is underlined and shown in bold, above) -- applied to its claims, because everything following that word applied only to claims in relation to Equipment, which Overwaitea's claims were not.

Madam Justice Holmes stated although the clause was clearly not expertly drafted, the expressed intent of the clause was unambiguous and clear. She noted that both parties were large commercial entities with in-house legal counsel and a long history of negotiated agreements. She held that the parties could be taken to have understood the implications of the clause.

Holmes J. confirmed the principle that a limitation of liability clause is to be construed against the person seeking to rely upon it. Notwithstanding the application of that principle, the limitation of liability clause was found to bar most of the defendant Overwaitea's claims made in counterclaim.

C. Fundamental Breach and Exculpatory Clauses

Ever since *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426, when Chief Justice Dickson famously attempted to "lay the doctrine of fundamental breach to rest", the courts have struggled with the issue of whether an exclusion clause will bar a claim for fundamental breach. Recent decisions of the British Columbia courts have not settled this issue, but as we will see below, these cases do confirm that the nature of the parties is likely to have a large impact on the outcome of any given case.

A recent decision by the Court of Appeal, *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2007 BCCA 592, leave granted to appeal to the Supreme Court of Canada, 2008 CanLII 35169, deals with a broadly worded exclusion clause and an allegation of fundamental breach.

At issue was the tendering process for the construction of 25 kilometers of highway in the Nass Valley of British Columbia. Tercon had the capacity to do the job; Brentwood Enterprises Ltd., on its own, did not. Brentwood joined with Emil Anderson Construction, a leader in the road-building industry, to bid on the job. Tercon and Brentwood were qualified bidders; the joint venture of Brentwood and EAC was not.

Despite the fact that the joint venture was not a qualified bidder, the Ministry awarded it the main contract. The trial judge found that the Ministry officials tried to disguise the true state of affairs by awarding the main contract in Brentwood's name alone. Tercon sued the Ministry for breach of Contract A (as that term is used in the jurisprudence dealing with bidding and tendering).

The request for proposals ("RFP") contained an exclusion clause which read:

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

The trial judge held that the Ministry committed a fundamental breach by accepting a non-compliant bid and that it was "inconceivable" that the exclusion clause should apply in this case to excuse it from that breach.

At the Court of Appeal, Mr. Justice Donald first adopted the trial judge's summary of the evolution of the doctrine of fundamental breach post *Hunter Engineering* (at para. 13):

> According to the approach in *Guarantee* and *Hunter*, whether the exclusion clause survives fundamental breaches depends on whether the result is unconscionable or unfair, unreasonable, or contrary to public policy (see also *Shelanu*). While it has been suggested that there may be no real difference between these approaches and both are to be used sparingly, it appears that fairness and reasonableness can be assessed at the time of the breach and not just at the time the contract is concluded (*Hunter* at 510-511; *MacKay v. Scott Packing & Warehousing Co. (Canada)*, [1996] 2 F.C. 36; *Plas-Tex Canada Ltd. v. Dow Chemical of Canada Ltd.* 2004 ABCA 309.) A party should not be allowed to commit a fundamental breach sure in the knowledge that no liability can attend to it and the court should not be used to enforce a bargain that a party has repudiated (*Hunter* at 509-510).

Despite agreeing with the trial judge's summary of the law, Mr. Justice Donald disagreed with her on the issue of how specific an exclusion clause must be, stating, "I do not accept, as the judge implied, that excluded breaches must be particularized or expressly stated for the clause to be effective."[2]

Mr. Justice Donald found the words of the exclusion clause to be, "so clear and unambiguous that it is inescapable that the parties intended it to cover all defaults, including fundamental breaches."[3] The judge inferred that Tercon was a sophisticated contractor because it had already successfully recovered damages from the Ministry on a bidding default in a previous case so would have had in contemplation at the time of the RFP all potential breaches by the Ministry.

Mr. Justice Donald held that since the parties clearly intended exclusion for fundamental breaches, "then it is difficult to say that it would be unconscionable, unfair or unreasonable to enforce the bargain between sophisticated parties on a roughly equal footing."[4]

Since the exclusion clause was found to be clear and unambiguous, it was effective to bar Tercon's claim and the appeal was allowed.

Up until *Tercon*, British Columbia courts had seemed reluctant to hold that exclusion clauses excluded liability for a fundamental breach. In *Zhu v. Merrill Lynch HSBC*, 2002 BCPC 535, for example, the Provincial Court held that an online stockbroker's legal disclaimers fell into the

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[2] At para. 15.

[3] At para. 14.

[4] At para. 18.

category of an agreement that "virtually eliminates liability for inaccuracy in the performance of services contracted for by the customer and in fact reserves the right to be grossly negligent to the broker." On this basis the legal disclaimer of the broker was held to be unenforceable. In *AT&T Canada Inc. v. Globe Printers Ltd.*, 2001 BCSC 1215, the British Columbia Supreme Court held that a supplier of photocopiers could not invoke an onerous exclusion clause because there had been a fundamental breach of the lease, even though that clause explicitly excluded liability "in the event of a fundamental breach."

The one case from British Columbia that has considered this issue post-*Tercon* is *Romfo v. 1216393 Ontario Inc*., 2008 BCCA 179. In *Romfo,* the Court of Appeal once again considered the issue of fundamental breach in the context of an exculpatory clause. The contract in question was for the purchase and sale of strata lots.

Shortly before construction of the strata lots was completed, the vendors notified the purchasers that they would not complete the contracts. The market value of the lots had risen substantially in the interim and the vendors attempted to sell the lots to others at higher prices. The purchasers sued for specific performance and the vendors sought to rely on a limitation of liability clause that limited the purchasers' remedy to return of their deposits and precluded specific performance or any other remedy.

The clause in question (the "deposit clause") read as follows:

> In respect of the Deposit, the Vendor's Solicitor, unless precluded by Court order, shall pay the Deposit to the Purchaser as liquidated damages and as the Purchaser's sole remedy without further recourse against the Vendor, if the purchase and sale contemplated by the Agreement is not completed by reason of the Vendor's default hereunder.

Writing for the Court of Appeal, Mr. Justice Mackenzie stated (at para. 26) that there are two possible approaches to the fundamental breach analysis:

> The first is the construction approach — does the deposit clause, properly interpreted, apply to a termination of the contracts in the circumstances? The second approach is to accept that a literal application of the deposit clause would apply to all terminations, however motivated, but the court will not give effect to the clause where to do so would be unconscionable. The opinions in *Hunter Engineering* are divided as to the correct approach, and *Guarantee* does not resolve the question beyond observing that either approach should lead to the same result in most cases.

While not stating which approach he preferred, Mr. Justice Mackenzie concluded that the deposit clause would not exclude liability for fundamental breach under either approach. If the issue was analysed using the first approach, it was inconceivable that the parties would have intended that the deposit clause should protect the vendors from the consequences of deliberate deception. If the second approach was used, the vendor's deception was unconscionable.

The Court of Appeal's decision in *Romfo* does little to clear up the confusion about which approach should be used to determine when an exclusion clause properly captures fundamental breach. Despite the uncertainty over the exact test to use, it is clear from both *Romfo* and *Tercon* that it is possible for an exclusion clause to exclude liability for fundamental breach, particularly when the parties are sophisticated commercial entities and there is no flavour of unconscionability.

D. Bottom Line

While the courts have recently tended to give effect to broadly worded exclusion clauses and to interpret them as excluding liability for negligent misrepresentation, even where the words "negligent" or "negligence" are not used, if the parties intend to exclude liability for negligent misrepresentations and other tortious conduct, the contract should still expressly so state.

At the other end of the spectrum, solicitors must be careful not to restrict the scope of a limitation clause unduly lest they end up with a result like to one in *Punto e Pasta Manufacturing*. You cannot lose sight of the fact that these clauses are construed strictly.

Even where the entire agreement or exclusion clause is carefully drafted, a party may still find themselves faced with a collateral contract argument or an argument that the clause is not effective to oust a pre-contractual representation made to induce the other party to enter into the contract, particularly where there is unequal bargaining power or the other party is unsophisticated or entered into the contract without legal advice. To limit this risk, solicitors dealing with relatively unsophisticated parties should not bury exclusion clauses in the fine print and should direct the other party's attention to the clause.

Finally, parties can at least attempt to exclude liability for fundamental breach by the use of explicit language to that effect. We may have more guidance from the Supreme Court of Canada on this point when the appeal in *Tercon* is heard.

III. Severability

A. Severance Clauses and the Blue Pencil Doctrine

A severance clause dealing with the consequences of illegality of a provision in a contract is routinely included in commercial agreements. For example:

> Severance - If any covenant or other provision of this Agreement is invalid, illegal or incapable of being enforced by reason of any rule of law or public policy, then that covenant or other provision will be severed from and will not affect any other covenant or other provision of this Agreement, and this Agreement will be construed as if such invalid, illegal or unenforceable covenant or provision had never been contained in this Agreement. All other conditions and provisions of this Agreement will, nevertheless, remain in full force and effect and no covenant or provision of this Agreement will be deemed dependent upon any other covenant or provision unless so expressed herein.

What these clauses typically do is codify what the case law describes as the "blue pencil doctrine", at least in terms of entire provisions or covenants that are found to be illegal or invalid. Judges do not feel constrained in applying that doctrine only where the agreement expressly so provides, and further will employ the blue pencil doctrine to excise words and phrases within a clause as well. The objective of the blue pencil doctrine is to cure the illegality while remaining otherwise as close as possible to the intentions of the parties as expressed in the agreement.

It should be noted that courts may conclude that a contract is so tainted by illegality, it should be declared *void ab initio* on public policy grounds. This remedy is at the extreme end of the spectrum of remedies, however, and is most likely to be granted in a consumer, as opposed to commercial, transaction context: see, for example, *Kotello v. Dimerman*, 2006 MBCA 77.

B. Notional Severance

You should also be aware of the concept of "notional severance", which was articulated by the Supreme Court of Canada in 2004, a doctrine that had the potential to justify judicial redrafting of problem clauses in agreements, but that has since been judicially restricted in its scope.

When considering severance of a provision in a contract, the courts have typically applied a two-part test as articulated in *William E. Thomson Associates Inc. v. Carpenter* (1989), 61 D.L.R. (4th) 1 at 8 (Ont. C.A.), leave to S.C.C. refused (1990), 65 D.L.R. (4th) viii:

(i) Does the balance of the agreement after the term is excised constitute an agreement that can sensibly be enforced? and

(ii) Is the nature of the illegality such that enforcement of the remainder would be inconsistent with policy considerations?

What became known as the "blue pencil" test or doctrine was either a re-articulation of this two-part test, or a technique, involving the actual excision of the provisions leading to the illegality. Strictly applied, the blue pencil doctrine does not allow the court to add to, revise or rewrite the agreement; only deletions were permissible.

In *Transport North American Express Inc. v. New Solutions Financial Corp.*, [2004] 1 S.C.R. 249, the Supreme Court of Canada, in a four justice majority judgment (the three other justices dissented) significantly modified the blue-pencil doctrine by approving a doctrine of "notional severance".

The case involved a loan agreement that provided for interest and certain other payments and fees. The parties were under the mistaken impression that the aggregation of these various charges resulted in an effective annual interest rate of 48 percent. In fact, the effective annual interest rate worked out to 60.1 percent, in contravention of section 347 of the *Criminal Code*.

The trial judge's approach was to reduce the effective annual interest rate to 60 percent (so that it was no longer in violation of the *Criminal Code*), an approach inconsistent with the strict blue pencil doctrine. The Court of Appeal found the trial judge's approach to be in error; it instead applied the blue pencil doctrine, severing the interest provisions and leaving in place only the royalties and other fees. This resulted in an effective annual interest rate of 30.8 percent.

In the Supreme Court of Canada, Arbour J., with whom Iacobucci, Major and LeBel JJ. concurred, allowed the appeal and endorsed the approach taken by the trial judge. In her view, the traditional blue pencil doctrine did, in fact, entail making a new agreement for the parties (by striking out a provision), and thus it was artificial to retain the blue pencil test to the exclusion of other techniques whereby the court could alter the agreement to remedy the illegality.

This concept of "notional severance" is not really severance at all; the court rewrites the problematic provision so as to avoid conflict with the statute or public policy that rendered it illegal as originally drafted. It would still be open to the court, on the "spectrum of available remedies" described by Madam Justice Arbour, to hold the entire loan agreement unenforceable (in the most egregious and abusive cases), or to find only the interest portion unenforceable. Where on this spectrum a particular contract lies will be determined by reference to the following factors: whether the purpose or policy of s. 347 of the *Criminal Code* would be subverted by severance; whether the parties entered into the agreement for an illegal purpose or with an evil intention; the relative bargaining position of the parties and their conduct in reaching the agreement; and the potential for the debtor to enjoy an unjustified windfall.

Subsequent to the decision in *Transport North American Express Inc.*, there was some disagreement amongst provincial appellate courts as to whether notional severance could be employed to save an overly broad restrictive covenant. In 2009, the Supreme Court of Canada resolved that controversy, definitively ruling that the doctrine of notional severance is not an appropriate mechanism to apply to unenforceable restrictive covenants found to be contrary to public policy in the employment setting.

Shafron v. KRG Insurance Brokers (Western) Inc., 2009 SCC 6, dealt with a restrictive covenant in an employment contract which had a stated geographic reach of the "Metropolitan City of Vancouver". At trial, the judge found that there was no fixed, recognized meaning for the phrase "Metropolitan City of Vancouver" and struck out the employer's claim against the former employee. The British Columbia Court of Appeal reversed this decision and construed "Metropolitan City of Vancouver" to prevent the former employee from competing in the City of Vancouver and municipalities directly contiguous to it (effectively rewriting the clause).

The Supreme Court decision revisits the two forms of severance. At paragraph 29, Mr. Justice Rothstein cited the dissent of Mr. Justice Bastarache in *Transport North America Express Inc.* for the correct description of blue pencil severance:

> Under the blue-pencil test, severance is only possible if the judge can strike out, by drawing a line through, the portion of the contract they want to remove, leaving the portions that are not tainted by illegality, without affecting the meaning of the part remaining.

Mr. Justice Rothstein stated that notional severance involves reading down an illegal provision in a contract that would be unenforceable in order to make it legal and enforceable. He noted that *Transport North America Express Inc.* appears to require that there be a bright line test for illegality before notional severance can be applied. Mr. Justice Rothstein held (at para 36):

> I am of the opinion that blue-pencil severance may be resorted to sparingly and only in cases where the part being removed is clearly

> severable, trivial and not part of the main purport of the restrictive covenant. However, the general rule must be that a restrictive covenant in an employment contract found to be ambiguous or unreasonable in its terms will be void and unenforceable.

He noted that there are two policy rationales for precluding the use of notional severance in the construction of employment contracts. First, because there is no objective bright-line rule that can be applied to render the covenant reasonable, applying notional severance in these circumstances simply amounts to the court rewriting the covenant in a manner that it subjectively considers reasonable. Second, to allow the use of notional severance would invite employers to impose an unreasonable restrictive covenant on employees with the only sanction being that if the covenant is found to be unreasonable, the court will still enforce it to the extent of what might validly have been agreed to.

The trial judge had found that the meaning of “Metropolitan City of Vancouver” was ambiguous. Mr. Justice Rothstein therefore concluded that the covenant was *prima facie* unreasonable and unenforceable and the doctrine of notional severance could not be invoked to resolve the ambiguity. Similarly, since there was no evidence that the parties would have unquestionably agreed to remove the word “Metropolitan” without varying any other terms of the contract, blue-pencil severance was also held to be unavailable.

Post-*Shafron* the question still remains whether the notional severance doctrine will be applied to cases involving other types of illegal provisions besides those involving criminal rates of interest. Solicitors can avoid this uncertainty by drafting clauses that have the potential to be found “illegal” in such a way that severance, even under the stricter blue pencil doctrine, is possible.

C. Bottom Line

It is never a bad idea to include a severance clause in the boilerplate provisions of a contract.

When drafting provisions that could be attacked as illegal or contrary to public policy, one should draft them with a view to it being easy for a court to strike out offending words or clauses without doing harm to the overall meaning of the clause. By necessity, this may involve listing fees and charges (in the loan agreement context) and territorial and other restrictions (in the non-competition and non-solicitation agreement context) in distinct subparagraphs or subclauses so that they are readily severable. In the employment context, *Shafron* makes it clear that solicitors must avoid drafting restrictive covenants with any uncertainty lest they be struck down in their entirety.

IV. Good Faith Obligations in Contract Law

Over the past two decades, we have seen an increasing number of cases in which litigants have sought to persuade a court to imply a duty of good faith into a contractual relationship or pre-contractual relationship. This is particularly so in the area of franchise and construction contracts;

however, good faith is exerting a growing influence in other areas of the law such as insurance and employment.[5]

The notion of an obligation to perform agreements in good faith is of ancient vintage, dating back to Roman law.[6] Section 1375 of the *Civil Code of Quebec*[7] reads as follows: “The parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished.”

A duty of good faith performance has also been codified in the *Uniform Commercial Code* in the United States (in sections 1-203 and 2-203) and in section 205 of the *Restatement of the Law of Contracts* 2d.[8]

Franchise statutes in some provinces have codified specific duties of good faith performance in the context of franchise agreements. Subsection 68(2) of the *Personal Property Security Act*, R.S.B.C. 1996, c. 359, expressly recognizes the concept of good faith, providing that, “All rights, duties or obligations arising under a security agreement, this Act or any other law applicable to security agreements or security interests must be exercised or discharged in good faith and in a commercially reasonable manner.”

The English and Canadian common law on the topic of good faith obligations in contract law has developed in a spotty fashion, and it is fair to say that there is not yet a universally recognized stand-alone duty of good faith that arises in every case, independent from the express terms of the contract in question. However, there are individual cases in which courts have implied, in particular fact patterns, just such a duty.

A. Is There a Duty to Negotiate in Good Faith?

Some litigants have argued for a duty of good faith in the context of negotiating an agreement. Until recently, Canadian courts had been consistent in rejecting this notion,[9] particularly when the parties in question are arm’s-length commercial entities and there is no overlay of a fiduciary relationship.[10]

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5 Shannon Kathleeen O’Byrne, “The Implied Term of Good Faith and Fair Dealing: Recent Developments” (2007) 86 Can. Bar Rev. 2 at 193.

6 John D. McCamus, “Abuse of Discretion, Failure to Cooperate and Evasion of Duty: Unpacking the Common Law Duty of Good Faith Contractual Performance” (2004) 29 Adv. Q. 1 at 1.

7 S.Q. 1991, c. 64.

8 This provision reads: “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”

9 See, for example, *Peel Condominium Corp. No. 505 v. Cam-Valley Homes Ltd.* (2001), 53 O.R. (3d) 1 (C.A.); *1402066 Ontario Ltd. (c.o.b. Cupps Coffee House) v. Cupps International Inc*., [2002] O.J. No. 2493 (S.C.J.); *978011 Ontario Ltd. v. Cornell Engineering Company Ltd.* (2001), 53 O.R. (3d) 783 at 793 (C.A.).

10 Of course, there is also the narrow body of law dealing with options to renew containing an objective benchmark for rent payable under such renewal, and the concomitant obligation to negotiate the terms of such a renewal in good faith, including *Empress Towers Ltd. v. Bank of Nova Scotia* (1990), 73 D.L.R. (4th) 400 (B.C.C.A.).

When given an opportunity to shut the door on the notion of an obligation to bargain in good faith, the Supreme Court of Canada instead left the question open. In *Martel Building Ltd. v. Canada*, [2000] 2 S.C.R. 860, the Court was considering whether a party could recover for pure economic loss arising out of alleged negligence of the other party in the conduct of pre-contractual negotiations. It concluded that there were policy considerations, under the second stage of the *Anns* test, which required it to reject the concept of a duty of care in the conduct of negotiations. At paragraph 73, the Court went on to state:

> As a final note, we recognize that Martel's claim resembles the assertion of a duty to bargain in good faith. The breach of such a duty was alleged in the Federal Court, but not before this Court. As noted by the courts below, a duty to bargain in good faith has not been recognized to date in Canadian law. These reasons are restricted to whether or not the tort of negligence should be extended to include negotiations. Whether or not negotiations are to be governed by a duty of good faith is a question for another time.

Recent decisions of the Ontario courts have revitalized the hopes of those in favour of a duty to act in good faith in the pre-contractual stage of the parties' dealings. In *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457 (C.A.), Transamerica sued ING for misrepresentation, breach of warranties and covenants and breach of an indemnity obligation in relation to a share purchase agreement whereby Transamerica purchased all the issued and outstanding shares of NN Life Insurance Company of Canada. ING pleaded in its Statement of Defence that Transamerica had implied duties of good faith requiring it to notify ING before closing on the share purchase agreement if it became aware of specific problems in the course of conducting due diligence. It also pleaded other implied duties of good faith that fit more readily into the "good faith performance" line of authorities. ING asserted that these duties of good faith precluded Transamerica from asserting its indemnity claims. While ING argued in the court below that it was not truly pleading a duty *to bargain* in good faith, the court disagreed. It struck the pleadings it saw as articulating such a duty. Madam Justice Macdonald of the Ontario Superior Court also took issue with pleadings that would require the implication of an obligation of good faith and fair dealing into the share purchase agreement, thereby adding to the obligations already contained in that agreement.

The decision was reversed on appeal (by two members of the Court of Appeal, with Laskin J.A. dissenting). The majority reinstated both the pleadings relating to the alleged pre-contractual duty to give notice of problems prior to closing and the pleadings seeking to imply good faith performance obligations into the share purchase agreement. ING was not, according to Associate Chief Justice O'Connor, seeking the implication of a stand-alone duty of good faith, but rather was describing a duty directed at preventing Transamerica from defeating one of the objectives of the share purchase agreement (*i.e.*, ING was alleging that Transamerica was seeking to bypass a price adjustment mechanism in the agreement).

In *Re Stelco Inc.*, [2006] O.J. No. 249 (C.A.), the Court stated that *Transamerica Life* confirmed that the jurisprudence as to whether Canadian courts recognize a stand-alone duty of good faith that is independent from the terms expressed in a contract is not settled. In that case, the plaintiff had entered into a memorandum of understanding ("MOU") with Stelco, which confirmed the general principles pertaining to the ongoing discussions between the parties with respect to a multi-part wind energy project. The MOU specifically provided that the parties agreed to negotiate in good faith the terms and conditions necessary to conclude an agreement. The parties subsequently entered into an Easement Agreement that gave the plaintiff certain rights over Stelco lands on which the wind turbines and related facilities were to be constructed. Subsequently, Stelco purported to terminate the MOU and the Easement Agreement, relying on a termination clause in the MOU. As Stelco was, by that point, under court protection under the CCAA, the plaintiff applied for an order lifting the CCAA stay so it could file a Statement of Claim claiming damages.

When the matter came before Farley J. in the Ontario Superior Court, he purported to distinguish *Transamerica Life*, suggesting that the Court there was focussing on the question of whether there was an implied duty of good faith during the due diligence phase and interim periods that might adversely affect or prejudice ING's position. The Court of Appeal in that case was not, according to him, discussing the question of whether the law was unsettled in terms of there being a duty to bargain in good faith. He cited a number of earlier decisions of the Court of Appeal for the proposition that an agreement to "negotiate in good faith" was an unenforceable agreement to agree. Farley J. ordered that all references to the MOU, including the alleged obligation to negotiate in good faith, be excised from the Statement of Claim.

The Court of Appeal reversed this decision. It held that the MOU contained specific wording calling on the parties to negotiate in good faith and to pursue specific opportunities in good faith. The Court concluded that it was not "plain and obvious" that the plaintiff would not succeed in arguing that Stelco's termination right may be subject to such an obligation.

TSP-INTL Ltd. v. Mills (2005), 74 O.R. (3d) 461 (S.C.) is an example of the uncertainty that continues to exist in this area. *TSP*, discussed in more detail below, was a case where it was held that the parties were under a mutual obligation and duty of good faith in the *performance* of their contractual duties. With respect to the issue of good faith in *negotiations* the Judge stated that "the imposition of the duty of good faith in the formation of a contract is evolving and somewhat controversial…" *TSP* was reversed on procedural grounds in (2006), 81 O.R. (3d) 266 (C.A.).

One of the more generous interpretations of whether there is a duty to negotiate in good faith is found in the case *Credit Security Insurance Agency Inc. v. CIBC Mortgages Inc.*, 2006 CanLII 12966 (Ont. S.C.), aff'd 2007 ONCA 287. That case involved a dispute between two mortgage brokers and posed the question of whether there was a duty to negotiate a mutual agreement for contract termination in good faith. Mesbur J. stated (at para 43): "Courts are increasingly wiling to recognize good faith obligations, including a duty to negotiate in good faith. This has been characterized in Ontario as an inherent obligation in contractual negotiations."[11]

[11] See also *1248671 Ontario Inc. v. Michael Foods Inc*., 2005 CanLII 32926 (Ont S.C.), where the duty to negotiate honestly was held to be "well supported by the analysis of the duty of good faith in such cases as *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533 (C.A.) and *TSP-INTL LTD. v. Mills*, 2005 CanLII 3945 (Ont. S.C.)."

B. Duty to Perform the Contract or Exercise a Discretion under the Contract in Good Faith

The two Ontario Court of Appeal cases discussed above dealt not only with an alleged duty to negotiate in good faith, they also commented on the circumstances in which Canadian courts have been prepared to imply a duty to act in good faith in the performance of the contract terms.

In *Transamerica Life*, O'Connor A.C.J.O., stated as follows at paragraph 53:

> I agree with Transamerica that Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates of defeats the objectives of the agreement that they have entered into…

In addition to the duty of good faith in the performance of contracts that the Ontario Court of Appeal summarizes in this quote, Canadian courts have also implied a duty of good faith in the context of contracts giving one party a discretion (which it is alleged to have abused); see, for example, *Greenberg v. Meffert* (1985), 18 D.L.R. (4th) 548 (Ont. C.A.) and *Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd.* (1992), 129 A.R. 177 (Q.B.), aff'd (1994) 19 Alta. L.R. (3d) 38 (C.A.).

It is important to note that the individual cases in each of the "good faith performance" and "good faith exercise of discretion" lines are fact dependent and rooted in the particular contract and relationship between the parties to the litigation. The courts, particularly at the appellate level, have been very cautious not to articulate broad principles of general application. One commentator has described the approach of Canadian common law courts as "an on-again, off-again romance in which the parties cannot decide whether to commit, continue, or go their separate ways."[12]

In light of the state of the law, it is still common for one contracting party to assert that the other party owed (and breached) a duty of good faith performance or a duty to exercise a discretion in good faith. In what follows, I will review the facts and ruling in a few recent cases to give you a sense of the circumstances in which parties have been successful in making these types of submissions.

Dunlaw Life Insurance Agency Ltd. v. Citadel Life Insurance Co. (2003), 35 B.L.R. (3d) 145 (Ont. S.C.J.), aff'd (2004), 1 B.L.R. (4th) 117 (Ont. C.A.), is an example of a case where the court implied a duty to perform a contract in good faith and found that the defendant had breached that duty. The defendant insurer entered into an agency agreement with Dunlaw Life Insurance Agency and

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[12] Maurizio Romanin, "Good Faith and Contracts: Principles, Doctrines, and Other Considerations" in *Special Lectures 2002 Real Property Law: Conquering the Complexities* (Toronto: Law Society of Upper Canada, 2003) at 737.

Autoturbo Inc. for the sale of group creditor auto insurance. The principals behind Dunlaw and Autoturbo were two individuals, Zeran and Ingrao. Zeran brought insurance expertise (and his insurance licence) to the table and Ingrao brought his contacts in the automobile dealer industry (which contacts would sell the insurance to the purchasers of automobiles). Zeran owned Dunlaw, and Autoturbo was owned jointly by Zeran and Ingrao (or their representatives). Ingrao also owned a software company, F&I Systems, which provided software to automobile dealers that was used to sell add-on products such as extended warranties. When things went sour between Zeran and Ingrao, the defendant insurer entered into a new agency agreement with a company controlled by Ingrao and assisted that company in obtaining its licence as an insurance broker. It cancelled its agency contract with Dunlaw and Autoturbo.

The trial judge held that the defendant insurer knew that Zeran and Ingrao were business partners and that Ingrao was the one with access to the automobile dealers (the potential customers). The insurer knew that Ingrao was proposing that his company F&I Systems would perform the same function for his new insurance company that it had performed for Dunlaw/Autoturbo. The insurer also knew that Ingrao's new company planned to approach the very same dealers who had signed up with Dunlaw/Autoturbo to persuade them to switch their business to it. The trial judge concluded that this constituted a breach of the duty of good faith performance. The Court of Appeal confirmed that the defendant insurer acted in such a way as to eviscerate or defeat the objects of the agency agreement with the plaintiffs by helping Ingrao get a broker's licence and take business away from the plaintiffs.

By contrast, *Rogers & Rogers Inc. v. Pinehurst Woodworking Company Inc.*, [2005] O.J. No. 5297 (S.C.J.), is an example of a plaintiff failing to persuade the court that the defendant breached a duty of good faith performance. The plaintiff (Rogers) carried on the business of supplying and installing store fixtures in prestige retail stores. Rogers would purchase store fixtures from manufacturers and resell them to its clients. It worked closely with the manufacturers to ensure the standards of its clients were met. The defendant (Pinehurst) carried on the business of manufacturing store fixtures.

Rogers had several meeting and conversations with a potential new client, Burberry Limited. Rogers approached Pinehurst as a potential manufacturer it could team up with on projects for a number of existing and potential high-end clients. When Rogers obtained contracts to supply fixtures to specific stores for Burberry, it entered into contracts with Pinehurst for the manufacture of the required fixtures. Each individual contract between the parties contained a clause stating that the client in question was a proprietary client of Rogers and that any future product inquiries by the client or work supplied to Pinehurst by the client was to be directed through Rogers. The parties worked together on a number of Burberry stores and on a number of stores for other Rogers clients. The relationship ultimately broke down. What led to the lawsuit was Pinehurst's decision to bid on a contract to supply millinery work on a Burberry store in Michigan, a contract that Rogers was also bidding on. Pinehurst was the successful bidder. Rogers sued, alleging breach of contract (citing the restrictive covenant in its standard form contracts), breach of fiduciary duty, breach of confidence and breach of a duty of good faith.

Perell J. concluded that Pinehurst was not seeking to contract in contravention of the restrictive covenant because in the context of each individual contract, the covenant was restricted in its application to the particular client, at the particular location. Accordingly, by bidding on the

Michigan Burberry store, Pinehurst was not engaging in conduct that would defeat the objectives of the contract. It was entitled to act in its own self-interest.[13]

The lower court in *TSP-Intl Ltd. v. Mills* held that a party had breached a duty to exercise discretionary powers in good faith.[14]

In *TSP*,[15] the plaintiffs were providers of computer technical services. They provided service to their clients through computer technicians they retained as independent contractors, including the defendant Mills. Mills provided all the technical support to a particular client of the plaintiffs over a four-year period. The client approached Mills to see if he would conduct work directly for them at a lower cost. He agreed to do so without advising the plaintiffs. The Court rejected the assertion that Mills owed a fiduciary duty to the plaintiffs. Wilson J. also held that this was not a case where the duty of good faith applied as a consequence of inherent vulnerability or a power imbalance (referring to wrongful dismissal and franchising fact patterns in other cases).

He held, however, that a duty of good faith arose out of the parameters of the parties' contractual relationship and conduct. Wilson J. listed four indicia in which a breach of duty of good faith may be found arising from the facts, circumstances, contractual terms and past conduct of the parties:

- If one party by their actions eviscerates or defeats the objectives of the contract they have entered into.
- If the parties' conduct fails to meet objective legitimate expectations and community standards of honesty, reasonableness, and fairness.
- If one party unilaterally nullifies contractual objectives, or causes significant harm to the other contrary to the original expectations of the parties.
- If one party benefits from a conflict of interest.

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13 While he did not find a breach of a duty of good faith on the facts, Mr. Justice Perell cited with approval the analysis of Professor P.D. Finn (now Mr. Justice Finn of the Federal Court of Australia) in his paper "The Fiduciary Principle" in T. Youdan, ed., *Equity, Fiduciaries and Trusts* (Scarborough: Carswell, 1989). Professor Finn wrote of a continuum on which good faith conduct was placed between unconscionability and fiduciary duty. The standard of unconscionability accepts that a contracting party may act in his or her own self-interest so long as the conduct is not exploitive and excessive. The standard of good faith, when it applies, accepts that a contracting party may act in his or her own self-interest but adds the qualification that the party must also have regard to the legitimate interests and expectations of the other party.

14 An Alberta case I relied upon as demonstrating this principle in my 2006 paper was overturned on appeal and can no longer be relied upon as illustrating the existence of this category of implied good faith obligations: *Dow Agrosciences Canada Inc. v. Philom Bios Inc*., 2005 ABQB 491, rev'd 2007 ABCA 122, leave to appeal to the S.C.C. refused, [2007] S.C.C.A. No. 339.

15 For a contrasting result, where the court found that an independent contractor could not owe implied duties of good faith in light of express terms of the contract (with which he complied), see *IT/NET Inc. v. Cameron*, [2006] O.J. No. 156 (C.A.).

Mr. Justice Wilson held that Mills exercised a discretionary contractual power and made unilateral contractual decisions that defeated the objectives of the parties' contract. He concluded that Mills' conduct essentially eviscerated the contract and did not accord with objective community standards of reasonableness and fairness. Mills was held liable and the Court awarded the plaintiffs the quantum of damages they sought, representing the additional profits earned by Mills by directly servicing the client for a one-year period.

As mentioned above, *TSP* was reversed on procedural grounds in (2006), 19 B.L.R. (4th) 21 (Ont. C.A.). The Court of Appeal stated: "Given my conclusion on this ground, it is unnecessary for me to address the appellants' other grounds of appeal, namely, whether the trial judge erred in her conclusions on good faith, unconscionability and implied contractual terms."

C. <u>Express Clause re Good Faith Performance</u>

It is, of course, open to parties to include an express clause in their agreement imposing good faith duties. *Compugen Systems Ltd. v. MFP Technology Services*, [2002] O.J. No. 366 (S.C.J.), aff'd [2003] O.J. No. 290 (C.A.), is recent example of a court construing such a clause.

In that case, the plaintiff was a supplier of computer products to the private and public sector. The defendant was in the same line of business, but it also engaged in lease financing. The defendant had supply agreements with the Ontario government, but those agreements were not exclusive; the government retained the freedom to choose its supplier of equipment, services and lease financing. In order to focus on the lease financing component of its business, the defendant entered into an agreement with the plaintiff whereby the plaintiff would supply product and the defendant would provide lease financing to their collective customer base. When the defendant used different suppliers to fulfill computer products requirements for a government project, the plaintiff sued, relying on an exclusive supplier clause in the agreement.

The agreement also contained a clause in the general provisions stating that the parties "shall perform their obligations and responsibilities under this Agreement in good faith".

Ground J. construed the exclusive supplier clause in the agreement in the context of the good faith clause and the circumstances surrounding the making of the agreement and held that each of the parties was obligated to use their best efforts to promote the other party. They were obligated to use their best efforts to ensure that Ontario public sector customers sourced their supply of products and services or its lease from the other party.

A recent case from the Saskatchewan Court of Queen's Bench, *Ascent Financial Services Ltd. v. Blythman*, 2006 SKQB 28, aff'd 2007 SKCA 78, is an interesting example of a contract lacking a specific clause requiring good faith performance, such as the one in *Compugen Systems*, but where the court nevertheless held that when read in its entirety, the contract required good faith performance.

The case involved the purchase and sale of the goodwill of a business. The judge referred to the following recitals contained in the agreement:

> [38] . . .
>
> WHEREAS Art and Anna have been conducting business in the [*sic*] Maple Creek for approximately 40 years and over the last 20

> years have established and carried on the business of investment brokers;
>
> AND WHEREAS Art and Anna's personal reputation and community involvement has contributed greatly to the success of their investment business;
>
> ...
>
> AND WHEREAS the Consenting Parties [Don and Carolyn] have not previously carried on an investment or financial services business in the Maple Creek area;
>
> ...
>
> AND WHEREAS all parties are desirous that any future good will generated by the efforts of Art and Anna as well as the efforts of the Consenting Parties or Peak be the property of Ascent.

This case contains a helpful and extensive review of the jurisprudence on the duty of good faith. The decision, however, was fact-specific. McLellan J. concluded that the objectives of the agreement were clearly that the former clients of the defendants would continue as clients of the new firm and that they had a duty to do everything that was reasonable to transition those clients from their personal control to that of the new firm. He found that the expectations of the parties were that the defendants would not speak of purchasers in a negative and derogatory fashion to clients and not try to divert clients to their daughter-in-law's firm. He concluded by stating that actions of the defendants, "were clearly in breach of the reasonable expectations of the plaintiffs and defendants when they entered into the contract for the sale of goodwill."

D. <u>The Bottom Line</u>

If it is important to the parties that one or both of them be held to duties of good faith performance, such obligations should be made express in the contractual language, even though there is a basis in the jurisprudence for such a duty being implied in the right circumstances. A pre-contractual duty of good faith negotiation is unlikely to be implied at common law. Where the parties have an existing contractual relationship that includes a future obligation to negotiate another contract or a contract extension, consideration should be given to imposing an express duty to negotiate in good faith.

V. Frustration and *Force Majeure*

In the current economic climate, parties are motivated to find legal excuses for non-performance or to look for a basis in the contract or at common law for bring contractual obligations to an end. Where parties have included a *force majeure* clause in their contract, frustration will usually not apply, for the simple reason that a frustrating event is one that was not foreseeable at the time the contract was entered into.

A. The Doctrine of Frustration

The law has not changed in the last decade in terms of what a party to a contract must demonstrate for the court to find that the contract has been frustrated. The leading case on the issue in this jurisdiction is still *KBK No. 138 Ventures Ltd. v. Canada Safeway Limited*, 2000 BCCA 295. In that case, the plaintiff agreed to purchase land from the defendant. The plaintiff intended to construct a mixed residential and commercial building. After the land purchase contract was entered into, but prior to construction, the municipality amended its zoning bylaws, which prevented the proposed building from being constructed as intended. The British Columbia Court of Appeal applied the law of frustration, summarized by *Folia v. Trelinski* (1997), 14 R.P.R. (3d) 5 (B.C.S.C.). The five-part test articulated in that case is as follows:

1. The event in question must have occurred after the formation of the contract and cannot be self-induced;

2. The contract must, as a result, be totally different from what the parties had intended;

3. The disruption must be permanent and not temporary or transient;

4. The change must totally affect the nature, meaning, purpose, effect and consequences of the contract so far as concerns either or both parties; and

5. The act or event that brought about such radical change must not have been foreseeable.

Recently there has been an increase in the number of cases where changes in government policy or the exercise of ministerial discretion were held to constitute frustration.

In *Klewchuk v. Switzer*, 2003 ABCA 187, leave to appeal to the Supreme Court of Canada denied (2004), 363 A.R. 397 (note), Klewchuk and Switzer were each in the casino business. In 1989, they entered into a written agreement that Switzer would provide a facility for casinos and receive funds from agreements with charitable organizations using the casino. Kluchuk would provide dealers and gaming equipment and be paid by the charitable organizations as well. The agreement also stated that neither party intended to make payments to each other for matters pertaining to their operations. In 1996, the rules governing casinos in Alberta changed, requiring that charities contract only with a casino facility licensee who provided an entire package of services.

The judge held that the arrangement contemplated in the 1989 Agreement could not have continued once the 1996 Gaming Rules came into effect and was therefore frustrated. In order to contract with the charities thereafter, either Switzer or Klewchuk would have been required to provide the whole range of services and facilities. Further, one of them would have had to pay the other for either the facility or for services, in breach of the 1989 Agreement, which stipulated that they would not make payments to each other.

In *Benson Construction Management Corp. v. Great Canadian Casinos Inc.*, 2003 BCSC 1033, the plaintiff sought to recover a percentage fee (based on construction costs) that it said it was entitled to pursuant to an agreement whereby it assisted the defendants in locating land for and managing construction of casinos. The defendants denied the existence of an agreement, but also argued that the alleged contract was frustrated by radical changes in government gaming policy (*i.e.*, the B.C. government's moratorium on the expansion of gaming in the relevant time period). Dorgan J. held that as the changes to government gaming policy unfolded, and particularly after the freeze on relocation, it became impossible for the parties to perform their obligations under the alleged agreement. She further held that the parties could not have anticipated the sweeping changes to gaming policy at the time they entered into the alleged agreement. Therefore, she found frustration at law.

In *Doucette v. Jones*, 2006 NBCA 38, the respondent sold his snow-crab licence and business to the appellant Doucette and a numbered company. The agreement of purchase and sale stipulated that the respondent was to continue to hold the licence (with Doucette as beneficial owner) until Doucette was entitled to obtain a licence by re-issuance on meeting certain government qualifications. While Doucette met the qualifications, prior to him obtaining a licence by re-issuance, the Department of Fisheries and Oceans put a freeze on some licences, including this one, due to concerns that licensing policy was being circumvented by trust arrangements of the type entered into by Doucette and Jones. Ultimately, DFO told the respondent that he would have to terminate his trust agreement with Doucette if he wanted the restriction removed from his licence. DFO would not re-issue the licence to Doucette or any other fisher.

The Court cited Sir Guenter Treitel, *The Law of Contract*, 10th ed. (London: Sweet & Maxwell, 1999) for the premise that if a change in government policy leads to the refusal of licences which previously had been issued as a matter of course, it is possible that the change of policy may be regarded as a supervening event which is capable of frustrating the contract.

The Court held that the substantial object that the parties had in view when entering into the agreement of purchase and sale was not longer obtainable and that performance had therefore become impossible. The contract was frustrated by DFO's exercise of its ministerial discretion.

Note that in *Doucette* and *Benson* the courts had to consider the claims of one of the parties to either partial compensation or restitution of amounts paid pursuant to the applicable *Frustrated Contracts Act*.

B. *Force Majeure*

Parties include *force majeure* clauses in their contracts to enlarge the types of circumstances under which contractual obligations will be terminated and to set out more flexible remedial measures for dealing with disruptive events, such as suspension of contractual obligations for a set period of time or until a particular problem is cured.

As with the law of frustration, the case law on *force majeure* clauses has not evolved significantly in recent years. Courts will interpret such clauses in light of their general purpose of excusing non-performance upon the occurrence of supervening events that make performance impossible. Absent explicit language to the contrary, a *force majeure* clause will not be interpreted so as to excuse performance where the event in question resulted from conduct of the non-performing party rather than from events beyond that party's control: *Atlantic Paperstock Ltd. v. St. Anne-Nackawic Pulp & Paper Co*., [1976] 1 S.C.R. 580.

Drafters are still faced with the same decision of whether to draft an all inclusive *force majeure* clause or a clause that is a long list of detailed triggering events. In *Atcor Ltd. v. Continental Energy Marketing Ltd.* (1996), 38 Alta. L.R. (3d) 229 (C.A.), a leading *force majeure* case in the petroleum industry setting, Kerans J.A. states (at 236):

> The office of the [*force majeure*] clause is to protect the parties from events outside normal business risk. A *force majeure* clause, then, should address three questions:
>
> - How broad should be the definition of triggering events;
> - What impact must those events have on the party who invokes the clause; and
> - What effect should invocation have on the contractual obligation.

The *force majeure* clause in *Atcor* read as follows:

> For the purposes of this Agreement, the term "force majeure" shall mean any acts of God, including therein, but without restricting the generality thereof, lightning, earthquakes and storms and in addition shall mean any strikes, lockouts or other industrial disturbances, acts of the Queen's enemies, sabotage, wars, blockades, insurrections, riots, epidemics, landslides, floods, fires, washouts, arrests and restraints, civil disturbances, explosions, breakages of or accidents to plant, machinery or lines of pipe, hydrate obstructions of lines of pipe, freezings of wells or delivery facilities, well blowouts, craterings, pipeline tie-ins, pipeline connections, pipeline repairs and reconditioning, the orders of any court or governmental authority, the invoking of force majeure pursuant to any gas purchase contracts, any acts or omissions (including failure to take gas) of a transporter of gas to or for Seller which is excused by any event or occurrence of the character herein defined as constituting force majeure, or any other causes, whether of the kind herein enumerated or otherwise, not within the control of the party claiming suspension and which, by the exercise of due diligence, such party is unable to overcome.

The first part of the *force majeure* clause in *Atcor* is a broad list of detailed triggering events that is tailored to the petroleum industry (hydrate obstructions, well blowouts, etc.). In contrast, the second part of the list uses all inclusive and catch-all language. It is suggested by Joni R. Paulus and Dirk J. Meeuwig in their article "*Force Majeure* – Beyond Boilerplate" (1999), 37 Alta. L. Rev. 302 at 307 that this type of format, where a balance is struck between a long list of detailed and tailored triggering events and a general all-inclusive clause, best allocates the risk between the parties. Additionally, it is recommended that parties should specify the consequences of a *force majeure* event and any particular steps (*e.g.*, notice) which must be taken by either party in the event of *force majeure.*

Force majeure clauses often impose obligations on the party being excused from performance to solve the problem caused by a supervening event. Even in the absence of such a clause, courts are likely to obligate a party to "mitigate" where it is commercially reasonable to do so (and will impose their own standard of what is commercially reasonable in the circumstances).

The drafter must consider the standard the party is going to be held to (best efforts, reasonable efforts, best commercial efforts, etc.) in terms of responding to the triggering event by mitigation and the extent to which the standard chosen will require the party to sacrifice or compromise its own economic interests to those of the other party.[16] If it is possible in the context of the type of agreement and industry, the drafter may wish to specifically enumerate the specific actions the parties have agreed a party must do in order to mitigate. Paulus and Meeuwig[17] give the example of a contract for gas supply where the supplier's ability to supply gas is reduced. In those circumstances, they suggest, the parties could specify in the contract that the supplier is required to distribute its remaining gas supply on a pro-rated basis between purchasers under firm supply arrangements.

Professor McMeel notes in his text *The Construction of Contracts*[18] that if suspension of contractual obligations is the stated result of a particular event in a *force majeure* clause, consideration should be given to imposing a time limit for the suspension: "If the [*force majeure*] event exceeds the specified time limit further provision may be necessary to deal with such lengthy impediments, such as excuse from further performance in such circumstances."[19] He cautions solicitors drafting contracts to consider this for the very reason that a *force majeure* event may continue for a long period of time and a party may effectively turn a suspension into a permanent exemption from the obligation to perform.

C. <u>Bottom Line</u>

Reliance on the common law doctrine of frustration will not provide any certainty for the parties in terms of when they will be excused from performance obligations.

A well-crafted *force majeure* clause can provide the parties with more certainty. The drafter of such a clause must consider: 1) the triggering events that will be listed, and whether they will include some sort of catch-all description; 2) the effect of any given triggering event, *i.e.*, suspension or termination, and if suspension, whether to include a set time period beyond which the suspension cannot continue; 3) the obligation to be imposed on a party to "mitigate" the triggering event, including what standard they will be held to and whether there should be a specific listing of steps they must take.

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[16] The view expressed in a number of U.K. cases is that where the obligation is to use reasonable efforts or endeavours to obtain a particular result, the party need not subordinate its own financial interests under the contract in obtaining that result: see *Phillips Petroleum Company United Kingdom Limited v. Enron Europe Limited,* [1997] C.L.C. 329 (C.A.) and subsequent cases citing this decision.

[17] At 311.

[18] Gerard McMeel, *The Construction of Contracts: Interpretation, Implication and Rectification* (New York: Oxford University Press Inc., 2007).

[19] *Ibid.* at 466-467, paras. 22 & 23.

VI. Contract Termination

A. Does a Contract Terminate when the Parties Effectively Ignore It?

A surprising number of contracts are silent as to the parties' right to terminate the contract in the absence of a breach or default by the other party or in the absence of a defined *force majeure* event.

A recent case from the Supreme Court of Canada has clarified that a contract does not become unenforceable or terminate by operation of law solely because the parties ignore it, or unsuccessfully try to renegotiate it.

Jedfro Investments (U.S.A.) Ltd. v. Jacyk, 2007 SCC 55, involved the companies controlled by three sophisticated businessmen (Iwaskyiw, Jacyck and Matukas). Their companies were parties to a multi-million-dollar joint venture agreement to develop and sell land near Denver, Colorado. The joint venture purchased the land partly with cash advanced by the three partners and with the balance secured under a promissory note. Unfortunately, the land proved not to be as saleable as first anticipated. Eventually the lender demanded repayment of the loan. That precipitated a crisis, with Jedfro (the company controlled by Iwaskyiw) and the company controlled by Matukas unable to pay their respective 30 percent and 10 percent shares of the note. To avoid foreclosure and the loss of the investment, Jacyk, who held a 60 per cent share, used one of his other companies, Prombank, to purchase the note. Jacyk settled with Matukas and his company, but not with Iwaskyiw. When Jedfro, which held 30 percent, took no meaningful steps to raise the money it owed, Prombank foreclosed, effectively appropriating the $1.4 million that Jedfro had invested. Jedfro sued for breach of the joint venture agreement.

The appeal was dismissed in a 7-0 decision. The Chief Justice held that a contract may be discharged by performance, agreement, frustration and by repudiatory or fundamental breach. In addition, it is possible to end a contract by merger, alteration, cancellation of a written instrument, and in particular circumstances, by death of a party to the agreement.

The Chief Justice held that the contract in question was not discharged by performance or frustration. This left discharge by agreement or by repudiatory breach. Applied to the facts of the case, discharge by agreement was problematic because the negotiations between the parties never culminated in a new agreement. The Chief Justice stated (at para. 16):

> In order to discharge the joint venture agreement, a new agreement that it be terminated must be established. The trial judge found that both parties acted as if they were not bound by the joint venture agreement. They ignored it, or parts of it, as they saw fit. But this does not establish a new contract to terminate the old contract. To establish a new agreement it must be shown that there was an offer by one party, accepted by the other, or an exchange of promises, supported by consideration.

Similarly, the contract was not terminated by repudiatory breach. Chief Justice McLachlin explained that while Jedfro had refused to pay its share of a debt incurred under the promissory note, this did not amount to repudiation since Jedfro nevertheless wanted to keep the joint venture going. She noted the trial judge's finding that all three co-venturers had "little regard" for the agreement, but held that, “Having ‘little regard’ for an agreement does not establish that a party is repudiating the agreement…Ordinary, non-repudiatory breach is consistent with ignoring the terms of an agreement. More is required to establish repudiation.”

Proceeding on the basis that the joint venture agreement was not terminated and remained in force, the Chief Justice refused to accept Jedfro’s assertion that the agreement had been breached. Jedfro argued that Jacyk was bound by the agreement to advance funds on behalf of the defaulting parties. Chief Justice McLachlin held that Jacyk's refusal to advance funds to pay the promissory note on behalf of defaulting Jedfro - which under the contract was a right, but not an obligation - did not breach the agreement. Nor did the defendant's purchase of the promissory note, something which any third party could have done, constitute a breach. Jedfro’s claim was dismissed.

The decision makes it clear that post-contractual negotiations to terminate an existing contract that do not culminate in a new agreement do not negate the original agreement. Similarly, the agreement does not become unenforceable simply because the parties behave as if they are no longer bound by the contract.

B. <u>Implication of Term Permitting Termination on Reasonable Notice</u>

Where an agreement is silent on the question of the respective rights of the parties to terminate the agreement and the amount of notice that will be required to terminate, the parties put themselves in the hands of the court, which may imply a condition that the contract may be terminated on reasonable notice. While such a practice is well-established the context of employment law and in the context of agency agreements, there are recent cases confirming that courts may imply a condition of termination on reasonable notice into certain types of commercial contracts as well.

In *SR & J Customer Care Call Centres Inc. v. Craig Wireless International Inc.*, 2004 MBQB 205, rev’d on other grounds, 2005 MBCA 136, the defendant wireless cable service company entered into a contract with the plaintiff whereby it would provide call centre services. The defendant terminated the contract without notice after 4 and 1/2 months, at the end of a particular advertising campaign. In the absence of an express clause providing for termination without notice or upon the advertising campaign ending, the Court implied a term for termination on reasonable notice, which it held to be one month.

In *Salex Technical Products Ltd. v. N.S.I. Holdings Inc.*, [2003] O.J. No. 631 (S.C.J.), aff’d [2004] O.J. No. 5159 (C.A.), the defendant was the manufacturer of lighting products based in the U.S. It solicited the plaintiff’s services as its exclusive representative in Toronto. The defendant put forward a written agreement that included a provision for termination on 30 days notice. The plaintiff refused to execute the proposed agreement, in part due to the termination provision. The plaintiff became the exclusive representative in Toronto for the defendant without a written agreement governing their relationship.

The trial judge ruled that this was not a mere mercantile agency requiring no notice to terminate. The plaintiff made significant changes to its business and expanded its sales force to meet its obligations to the defendant. The defendant exercised substantial control over the plaintiff and required it to install certain computer systems. The Court implied a term for reasonable notice of termination and held that one year's notice was reasonable in the circumstances.

In *Southwest Trucking Ltd. v. Abitibi Consolidated Co. of Canada*, 2004 NLSCTD 187, the plaintiff companies provided trucking service to the defendant over a 14 year period without the benefit of a written agreement. When a dispute arose between the parties about hauling rates, the defendant retained other contractors. The plaintiffs sued the defendant alleging intimidation and negligence in relation to damage caused to one of its trucks on a road maintained by the defendant. The plaintiffs' action was dismissed. The Newfoundland and Labrador Supreme Court found that the plaintiffs had repudiated the contract and awarded damages to the defendant on its counterclaim based on failure to give reasonable notice of termination. In light of the long and close relationship between the parties, the significant reliance by the plaintiffs on their contract with the defendant, and the considerable business integration between them, the Court implied a term that the agreement could only be terminated upon giving reasonable notice.

Most recently, by contrast, Madam Justice Garson of the B.C. Supreme Court refused to imply a right to terminate on reasonable notice into an agency agreement. In *Re Pine Valley Mining Corporation*, 2008 BCSC 297, leave to appeal denied, 2008 BCCA 263, Pine Valley had obtained an order under the CCAA protecting it from claims of its creditors. The court-appointed monitor terminated an agency agreement between Pine Valley, Falls Mountain Coal Inc. and Marubeni Corporation. Marubeni then filed a claim under the CCAA for the amount it said it would have earned in commission over the life of the agency agreement, an amount in excess of $8 million The monitor reduced that claim to $351, 909 on the basis that Falls Mountain would have been entitled to terminate the agency agreement on reasonable notice. On an application to determine a preliminary issue in the disputed claim of Marubeni, the chambers judge disagree with the monitor, holding that there was no basis to impute a provision entitling Falls Mountain to terminate the agency agreement on reasonable notice.

The decision of the Ontario Superior Court of Justice in *Credit Security Insurance Agency Inc.*, which I discussed above in the context of implied duties of good faith, is another example of a court refusing to imply a term permitting unilateral termination on reasonable notice. The contract in that case contained a termination clause, but that clause only provided for termination by mutual agreement or for material breach. The Court noted the sophistication of the parties and concluded that if they had intended for there to be a unilateral right to terminate on reasonable notice, express language to that effect would have been included in the contract.

C. Bottom Line

Contract drafters should consider whether it is desirable to include a clause permitting termination of the contract on notice in the absence of breach, default and *force majeure* (or conversely making it plain that the parties agree that there is no such right). As the cases on this issue reveal, it is hard to predict when a court will feel justified in implying such a clause, so the absence of such a clause will lead to uncertainty. Generally speaking, such a clause is more likely to be implied in personal service contracts, or contracts where there are elements of trust and confidence reposed by the parties on each other (and therefore not in many categories of commercial contract).

As the Supreme Court of Canada has explained, the parties cannot, by ignoring a contract or acting as if it no longer binds them, bring about a contract termination.

VII. Privity of Contract

The doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. This basic principle has not changed; however, in recent years Canadian courts have delineated circumstances in which the doctrine of privity should be relaxed with respect to third party beneficiaries. Unlike their counterparts in some other jurisdictions, Canadian legislators have not chosen to create statutory rules in relation to rights and remedies of third party beneficiaries.[20]

A. Third Party Beneficiaries and Relaxation of the Doctrine of Privity

The two leading cases on this "principled exception" to the doctrine of privity are the Supreme Court of Canada cases *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 and *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108. In *London Drugs,* the Supreme Court considered whether the warehouse employees of London Drugs should be protected by a limitation of liability clause in a contract made between their employer and Kuehne & Nagel. The employees were in a position where they could not have protected themselves by contractual provisions and where it did not accord with commercial reality for them to insure themselves independently. The Court held that the employees were carrying out the contractual obligations of a party to a contract and could therefore claim its protection.

In *Fraser River*, the question was whether a third party charterer could rely on a waiver of subrogation clause agreed to by the barge owner with its insurer. The Court extended the "principled exception" to the privity doctrine to the charterer as a third party beneficiary. The Court held that the owner's agreement with the insurer showed a clear intention to protect a class of beneficiaries in the charterer's position and the charterer's activities arose in the context of the very activity contemplated in the policy under the waiver of subrogation clause.

In both *London Drugs* and *Fraser River*, the third parties sought to use the contract as a shield to protect themselves from a claim advanced against them.

The third party beneficiary issue has recently been considered by the British Columbia Court of Appeal in *District of Kitimat v. Alcan Inc.*, 2006 BCCA 75. Kitimat sought to expand the category of third party beneficiaries beyond just employees and subrogation clauses and to use it as a sword. Kitimat argued that Alcan was in breach of its obligations to Kitimat as a third party beneficiary under agreements between Alcan and the Province of British Columbia. The agreements in question concerned Alcan's production and sale of hydro-electric power in the district of Kitimat.

Chief Justice Finch relied on *Fraser River*, stating that the principled exception to the doctrine of privity depends on the intention of the parties and that two factors must be considered (at para 72):

[20] For a discussion of the legislative initiatives in other jurisdictions, see the paper entitled "Privity of Contract and Third Party Beneficiaries" prepared by Maria Lavelle for the Civil Section of the Uniform Law Conference of Canada (2007 Conference) available at http://www.ulcc.ca/en/poam2/index.cfm?sec=2007&sub=2007g.

> (a) did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision? and
>
> (b) are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, again as determined by reference to the intentions of the parties?

The Chief Justice dismissed Kitimat's theory of why Alcan owed it duties for two reasons. First, Kitimat had not established that it shared an identity of interest with either the Province or Alcan and therefore Kitimat's third party beneficiary submission failed upon a consideration of the two *Fraser River* factors. Second, Kitimat was attempting to use the exception as a sword not a shield.

The proposition that the third party beneficiary exception to the privity doctrine can only be used as a shield has recently been supported by the Federal Court of Appeal. In *Canada v. Design Services Ltd.*, 2006 FCA 260, the Court considered a tendering dispute where the subcontractors to a head contractor (who should have been awarded the main contract) claimed that they were third party beneficiaries of Contract A.

The Federal Court of Appeal relied on *Kitimat* for the proposition that the doctrine of privity is relaxed only for use as a shield, not as a sword. *Canada v. Design Services Ltd.* went to the Supreme Court of Canada (2008 SCC 22), but that Court did not deal with the third party beneficiary question, with the only question before it being whether an owner in a tendering process owes a duty of care in tort to subcontractors.

Despite the appellate court holdings in *Design Services* and *Kitimat*, a recent case from the Ontario Supreme Court (Commercial List) provides ammunition for those who would wish to use the third party beneficiary exception as a sword.

Re Stelco (2006), 24 C.B.R. (5^{th}) 59 dealt with the financial restructuring of Stelco Inc. The dispute before the Court was over a pool of cash, notes, shares and warrants. In early 2002, Stelco issued convertible unsecured subordinated debentures in the amount of $90,000,000 to the "Noteholders" pursuant to a note indenture agreement. Under the terms of the agreement, in the event of insolvency or reorganization of Stelco, the Noteholders expressly agreed to subordinate their claim to the extent necessary to result in payment owing to the Senior Debt Holders. At trial the Senior Debt Holders sought to enforce the subordination covenants of the agreement as third party beneficiaries, thereby using the exception to the privity doctrine as a sword.

The Noteholders relied on the trial decision in *Kitimat* (2005 BCSC 44) and an earlier British Columbia case (*R.D.A. Film Distribution Inc. v. British Columbia Trade Development Corp.* (1999), CanLII 5862 (B.C.S.C.)) to argue against the third party beneficiary exception being used as a sword. The Court disagreed.

The Court held that the two part test from *Fraser River* was satisfied because there was no question that the benefit of the provision was intended to extend to the Senior Debt Holders. On the sword/shield issue the Court held that on these facts it was immaterial whether the principle was being used as a sword or a shield. The Court stated (at para. 75):

> It is clear from that decision [*Fraser River*] that the fundamental consideration in the determination of whether, in any particular circumstance, relaxation of the doctrine of privity can be characterized as "incremental" is the potential for double recovery and multiplicity of actions. I would note that these concerns were present in both *Kitimat* and *R.D.A. Film Distribution*. In the present proceeding where such concerns are not present, I believe the principle in *Fraser River* contemplates extension of the third party beneficiary principle regardless of whether it is being used as a shield or a sword.

The Court held that the Senior Debt holders were entitled to enforce the provision directly as third party beneficiaries.

Re Stelco was appealed but the Court of Appeal in *Re Stelco Inc.*, 2007 ONCA 483 dodged the third party beneficiary issue. It stated at (para 16):

> [W]hile they are not parties to the Note Indenture between Stelco and the Noteholders, the Senior Debt Holders can rely on trust principles to provide an exception to the privity of contract doctrine … It is therefore unnecessary for us to decide whether the trial judge erred in allowing the Senior Debt Holders to enforce the Indenture as third party beneficiaries by extending to this case the principled exception to privity of contract found in *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*

Despite *Stelco*, it is probably safe to assume that the third party beneficiary exception to the doctrine of privity is restricted to being used as a shield, at least in British Columbia.

B. Bottom Line

If the contracting parties do intend to benefit third parties, especially if they intend to give them rights to sue, they should make that intention (both who is benefited and how) plain by explicit language to avoid the uncertainty in the jurisprudence.

VIII. Legislative Alert

While there have not been any statutory developments of note that impact on the topics discussed in the rest of this paper or that modify significant principles of contract law, there some ongoing legislative developments that pertain broadly to general commercial practice that are worth noting.

The *Canada Not-for-profit Corporations Act* (Bill C-4) received first reading on January 28, 2009. The Bill establishes a framework for the governance of not-for-profit corporations and other corporations without share capital, mainly based on the *Canada Business Corporations Act*.

The Bill replaces the "letters patent" system of incorporation under Part II of the *Canada Corporations Act* (Letters Patent) with an "as of right" system of incorporation. Currently, under the *Canada Corporations Act* (Letters Patent) a not-for-profit that wishes to incorporate must seek ministerial approval to do so. The system established by Bill C-4 provides that incorporation will be granted "as of right" once incorporation documents are filed along with the requisite fees. The Bill also provides for electronic filing, an option that will likely reduce the waiting period for incorporation. The Bill requires the holding of an annual meeting and the sending of an annual return, and regulates a change of a corporation's name and its dissolution.

Under the Bill the *ultra vires* doctrine is abolished; corporations will enjoy all of the rights, powers and privileges of a natural person and will be able to engage in any commercial or non-commercial activities subject only to any voluntary restrictions in their articles.

The Bill also modernizes the corporate governance regime of not-for-profit corporations and other corporations without share capital. It sets out a statutory standard of care to be met by directors and establishes a due diligence defence for the directors who meet that standard.

The provincial legislative development worth noting is the ongoing implementation of the Trade, Investment and Labour Mobility Agreement ("TILMA") between B.C. and Alberta. TILMA is scheduled to be fully implemented by April 1, 2009. A discussion of the implications of TILMA for persons contracting with government is beyond the scope of this paper. However, it is worth noting that TILMA has been designed to have a more robust effect that the national Agreement on Internal Trade and the definition of "government entities" (to which TILMA applies) is extremely broad.

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