
Contract Law Update: Developments of Note

**Presented by Lisa A. Peters
Senior Research and Opinions Partner**

November 2012

© 2012 Lawson Lundell LLP. All Rights Reserved. This information provided in this publication is for general information purposes only and should not be relied on as legal advice or opinion. For more information please phone 604.685.3456 and ask to speak to Lisa Peters.



CONTRACT LAW UPDATE: DEVELOPMENTS OF NOTE (2012)

Focus and Scope of This Paper

Each year I review judgments dealing with contract law issues looking for decisions of relevance to commercial lawyers and business leaders. Contract law principles typically do not change overnight; rather, they are modified incrementally. Where I find a case that illustrates an incremental change, I use it as a springboard for discussing the state of the law on the particular issue and how it affects commercial practice. I also consider legislative developments that are relevant to lawyers engaged in contract drafting.

This paper is not meant to be a comprehensive review of Canadian contract law principles. There are a number of excellent textbooks that take on that daunting task.¹

This year, the topics I have chosen are:

- Acceptance by conduct;
- Privity of contract and third party beneficiaries;
- Implied terms;
- Enforceability of exculpatory clauses – update on the application of the *Tercon* test by lower courts;
- Electronic transactions and computer contracts;
- Statutory illegality; and
- Liquidated damages clauses.

If I have not covered a topic of interest to you in this year's paper, I may have covered it in past papers (published in the materials for this seminar in prior years and on-line at <http://www.lawsonlundell.com/Team/Lawyers/Lisa-Peters>).

¹ I recommend, for example, John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) and Angela Swan, *Canadian Contract Law*, 2nd ed. (Markham: LexisNexis, 2009).

The topics covered in my prior updates are:

2011: Unconscionability in commercial transactions; unconscionability and exculpatory clauses post-*Tercon*; impact of consumer protection legislation on mandatory arbitration/mediation clauses; buy/sell clauses; best efforts clauses (and their variants); equitable mistake and contract rescission; clauses affecting non-contracting related entities, privity and the corporate veil

2010: Fundamental breach; arbitration clauses; choice of court (forum selection) clauses; time of the essence clauses; economic duress; pre-incorporation contracts; illegal contracts.

2009: Enforceability of exculpatory clauses (exclusion clauses and limitation of liability clauses); illegal contracts and severance; good faith obligations in contract; frustration and *force majeure*; contract termination; privity of contract and third party beneficiaries.

2006: Good faith in contract law; assignment of contractual rights; mistake; rectification; entire agreement and exclusion clauses; termination clauses; frustration; severability of illegal provisions; penalty and liquidated damages clauses; unilateral contracts.

Acceptance by Conduct

Professor McCamus² describes what he calls the “calculus of offer and acceptance”:

...the communications of the parties must have created an “offer” that sets out the offeror’s willingness to enter into an agreement on certain terms; this is then matched with a corresponding agreement or “acceptance” forthcoming from the other party, the offeree, which also communicates a willingness to enter into an agreement on the proffered terms.

In the commercial world, offer and acceptance are often manifested in writing and, leaving aside situations where there are counteroffers, it will be obvious when the offeree is communicating an acceptance.

Classic contract law describes acceptance as a communication. However, there can be circumstances in which conduct can amount to acceptance, absent either written or oral

² McCamus, *supra* note 1 at 31.

communication of a willingness to be contractually bound. Numerous B.C. cases³ cite the dictum of Blackburn J. in *Smith v. Hughes* (1871), L.R. 6 Q.B. 597 at 607:

If whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party and that the other party upon that belief enters into a contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.

Two recent B.C. cases serve to illustrate this principle.

In *Timberwolf Log Trading Ltd. v. Columbia National Investments Ltd.*, 2011 BCSC 864, the defendant CNI purchased property on the Sechelt peninsula with the intention of developing it by building a resort and selling residential real estate. The plaintiff Timberwolf was a log broker. At the time CNI purchased the property, Timberwolf, with its logging contractor, was in the process of logging one part of the property (McNab Creek) for the previous owner. The parties agreed that Timberwolf would finish that job for CNI. They also entered into discussions about a contract for Timberwolf to log the other portions of the property (Christy Cove, Chapman Creek, Wilson Cove and the pine flats).

It was uncontroversial at trial that some logging had been done by Timberwolf at Christy Cove, Chapman Creek and the pine flats. However, while Timberwolf alleged that the logging was done under a contract, which CNI then breached by ordering it to terminate all logging activities in October of 2006, CNI denied that the parties entered into a timber harvesting contract. CNI admitted that it authorized hand fallers at Christy Cove and Chapman Creek, but denied authorizing removal of logs.

There was clearly no written contract. Mr. Justice Leask reviewed the communications between the representatives of the parties over the relevant period of time to assess whether the parties had entered into an oral contract by communication of terms (some by way of a written proposal) and offer and acceptance. He found that the operating minds of CNI did not intend to enter into a binding harvesting contract with Timberwolf and understood that hand fallers were working at Christy Cove and Chapman Creek (without a contract in place) while the parties continued to negotiate.

Citing appellate authority⁴ and textbook authority, Leask J. held that while parties must have evinced clear agreement on the essential terms of the intended contract, a subjective meeting of minds is not necessary for the formation of a contract. It is only necessary

³ Most recently, Mr. Justice Voith in *Re Crosse Estate*, 2012 BCSC 26, at para. 31.

⁴ Including what remains the leading Supreme Court of Canada case on acceptance of an offer by conduct: *Saint John Tug Boat Co. Ltd. v. Irving Refinery Ltd.*, [1964] S.C.R. 614.

that there be an objective manifestation of mutual assent, and acceptance of an offer may be implied from conduct.

He also noted that the context of the particular industry was important in determining whether a contract was formed. The question had to be viewed, therefore, from the perspective of a reasonable person familiar with contracting practices in the B.C. logging industry.

Timberwolf had made it clear that it was not prepared to do bits and pieces of logging and that the hand logging of Christy Cove and Chapman Creek were not economically viable logging projects on their own. While the CNI representatives at a critical meeting on September 20, 2006 communicated neither agreement nor disagreement with the proposed terms and course of action set out by Timberwolf at that meeting, Timberwolf did begin logging, with CNI representatives attending at various sites in the one month period before CNI told Timberwolf to cease logging activities.

Mr. Justice Leask concluded that it would be clear to a reasonable person familiar with contracting practices in the B.C. logging industry, in light of all the material facts, that the parties intended to contract and that the essential terms of the contract could be determined with a reasonable degree of certainty. It was therefore reasonable for Timberwolf to believe, based on the behaviour of the CNI representatives, that there was a contract to log and market the timber from Christy Cove and Chapman Creek.

In his view, the fact that the CNI representatives did not accept or reject what was put forward at the meeting simply demonstrated that they sought to benefit from the labour of Timberwolf in the less economically viable locations while negotiating for better prices over the locations with better value. According to Leask J. (at para. 116):

It is precisely this situation, where one party represents through conduct and silence that a contract has been formed so as to lead the other party to reasonably conclude that such is the case, that the law finds a contract to have been formed. The test is not subjective; it is objective.

The decision of Mr. Justice Punnnett in *Century 21 Canada Limited Partnership v. Rogers Communications Inc.*, 2011 BCSC 1196, considers offer and acceptance in the context of electronic contracts made on the internet.

The plaintiff Century 21 operated a real estate website featuring property listings belonging to Century 21 brokers and agents. It allowed users to search for properties by location, price and other attributes.

The defendant Zoocasa Inc. operated its own website containing information of interest to consumers searching for real estate. The website functioned as a type of search engine, indexing property listings from a number of real estate websites and returning relevant ones in response to search queries and bringing them together with other

neighbourhood information. In the relevant time period, Zoocasa's indexing resulted in content and photos from the Century 21 website being available on the Zoocasa website.

Century 21 sued Zoocasa in contract and tort for its conduct in accessing Century 21's website and copying photographs from that website without consent.

One of the issues in the litigation was whether there was a binding contract between the parties. Century 21's website contained Terms of Use on the first (home) page, which stated that upon accessing the website, the user was bound by the Terms.

Zoocasa pointed out that the Terms of Use were not prominently displayed and asserted that they never agreed to the Terms and that therefore there was no binding contract. Zoocasa also made public policy arguments to the effect that the internet would be crippled if users were found to have accepted Terms of Use simply by using the website in question, implying that all information that is made available on the web should be made available without contractual restrictions and that indexing and linking should be freely permitted.

Mr. Justice Punnnett reviewed the application of common law contract principles to evolving types of contracts including shrink wrap agreements (in the software licensing context), click wrap agreements (where the user indicates agreement to terms by clicking on an "I agree" box) and browse wrap agreements (where all that is required is that the user use the product after being made aware of the product's Terms of Use). After reviewing the principles arising out of this body of law (mostly out of the U.S.), Mr. Justice Punnnett drew the following conclusions:

- The evolution of the internet as an open medium with the ability to hyperlink being key to its success did not mean it must function free of traditional contract law.
- It is the manner of contracting that has changed, not the law of contract.
- The acceptance of click wrap and browse wrap agreements by courts acknowledges the right of parties to control access to, and the use of, their websites.
- A publically available website does not necessarily give a right of access free of any contractual terms. Depending on the circumstances, a contract may be formed.
- Taking the service of a website with sufficient notice of the Terms of Use and knowledge that the taking of the service is deemed agreement constitutes acceptance sufficient to form a contract. The act of browsing past the initial page of the website or searching the site is conduct indicating agreement with the Terms of Use if those terms are provided with sufficient notice, are available for

review prior to acceptance and clearly state that proceeding further is acceptance of the terms.

He acknowledged that courts in other cases might face issues as to the reasonableness of the terms posted on a website, the sufficiency of notice given or contractual terms exceeding copyright.

Bottom line: Negotiating parties should be alive to the fact that even where they do not subjectively intend to communicate acceptance of an offer, they may be found to have accepted by their conduct where a reasonable person would construe the conduct that way.

In the context of the internet, operators of websites offering goods or services may be able to rely on this principle to contractually bind their users provided they give sufficient notice of the website's terms of use and those terms set out that taking the service (by steps such as proceeding beyond the home page) constitutes acceptance sufficient to form a contract.

Privity of Contract and Third Party Beneficiaries

The doctrine of privity of contract remains a fundamental component of Canadian contract law. Pursuant to the unmodified doctrine, a contract can neither confer rights nor impose obligations on non-parties.

As I noted in my 2009 paper, the doctrine has been modified by the so-called principled exception to the doctrine of privity explained by the Supreme Court of Canada in *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. Under the principled exception, third parties can benefit from contractual provisions to which they were not contracting parties. Thus, for example, in *London Drugs*, warehouse employees of London Drugs were held to be entitled to the protection of a limitation of liability clause in a contract made between their employer and Kuehne & Nagel.

The two factors that courts must take into account when deciding whether the benefit of a contract should be extended to third parties in a particular case are:

- (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?

Not surprisingly, non-parties routinely try to persuade courts to expand the rather narrow boundaries of the principled exception. Litigants in B.C. generally have been

unsuccessful in persuading courts in this province to consider extending the exception so that it can be used by a third party as a “sword” (to pursue a claim under the contract) rather than as a shield.

I have always viewed the B.C. jurisprudence as precluding the use of the principled exception as a sword in a rather conclusive way, with the Court of Appeal weighing in in *District of Kitimat v. Alcan Inc.*, 2006 BCCA 75.

In that case, Chief Justice Finch, when commenting on Kitimat’s reliance on the two seminal Supreme Court of Canada cases stated (at para. 70):

The learned chambers judge distinguished these cases from this one, correctly in my view, on the basis that here Kitimat seeks to avail itself of the statutory and contractual relationship between Alcan and the Province so that it can advance a claim against Alcan. If, however, Kitimat had standing to advance its claim against Alcan for the latter’s breach of its public obligations, it would have no need to resort to a third party beneficiary claim under the contract. In attempting to extend the third party beneficiary principle to permit it to advance, rather than to defend a claim, Kitimat is simply trying to circumvent the well settled principles governing private interest standing.

In the context of an application for leave to amend pleadings, counsel in *Holmes v. United Furniture Warehouse LP*, 2009 BCSC 1805, argued that the Court of Appeal in Kitimat did not go so far as to establish that a third party beneficiary can **never** advance a claim and argued that the reasons in that case should be limited to its facts, where a municipality was seeking private interest standing. Madam Justice Fisher indicated that she tended to agree. After reviewing authorities from other jurisdictions alluding to the possibility of the principled exception being used as a sword, she stated that she would not refuse to permit the proposed amendment in which the plaintiffs sought to pursue contractual claims as third party beneficiaries “only on the basis that the exception cannot ever apply where a third party seeks to rely on a contractual benefit to bring an action against a party to a contract”. However, she concluded that the plaintiffs could not meet the key threshold requirement that the parties to the contract must have intended the relevant provision to confer a benefit on the third parties, and refused leave for the amendment on that basis.

The plaintiffs sought and obtained leave to appeal: 2012 BCCA 227. The Court of Appeal could have explained its reasons in *Kitimat* and, in particular, whether it intended to rule out the possibility of a third party ever being entitled to use the principled exception to privity as a sword. It did not do so. Instead, Mr. Justice Groberman dismissed the appeal on the basis that nothing in the contract in question or in the objective circumstances surrounding its making suggested that the parties entered into the agreement with the intention of benefitting the plaintiffs.

Where does this leave us? Until the Supreme Court of Canada weighs in definitively on the matter, there is scope for arguing that a third party ought to be able to pursue a contractual claim, provided there is sufficient evidence of the intention of the parties to the contract to extend that benefit to the third party.

As noted by Madam Justice Fisher, there are allusions in case law from other provinces to the potential viability of such a claim. She referred to the following cases:

- *MacNeill v. Fero Waste & Recycling Inc.*, 2002 NSSC 86, aff'd on other grounds 2003 NSCA 34
- *Vandewal v. Vandewal*, [2002] O.J. 393, aff'd [2003] O.J. 3269
- *Landex Investments Co. v. John Volken Foundation*, 2008 ABCA 333

In *Virk v. Sidhu*, 2010 BCSC 369, Mr. Justice Grist said that he found no extenuating circumstances motivating a departure from the “shield – not a sword” feature of the principled exception in the case before him, suggesting he was not rejecting the possibility of such a departure in the right case.

In addition to these cases, there are a number of other relevant decisions in Ontario.

Re Stelco Inc. (2006), 24 C.B.R. (5th) 59 dealt with the financial restructuring of Stelco Inc. The dispute before the Ontario Superior Court of Justice 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 B.C. cases to argue against the third party beneficiary exception being used as a sword. The Court was not persuaded.

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 Inc. was appealed but the Ontario 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.*

More recently, in *Coast-to-Coast Industrial Development Co. v. 1657483 Ontario Inc.*, 2010 ONSC 2011, a justice of the Ontario Superior Court of Justice stated that “the principled exception to privity of contract is not restricted to defensive provisions” (at para. 44). He went on to say that it would take very clear language to find that a contracting party has assumed a liability to a third party, and found that the language in the contract under consideration was insufficient.

In another Ontario case, *Waterloo (City) v. Wolfrain*, 2006 CanLII 26166, rev’d on other grounds, 2007 ONCA 732, Mr. Justice Cumming cited with approval passages from a leading contract law textbook as follows (at paras. 77-79):

However, as Prof. McCamus states in his text, at 298:

...the doctrine of consideration is designed for the purpose of determining whether a particular promise should be considered to be legally binding....the doctrine... says nothing with respect to the question of who should be able to enforce a binding promise. Indeed, it might be suggested that the privity doctrine is inconsistent with consideration theory inasmuch as it will lead, in many situations, to the perverse result that a promise given for good consideration will be essentially unenforceable for all practical purposes.

Prof. McCamus argues (at 315-316) that given the purpose underlying the principled exception as articulated in *Fraser River Pile*, the exception

could apply even where a third-party beneficiary, as plaintiff, seeks to *enforce* a provision in a contract.

Prof. McCamus states, at 314:

The purpose of the principled exception in *Fraser River Pile* is to confer upon courts, in cases where the traditional exceptions of agency and trust do not apply, a discretion to “undertake the appropriate analysis, bounded by both common sense and commercial reality, in order to determine whether the doctrine of privity with respect to third-party beneficiaries should be relaxed in the given circumstances.” [Quoting Iacobucci, J. in *Fraser River Pile*, at 123.]

In any event, the MFP employees seek to invoke the terms of the release merely as a shield to defend against the City’s claim in the second action. They do not raise the release as a sword to initiate a claim for damages.

Finally, in two other Ontario cases, the Superior Court refused to strike a claim in which the plaintiff was using the principled exception to privity as a “sword” (while either expressing some doubt as to whether the action would ultimately succeed or noting that the law was in a state of evolution): *Saltsov v. Rolnick*, 2007 CanLII 68832 (Ont. S.C.); *Parlette v. Sokkia Inc.*, 2006 CanLII 34341 (ON SC), leave to appeal refused 2007 CanLII 2212 (ON SCDC).

Bottom Line: If contracting parties want third parties to benefit from a contract, *e.g.*, to be entitled to rely on a limitation of liability clause, they should state that intention as explicitly as possible. While there is still some doubt as to whether a non-contracting party can use the principled exception to the doctrine of privity as a sword, if the contracting parties wish to give third parties the right to enforce performance obligations under the contract, they should state that intention explicitly. Whether such a clause ought to be enforceable has still not received adequate appellate consideration. In the same vein, if parties do not want obvious categories of third parties (such as employees or subcontractors) to benefit from contractual terms, they can exclude that possibility by express language.

Implied Terms

The Supreme Court of Canada has listed three ways in which terms can be implied into a contract:⁵

⁵ This summary of the Supreme Court of Canada jurisprudence is taken from Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2nd ed. (Markham: LexisNexis, 2012) at 149.

1. Based on custom or usage;
2. As the legal incident of a particular class or kind of contract; and
3. Based on the presumed intention of the parties where the implied term must be necessary “to give business efficacy to a contract or as otherwise meeting the ‘officious bystander’ test as a term which the parties would say, if questioned, that they had obviously assumed.”

The first and third categories are based on presumed intention; the second category is not based on intention at all – a term is implied under this category as a matter of law.

There are two important restrictions on implying terms to keep in mind. First, the court may not imply terms as a means of rewriting the parties’ agreement or to contradict express terms in the contract. The second is that under the third category, the business efficacy or officious bystander approach is based on the intentions of the actual parties to the particular contract and not the intentions of a hypothetical reasonable party. Therefore, the implication of a term under this category must have a certain degree of obviousness to it and, if there is evidence of a contrary intention, the term cannot be implied.

The third category is the one most often invoked. There were three commercial law decisions in the past year that help illustrate how it is applied. Each of them confirms how difficult it is to establish that the proposed implied term is “necessary” to give business efficacy to the contract.

JEL Investments Ltd. v. Boxer Capital Corp., 2011 BCSC 1526, illustrates the tension between the exercise of contract interpretation and the court’s ability to imply a term into the contract. In that case, the parties arbitrated the amount that JEL had to pay after invoking a shotgun clause in a co-owner’s agreement. While JEL triggered the shotgun by offering to sell its interest to the other venturers, because they did not accept that offer, it was required to buy their interests under the terms of the Agreement. The arbitrator found that a term should be implied into the Agreement to the effect that, on the purchase by JEL of the interest of the other co-owner pursuant to the shotgun clause, the capital accounts must be equalized. As a result, JEL had to pay a capital adjustment of \$765,732.26 in addition to the amount it had offered to buy the co-owner’ shares for. JEL obtained leave to appeal the arbitration award.

Mr. Justice Goepel held that the arbitrator erred in implying a term into the Agreement that the capital contributions must be equalized on triggering the shotgun clause. Such an implied term, he concluded, was not necessary to give the Agreement efficacy and it did not go without saying that the parties would have agreed to it if they had put their minds to it. (There is some debate whether the two components of this third category are alternative, as they are described in my list above, or conjunctive – Mr. Justice Goepel seems to adopt the latter view, making it even harder to persuade a court to imply a term).

He concluded that the proposed implied term was also inconsistent with the express provisions of the Agreement.

Goepel J. referred to evidence of the factual matrix underpinning the Agreement. JEL had rejected a proposal that Boxer and the other party to the joint venture (Yanco) loan JEL \$1 million to fund its capital contribution. Instead, it was agreed that Boxer and Yanco would make a disproportionate capital contribution to the venture, to be repaid with interest from the venture's profits in priority to JEL receiving any return from the project. The term implied by the arbitrator, Mr. Justice Goepel concluded, had the effect of turning the disproportionate capital contributions into a loan that was repayable on the shotgun clause being triggered, regardless of whether the venture was profitable. This, he said, was the antithesis of the bargain that the parties made.

ONCAP L.P. v. Computershare Trust Co. of Canada, 2011 ONSC 7129, dealt with a plan of arrangement whereby ONCAP was to acquire all of the issued and outstanding shares of BAE Systems Canada Inc. through one of its affiliates ("Subco") at a price of \$25.25 per common share. Under the arrangement, shareholders of BAE were given the right to elect to receive dividends for a portion of the purchase price, but all shareholders failing to make an election were deemed to have elected to receive the all cash option.

Computershare Trust Company of Canada was the depository for the Arrangement under the terms of a depository agreement. Just under \$530 million was paid to Computershare by ONCAP, its affiliates and BAE to fund the payments to BAE shareholders. Under the terms of the Plan of Arrangement, any money not paid out to shareholders after a stipulated six year period was deemed to have been surrendered to Subco, with the rights of BAE shareholders being extinguished. At the end of the six year period, Computershare held approximately \$12 million that had not been paid out to BAE shareholders.

One month before the six year period ended, ONCAP sold the BAE business to Esterline Technologies. The sale included Subco. ONCAP claimed it did not know that Computershare was holding the \$12 million and that if it had known, it would have negotiated a higher sale price with Esterline. A year after Esterline acquired the BAE business, it requested payment to it of the sum held by Computershare, which happened.

ONCAP sought to recover \$12 million from Computershare based on a number of legal theories (and was unsuccessful on each theory).

One of the arguments it made was that the Court should imply a term into the Plan of Arrangement that any money held by Computershare at the end of the six-year period was to be paid to Subco without Subco having to request it. The Court rejected the proposition that such a term was necessary to give business efficacy to the Plan of Arrangement, noting that it would be obvious to assume that ONCAP or Subco would be interested in obtaining what Subco was entitled to and would request a payment out. Newbould J. also pointed out that even if there were an implied term requiring

Computershare to take action to pay the sum to Subco, by the time the six year period had expired, Esterline owned Subco.

The contracts at issue in *Rio Algom Ltd. v. The Attorney General of Canada*, 2012 ONSC 550, were contracts for the supply of uranium oxide made during the Cold War between a federal Crown corporation (Eldorado Nuclear Mining and Refining Ltd.) and the predecessor corporations. Eldorado acquired the uranium oxide in order to sell it without profit to the United States Atomic Energy Commission.

The contracts stipulated the price of the uranium, fixed the quantities and set a firm deadline for deliveries. Over the nearly twenty years the contracts were in existence, Rio Algom earned profits in excess of \$72 million (in 1960's dollars).

The production of the uranium oxide led to the creation of an enormous amount of tailings. While these tailings were treated to neutralize acidity, the treatment was inadequate to protect the environment from this radioactive waste. In the late 1990's, the federal government approved the enactment of regulations that required uranium mine operators, including those who sold uranium oxide to Eldorado under the Cold War Contracts, to remediate the environmental harm. Rio Algom spent significant amounts to comply with the regulatory regime and will incur considerable expense in perpetuity. It asked the federal government, as Eldorado's principal, to reimburse it. Canada refused and Rio Algom sued.

Rio Algom argued that it was an implied term of the Cold War Contracts that if Canada took any unilateral action that retroactively or prospectively increased Rio Algom's cost of having produced and sold uranium at a fixed price, then Canada would provide an indemnity of the increased costs. It also alleged breach of an implied duty of good faith.

Mr. Justice Perell dismissed Rio Algom's claim. He held that the proposed implied term would be inconsistent with the express terms of the Cold War Contracts since its effect would be to increase the purchase price for uranium oxide. Such an outcome, in his view, would be inconsistent with the express terms fixing the price and limiting the circumstances in which the price could be adjusted. He also concluded that the proposed implied term was not "necessary" to give business efficacy to the Cold War Contracts.

Perhaps the most significant parts of Perell J.'s reasons, from a practice perspective, are those dealing with the argument that an entire agreement clause precluded the Court from implying any term into the Cold War Contracts. He revisited his prior decision in *Allarco Entertainment 2008 Inc. v. Rogers Communications Inc.*, 2011 ONSC 5623, and compared the entire agreement clause from that case to the one in the Master Agreement that was negotiated following the amalgamation of the various Rio Algom entities in 1960.

In *Allarco*, the entire agreement clause read as follows:

(b) This Agreement, including the schedules hereto and any agreements or documents to be delivered pursuant to the terms of this Agreement, constitutes the entire agreement of the parties relating to the subject matter hereof and supersedes all prior agreements, understandings, negotiations, representations and proposals, whether written or oral, relating to the subject matter hereof. There are no conditions, covenants, representations or warranties, express or implied, statutory or otherwise relating to the subject matter hereof, except as herein expressly provided (emphasis added).

In that case Mr. Justice Perell found that to imply a term in the face of this clause would breach the rule against implying terms that would conflict with the express language of the contract.

The entire agreement clause in the Master Agreement in *Rio Algom v. The Attorney General of Canada* did not contain the same explicit language. That Agreement was simply expressed to be “one agreement between Eldorado and Rio Algom containing a full and complete statement of the rights between the parties all as hereinafter fully set forth.” Mr. Justice Perell took the view that this clause was not strong or clear enough to preclude implied terms being part of the contract (although, as set out above, he declined to imply a term on other grounds).

Mr. Justice Perell’s analysis suggests that a sufficiently clearly worded entire agreement clause that refers specifically to implied terms will preclude a court from implying terms, as to do so would be inconsistent with the express agreement.

However, another recent decision muddies the waters, at least as regards the ability of the court to imply a duty of good faith in the face of such an explicit entire agreement clause.

In *Bhasin v. Hrynew*, 2011 ABQB 637, Mr. Bhasin entered into a contract with Canadian American Financial Corp. (Canada) Limited (“CAFC”) to act as an Enrollment Director in 1989. CAFC was in the business of selling Education Savings Plans.

In 1998, CAFC decided it wanted its Enrollment Directors to all enter into a standard contract. Mr. Bhasin agreed to sign this contract after accepting assurances that a specific clause in it would not be interpreted strictly so as to provide CAFC a means to end their relationship. Thereafter, however, CAFC did rely on this clause to terminate the relationship. Mr. Bhasin alleged a conspiracy between CAFC and another Enrollment Director to take away his business in the lucrative community of Southeast Asians in Alberta.

One of Mr. Bhasin’s allegations was that CAFC breached an implied duty of good faith. CAFC argued that no such duty could be implied in the fact of the entire agreement clause, which read as follows:

This Agreement expresses the entire and final agreement between the parties hereto and supersedes all previous agreements between the parties. There are no representations, warranties, terms, conditions or collateral agreements, express, implied or statutory, other than expressly set out in this Agreement.

Madam Justice Moen reviewed Alberta case law standing for the proposition that a good faith term will not be implied where it is inconsistent with the express terms of the written contract and specific cases where an entire agreement clause was held to have that effect. She then ruled as follows (at paras. 116-118):

Certainly, an exclusion clause may be evidence that the parties did not intend to be governed by an implied term of good faith where the contract is between equal parties in a standard commercial context. However, in each of the cases set out above decided in Alberta, there was no imbalance of power between the parties. Where there is an imbalance of power, as in the case before me, parties to a contract will not be permitted to rely on an exclusion clause to avoid contractual obligations...

Courts have refused to let a party shelter under an entire agreement clause where it would be unjust or inequitable to do so, such as when the party seeking to rely on the clause has exercised its contractual power abusively. CAFC, who is seeking to take advantage of the entire agreement clause, exercised its rights under the contract in a capricious and arbitrary manner. See: *Civiclifecom Inc v Canada (Attorney General)* 2006 CanLII 20837 (ON CA), (2006), 215 OAC 43 at para 52 (Ont CA), citing *Guarantee Co of North America v Gordon Capital Corp*, 1999 CanLII 664 (SCC), [1999] 3 SCR 423 at para 65; and *Shelanu* at paras 30-35.

Therefore, I find that the entire agreement clause does not bar a review of the exercise of the non-renewal power by CAFC or other contractual terms to determine if it was exercised unfairly or abusively.

Bottom Line:

Courts are not out to rewrite contracts for parties. Accordingly, it will be difficult to persuade a court to imply a term into a commercial contract on the basis it is “necessary” to give the contract business efficacy. It is the actual parties’ intentions that are relevant in this context and evidence that the parties would not have intended such a clause had they turned their mind to it will preclude implication of the term. A term will also not be implied if it contradicts express terms in the contract. For this reason, an entire agreement clause that expressly sets out that there are no implied terms will usually be effective. There is some doubt as to the efficacy of such a clause in a contract involving

unsophisticated parties, particularly where the term a party is seeking to have the court imply is the implied duty of good faith performance.

Enforceability of Exculpatory Clauses – Application of the *Tercon* Test by Lower Courts

In *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, the Supreme Court of Canada articulated a test for dealing with the application of exclusion clauses where there is a breach of the contract by a party *prima facie* entitled to rely on such clause, and an allegation by the innocent party that the breaching party should not be permitted to so rely.

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

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

Last year I reviewed a number of commercial cases in the past year in which this test has been applied. In those cases, the trial judge emphasized the commercial sophistication and equal bargaining power of the parties in applying the test and ultimately upholding the exculpatory clause in question.

This year, the B.C. Court of Appeal arguably narrowed the scope of the third element of the *Tercon* test by implying that an exemption clause will only be invalidated on account of public policy where the defendant either knowingly or recklessly puts the public in danger by providing a deficient product or service. In *Loychuk v. Cougar Mountain Adventures*, 2012 BCCA 122,⁶ the defendant operated zip line tours. The plaintiffs were injured when, due to the negligence of the defendant’s employees, they collided while on the zip line. The release signed by the plaintiffs included the following language:

I hereby agree as follows... TO WAIVE ANY AND ALL CLAIMS that I have or may in the future have against the RELEASEES AND TO RELEASE THE RELEASEES from any and all liability for any loss, damage, expense or injury, including death, that I may suffer or that my next of kin may suffer, as a result of my participation in Eco Activities, DUE TO ANY CAUSE WHATSOEVER, INCLUDING NEGLIGENCE, BREACH OF CONTRACT, OR BREACH OF ANY STATUTORY OR OTHER DUTY OF CARE, INCLUDING ANY DUTY OF CARE OWED

⁶ Leave to appeal to the SCC refused, 2012 CarswellBC 2933.

UNDER THE OCCUPIERS LIABILITY ACT, R.S.B.C. 1996, C. 337
ON THE PART OF THE RELEASEES, AND FURTHER INCLUDING
THE FAILURE ON THE PART OF THE RELEASEES TO TAKE
REASONABLE STEPS TO SAFEGUARD OR PROTECT ME FROM
THE RISKS, DANGERS AND HAZARDS OF PARTICIPATING IN
THE ECO ACTIVITIES REFERRED TO ABOVE;

The trial judge held that the release was a complete defence to the plaintiffs' action and dismissed their claims. On appeal (as they had at trial), the plaintiffs argued that the release was unconscionable. While acknowledging that there is a well-established line of authority in Canada holding that releases relating to recreational sports activities are not unconscionable, the plaintiffs submitted that those authorities were inapplicable because they did not relate to activities in which the operator has total control of the risk. Mr. Justice Frankel, for the Court, rejected this proposition. In his view (at paras. 33 and 40):

...the authorities are clear that there is no power-imbalance where a person wishes to engage in an inherently risky recreational activity that is controlled or operated by another. Equally important, they are also clear that it is not unfair for the operator to require a release or waiver as a condition of participating.

... it is not unconscionable for the operator of a recreational-sports facility to require a person who wishes to engage in activities to sign a release that bars all claims for negligence against the operator and its employees. If a person does not want to participate on that basis, then he or she is free not to engage in the activity.

The plaintiffs cited from law reform commission reports to support their submission that where a sporting activity is totally within the control of the operator, comprehensive releases of the type used were contrary to public policy.

Mr. Justice Frankel stated that the law reform commission reports did not establish an overriding public policy that would justify judicial nullification of an agreement knowingly and voluntarily entered into by a person wishing to engage in an inherently risky recreational activity. He went on to give his interpretation of the kind of egregious conduct that the Supreme Court of Canada was describing in *Tercon* that would justify refusal to enforce an exculpatory clause (at para. 46):

What those examples have in common is that the party seeking to rely on an exclusion clause either knew it was putting the public in danger by providing a substandard product or service, or was reckless as to whether it was doing so. In other words, that party engaged in conduct that is so reprehensible that it would be contrary to the public interest to allow it to avoid liability. I am not convinced that where a participant is injured through the negligence of an operator, there is such a difference between

situations where participants have some measure of control and those where they do not, that the latter rises to this high level of public policy. In both cases the injury was caused by negligence which cannot itself be controlled by the participant.

Bottom Line: Commercial parties have been singularly unsuccessful in persuading courts to interfere with freedom of contract by striking down exculpatory clauses under the *Tercon* test. Outside the context of standard form contracts with consumers as contracting parties, it will be very difficult for a party to establish that exclusion or limitation of liability clauses are unconscionable. While the “overriding public policy” component of the test could have been used by courts as an open means for striking down clauses they found unpalatable, this has not happened. Instead, the courts have narrowly described the type of egregious conduct that would justify application of this third prong of the *Tercon* test.

Electronic Transactions and Computer Contracts

The evolving interplay between common law contract principles and the reality of electronic communications is the subject-matter for a book, not a contract law update. I do want, however, to highlight three cases that shed some light on how the law dealing with this subject-matter is developing.

I already discussed the decision in *Century 21 Canada Limited Partnership v. Rogers Communications* under the heading of acceptance by conduct. One of the important principles articulated by Mr. Justice Punnnett is that taking a service on the internet with sufficient notice of the Terms of Use and knowledge that taking of the service is deemed agreement constitutes acceptance sufficient to form a contract. Stated another way, the act of browsing past the initial page of the website or searching the site is conduct indicating agreement with the Terms of Use if those terms are provided with sufficient notice, are available for review prior to acceptance, and clearly state that proceeding further is acceptance of the terms.

Ensuring that website Terms of Use reflect these principles will obviously be important for website operators seeking to contractually bind users. However, as Mr. Justice Punnnett acknowledged, courts in the future will likely end up developing additional principles including:

- What constitutes sufficient notice;
- Whether terms imposed in this fashion will ever be so unreasonable or unconscionable as to be unenforceable;
- The effect of the website operator reserving the right to change the Terms of Use over time and actually doing so; and

- Whether the website operator can contract for terms that exceed the protection available under copyright law.

In *Kobelt Manufacturing Co. v. Pacific Rim Engineered Products (1987) Ltd.*, 2011 BCSC 224, one of the issues was whether a reference to a website on a delivery slip in relation to brakes ordered by the plaintiff constituted adequate notice of the terms on the website so as to incorporate the limited warranty and exclusion clause found in the Terms and Conditions on the website into the contract.

Mr. Justice Sigurdson found that the first time the defendant had actual notice of the terms was by way of the delivery slip received after the contract had been entered into by the defendant's order. He cited cases for the proposition that where a party seeks to rely on standard form exclusion clauses, they must be provided to or brought to the other party's attention prior to the making of the contract. He then considered the plaintiff's argument that there was adequate notice of the terms and conditions on the website and that the defendant was aware of those terms and conditions at the time it purchased the brakes.

This argument failed on the evidence. While Sigurdson J. accepted that terms and conditions may, in appropriate circumstances, be incorporated into an agreement by way of reference to a website link, he was not persuaded that the brake buyer had adequate knowledge of the particular warranty and exclusion clauses on the facts.

He concluded at paragraph 124:

In an appropriate case it might be that parties, especially sophisticated commercial actors, would be taken to know that terms and conditions are found on a website. It is now commonplace for companies to have internet websites which allow for electronic transactions. However, in order for terms and conditions on an internet website to be within the common understanding of the parties and part of their contract, there should be some evidence that those parties had interacted through the use of their websites, not just by email, or at least had notice of the terms and conditions on the other's website at the time of entry into contract. There must also be evidence that those terms and conditions were posted on the website at the requisite time. It would be inappropriate to simply imply notice of terms absent any evidence that the website had been used before or that reasonable steps were taken to bring the existence of that website, and specifically the terms and conditions contained therein, to the attention of the other party prior to the contract.

In this day and age, agreements are routinely negotiated and entered into electronically through an exchange of emails or other electronic communications. A recent decision of the New Brunswick Court of Appeal serves to remind us that statute law may impose specific requirements for particular types of contracts to be enforceable, but that many

jurisdictions have adopted electronic transactions legislation that may ameliorate or modify those requirements so as to facilitate electronic contracting.

In *Druet v. Girouard*, 2012 NBCA 40, Mr. Girouard negotiated a purchase of a condominium with Ms. Druet via email after seeing it advertised on Kijiji. While the parties agree on a price, the Court ultimately found that they lacked the requisite intention to create legal relations, in light of a reference in the emails to the future preparation of a draft agreement and the fact that the Girouards had not even viewed the condominium unit.

However, one of the issues that the Court considered was whether the alleged agreement was invalid as failing to comply with the *Statute of Frauds*, R.S.N.B. 1973, c. S-14, which provides that no contract for the sale of land is enforceable unless the agreement is in writing and signed by the party to be charged. This led the Court to consider the provisions of the *Electronic Transactions Act*, R.S.N.B. 2011, c. 145, and in particular, s. 10(1), which provides that, “A legal requirement for the signature of a person is satisfied by an electronic signature.”

There were no formal signature lines in Ms. Druet’s emails, although she identified herself by name in each email. The New Brunswick statute defined “electronic signature” as meaning “electronic information that a person has created or adopted in order to sign a document and that is in, attached to or associated with the document.” In s. 11(2), the statute provided in part that:

...an electronic signature may be

- (a) an electronic representation of the manual signature of the person signing the document, or
- (b) electronic information by which the person signing the document
 - (i) provides his or her name, and
 - (ii) indicates clearly that the name is being provided as his or her signature to the document.

Unfortunately because the “electronic signature” issue was not raised by the parties, the Court did not resolve it. Rather, it reviewed jurisprudence from the U.K. and the U.S. and reviewed the genesis of the *Electronic Transactions Act* in the *UNCITRAL Model Law on Electronic Commerce* and the Uniform Law Conference of Canada’s *Uniform Electronic Commerce Act*, and then posed a series of questions raised.

The Court did find that the parties’ exchange of emails satisfied the requirement of the agreement being in writing under the *Statute of Frauds*. By applying the principle of “joinder”, the Court found that while the emails in question did not make specific

reference to each other and were scant on details of the particular condominium unit, the seven emails could properly be “joined” to satisfy the “in writing” requirement.

Given the popularity of online sites for selling all manner of things, these issues will likely arise again. It is important to note that while a version of the ULCC’s *Uniform Electronic Commerce Act* has been enacted in all the common law jurisdictions, it has been modified in a number of those jurisdictions so you should not presume that the statutes contain identical terms.

Bottom Line: The prevalence of electronic communications has not completely altered the law of contract. Rather, the mode of contracting has changed and the law has adjusted to the new mode, as it did on the advent of phones, telex and fax machines. There will be some refinements as contracting on-line becomes more and more commonplace; the U.S. serves as a useful source of legal principles and precedents in this regard.

Contract drafters should familiarize themselves with the electronic commerce statute in jurisdictions in which they practice since these statutes generally serve to validate electronic ways of communicating where some other law requires “writing”.

Statutory Illegality

As I noted in my 2010 paper, when statutory illegality is raised by a party seeking to resist enforcement of a contract, it is often raised in the context of a statute that does not plainly determine the question of enforceability but instead prohibits specific conduct or delineates mandatory regulatory requirements. The party seeking out from under its contractual obligations argues that because the contract contemplated the prohibited conduct or was formed or operates in a manner inconsistent with the statutory scheme, it is illegal and unenforceable.

As I noted in 2010, commentators suggest that modern courts are increasingly less inclined to find a contract illegal on the basis that it conflicts with or is inconsistent with a statutory regime.⁷ Instead, the courts, mindful of the importance of enforcing contracts as a valid policy objective in and of itself, consider whether enforcing the contract would be consistent with the policies underlying the legislation or, to the contrary, would subvert those policies and exercises its discretion to enforce or not enforce accordingly. As another means to the same end, courts are prepared to consider permitting a party to recover through a claim of unjust enrichment, as an alternative to enforcing an “illegal” contract.

Recent decisions confirm this trend.

⁷ McCamus, *supra* note 1 at 459-67; Swan, *supra* note 1 at 876-9.

In *Teresa McCrea Investments Inc. v. Conley Management Ltd.*, 2012 SKQB 374, the plaintiff corporation financed a condominium project and secured the loan by way of a mortgage. In a foreclosure action, the only issue in dispute was whether the plaintiff was entitled to claim for monies advanced by it for various lenders' and brokers' fees as well as legal fees.

The Saskatchewan Lawyers' Insurance Association took the position that because the plaintiff was not licensed to lend money in Saskatchewan pursuant to *The Trust and Loan Corporations Act*, 1997, S.S. 1997 c. T-22.2, the court should refuse to enforce the obligation to pay the disputed fees based on the doctrine of statutory illegality. The statute required an entity that was a "financing corporation" to be licensed in order to lend money in the province. The plaintiff was plainly a financing corporation and was not licensed.

Mr. Justice Barrington-Foote confirmed that illegality does not necessarily result in a finding that the contract is illegal or void, or that it should not be enforced by the court. Rather, he said, the court should consider the purpose of the legislation at issue, and whether the proposed refusal to enforce the contract would advance that purpose.

He found that the purpose of the licensing provisions in the statute before him was to protect the borrowing public. However, he noted that the plaintiff was not claiming lender's or broker's fees on its own behalf. Rather, the fees in question were effectively paid by the defendant to various third parties out of the loan proceeds. The plaintiff funded those fees as part of its loan and was seeking reimbursement. Cases where courts declined to allow recovery of fees by unlicensed service providers were thus distinguishable.

The Court then considered whether it ought to reduce the cost of borrowing by refusing to enforce an amount equivalent to the disputed fees. Mr. Justice Barrington-Foote specifically refused to apply the doctrine of notional severance articulated by the Supreme Court of Canada in *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 SCC 7. The illegality of lending without a license, he pointed out, related to the entire agreement to lend money. There was no offending provisions relating to the disputed fees that could be severed and the provisions providing for payment of those fees were spent.

Horizon Resource Management Ltd. v. Blaze Energy Ltd., 2011 ABQB 658, which I discussed last year as an example of a party unsuccessfully trying to persuade a court to not enforce an exclusion clause, also contains a discussion of statutory illegality.

In that case, the defendant trotted out multiple legal arguments as justification for its failure to pay the plaintiffs for service they rendered in relation to abandonment of an existing shut-in sour gas well and drilling of a new well. One allegation was that the plaintiff Roll'n Oilfield Industries Inc. had failed to comply with requirements of the

Alberta Energy and Utility Board and with occupational health and safety legislation, making the contract illegal and unenforceable.

Mr. Justice Brooker gave the following helpful summary of the applicable principles (at para. 522):

- 1) If the very formation of the contract is obviously and expressly prohibited by statute, or the contract is for an unlawful purpose, then it is void *ab initio*, and only in exceptional circumstances will a party be entitled to relief.
- 2) If it seems that the formation of the contract may be *impliedly* prohibited by a statutory scheme (for example certain conduct is prohibited), then the court should engage in a policy-oriented analysis, considering the “effect on the parties for whose protection the law making the bargain illegal exists”. If the policy underlying the legislation would not be advanced by treating the contract as void, then the court should hesitate to do so.
- 3) Where the purpose of the contract is not impugned, but the method of its performance is, the court should consider the good faith of the parties, the intention to perform the contract in a legal manner, and the relative importance of the infringement compared with the hardship that would be suffered by treating the contract as void. In performing this balancing, the court must remember the presumption of legality.

After finding that neither of the first two principles applied on the facts before him, he concluded that any failure by the plaintiff Roll’n Oilfield Industries Inc. to comply with the legislation were minor, were not willful or intentional, did not result in the shutdown of the operations and were ultimately rectified. He also considered the hardship to the plaintiff if the contract was treated as void and concluded that held that the contract was not void for illegality.

Bottom Line: The circumstances in which a contract will be found to be unenforceable because it is “illegal” continue to be narrowly mapped by the courts. It is only where the very formation of the contract is obviously and expressly prohibited by statute, or the contract is for an unlawful purpose, that this result will be a given.

Liquidated Damages Clauses

While it is open to parties to a contract to attempt to predict the financial consequences of breach and stipulate for the payment of an equivalent sum in the event of a breach in order to avoid the risk of litigation, where the term is designed to operate in *terrorem* by stipulating payment of an amount that exceeds the likely damages caused by breach, the clause will be unenforceable as a “penalty”.

The legal principles applying to the characterization of such clauses have not changed significantly since I last wrote about them in 2006, but a recent series of cases dealing with rather onerous clauses in waste disposal contracts summarize the applicable principles in a helpful way.

As Mr. Justice Fitch noted in *Super Save Disposal Inc. v. Blazin Auto Ltd.*, 2011 BCSC 1784 at para. 26, “[t]he enforceability of a liquidated damages provision in an agreement engages two competing objectives: freedom of contract versus the right of the courts to intervene in a given case to relieve against an oppressive or unconscionable result flowing from enforcement of the liquidated damages term”.

A practice apparently developed in the waste bin industry to stipulate for the equivalent 12 months’ billing as liquidated damages payable on breach, even in circumstances where the original contract was only for a one year term. Alternatively, the clauses in question in some contracts provided for liquidated damages for the amount owing under the contract for the balance of the term (or an amount equivalent to 9 months’ billings, whichever was greater). The clauses typically had the customer acknowledge that the specific liquidated damages were reasonable in light of the anticipated loss to the disposal company and were not imposed by a penalty and also provided that the customer would pay the costs incurred by the disposal company in pursuing an action for recovery.

Defendants in Small Claims cases challenged these clauses as constituting penalties, with varying success. In *Super Save Disposal Inc. v. Blazin Auto Ltd.*, where the clause provided for liquidated damages in the amount of nine months’ billing or the balance of the term (whichever was greater), the B.C. Supreme Court, on appeal,⁸ found that the defendants had not met the onus of establishing that the stipulated sum was a penalty. The defendant in *Super Save Disposal Inc. v. Makhija Holdings Inc.*, 2011 BCPC 249, who failed to appear to defend the claim met the same fate, although Adjudicator Nordlinger noted her “grave concern” that a contract with a 12 month term that imposed a 12 month liquidated damages provision in the event of default might rise to the level of oppression.

Defendants who appeared at trial and led evidence on the oppressive nature of a particular liquidated damages clause in the particular circumstances of their case fared better.

In *Northwest Waste Solutions Inc. v. 99 Nursery & Florist Inc.*, 2012 BCPC 79, where the liquidated damages clause provided for an amount equal to the balance of the term (which was thirty-three months), Judge O’C. Wingham found that such amount bore no relationship to the actual damages the claimant might have suffered and were a penalty.

⁸ The Court was hearing an appeal from two Small Claims judgments in which the Provincial Court judge found that the clause in question was a penalty and limited recovery of the waste disposal company to rent for a sixty day period.

He distinguished the cases involving sign rentals, noting that the product at issue before him was not a custom-made sign, but rather a contract for the supply and servicing of generic garbage and recycling bins.

See also *BFI Canada Inc. v. Persia Food Products Inc.*, 2010 BCPC 308; *Northwest Waste Solutions Inc. v. Bimmer Haus Enterprises Inc.*, 2011 BCPC 276; *Super Save Disposal Inc. v. Northwest Waste Solutions Inc.*, 2012 BCPC 42; *Super Save Disposal Inc. v. Dinoking Tech Inc.*, 2012 BCPC 245; *North West Waste Solutions Inc. v. Lin (c.o.b. Westwood Millwork)*, 2012 BCPC 209; *Housewise Construction Ltd. (c.o.b. Segal Disposal) v. Golden Sichuan Enterprise Ltd.*, 2012 BCPC 43.

The applicable principles to be derived from these recent cases are the following:

1. The courts should not describe as a penalty clause every condition which calls for a sum of money to be paid to another for a breach of contract.
2. The use of the words “liquidated damages” or “penalty clause” in an agreement is not conclusive. The court must consider in each case whether a clause is a genuine pre-estimate of damages or a clause inserted to compel performance.
3. A case-specific inquiry which takes into account the inherent circumstances of the contract should be undertaken.
4. The onus of establishing that a stipulated sum is a penalty, rather than a genuine pre-estimate of damages that the parties have agreed in advance will be sustained in the event of a breach of the contract, rests on the party against whom the stipulated sum is claimed.
5. The type of contract may be relevant as well as the length of the contract and the length of the term remaining on the contract when the breach occurred.
6. Whether a clause is a penalty or liquidated damages should be considered as of the date of the contract.
7. The power to strike down a penalty clause is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum.
8. Where there is no oppression the clause should not be struck down.
9. Relief against a penalty clause should be granted only where it would be unconscionable, determined as of the date of invocation of the clause.

10. If a provision is found to constitute an unenforceable penalty, the plaintiff must prove its damages in the ordinary way and the defendant is entitled to advance the position that the plaintiff ought reasonably to have taken certain mitigating steps.

Bottom Line: Liquidated damages clauses will not be struck down as penalties unless they are oppressive or unconscionable. The onus to establish that a clause is a penalty is on the party making that assertion; they should not assume a court will take judicial notice of the clause's oppressive nature. However, parties relying on a standard form contract to bind their customers should not overreach and should not expect to rely on self-serving language to the effect that the parties agree the amount stated to be payable on default is a genuine pre-estimate of the innocent party's likely loss, particularly when they are dealing with unsophisticated customers.

Legislative Development of Note – B.C. New *Limitation Act*

B.C.'s new *Limitation Act*, S.B.C. 2102, c. 13, will come into force on June 1, 2013.

Some of the key changes are:

- It puts in place a single two year basic limitation period.
- It provides for a 15 year ultimate limitation period (in place of the former 30 year period).
- The time starts running under the ultimate limitation period based on the act or omission (not based on the prior accrual model).

The transition provisions are obviously important. In simple terms:

- Claims that are out of time before the new Act comes into force are not revived.
- The former Act applies to claims discovered before the new Act comes into force (the new Act codifies the concept of discoverability).
- The new Act applies to claims discovered after it comes into force.

Materials to aid in the transition to the new Act are being developed by government, including a Q&A document, section notes, a transition flowchart and timeline, and a record retention chart. These materials should be available on the Attorney General's website relatively soon.

The new *Limitation Act* is based, at least in part, on the *Uniform Limitation Act* put forward by the Uniform Law Conference of Canada (ULCC), which was also a source for legislative reform in other provinces.

The ULCC Act includes a provision stipulating that a limitation period under the Act may be extended, but not shortened, by agreement. One advantage of such a provision is that it provides clarity as to the lawfulness, in the given jurisdiction, of contracting out of limitation periods.

The B.C. Legislature did not include such a provision in the new *Limitation Act*. This is in contrast with the approach followed in the other jurisdictions that have modernized their limitations statute. The Ontario *Limitations Act*, 2002, S.O. 2002, c. 24, Sch. B, for example, contains the following complicated provision:

22. (1) A limitation period under this Act applies despite any agreement to vary or exclude it, subject only to the exceptions in subsections (2) to (6).

(2) A limitation period under this Act may be varied or excluded by an agreement made before January 1, 2004.

(3) A limitation period under this Act, other than one established by section 15,⁹ may be suspended or extended by an agreement made on or after October 19, 2006.

(4) A limitation period established by section 15 may be suspended or extended by an agreement made on or after October 19, 2006, but only if the relevant claim has been discovered.

(5) The following exceptions apply only in respect of business agreements:

1. A limitation period under this Act, other than one established by section 15, may be varied or excluded by an agreement made on or after October 19, 2006.

2. A limitation period established by section 15 may be varied by an agreement made on or after October 19, 2006, except that it may be suspended or extended only in accordance with subsection (4).

(6) In this section,

“business agreement” means an agreement made by parties none of whom is a consumer as defined in the Consumer Protection Act, 2002;

⁹ Section 15 is the ultimate limitation period in this statute.

“vary” includes extend, shorten and suspend.

The Alberta *Limitations Act*, R.S.A. 2000, c. L-12, validates agreements providing for the extension of a limitation period in s. 7(1), but in s. 7(2) provides that an agreement that purports to provide for the reduction of a limitation period under the Act is not valid.

The approach in the Saskatchewan *Limitations Act*, S.S. 2004, c. L-16.1, s. 21, is to expressly validate agreements to extend limitation periods while remaining silent as to the effect of an agreement to shorten limitation periods.

Where does this leave us in British Columbia? While I did not find a B.C. Court of Appeal directly on point, there is *dicta* from the Supreme Court of Canada supporting the proposition that an agreement to extend a limitation period is valid or at least can operate as a waiver of a limitation defence.¹⁰

In *Tolofson v. Jensen*, [1994] 3 S.C.R. 1022 at 1073, Iacobucci J. stated:

Additionally, a substantive limitation defence such as the one in the case at bar may be waived either by failure to plead it, if this is required, or by agreement.

Whether an agreement to shorten a limitation period under the B.C. *Limitation Act* would be enforced by a court is unclear. If parties should include such a clause in their agreement, they should be advised that its enforceability is not indisputable.

¹⁰ See also *Cadboro Investments Ltd. v. Canada West Insurance Co.* (1987), 19 B.C.L.R. (2d) 352 (C.A.), where a defendant was found to be estopped from relying on a limitation defence.