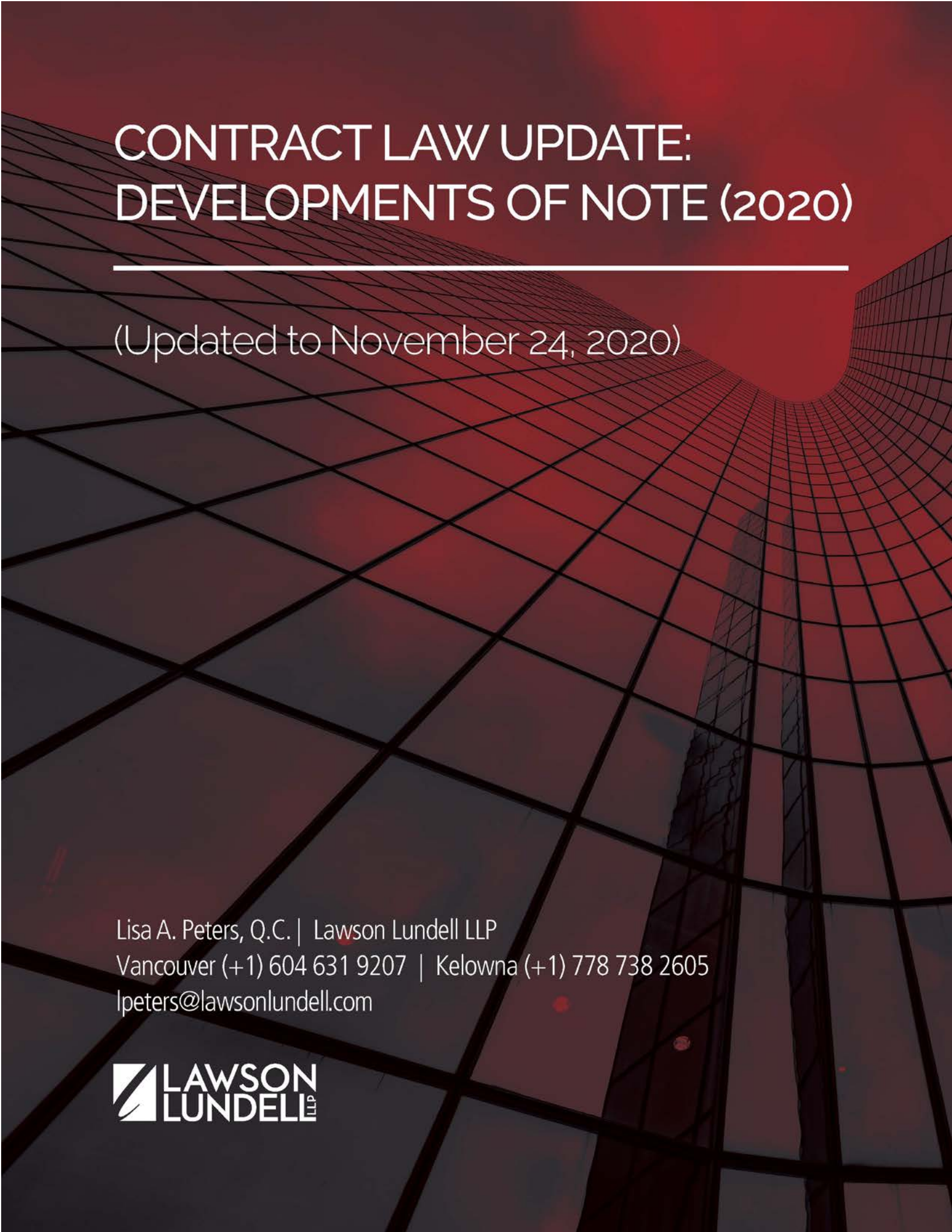

CONTRACT LAW UPDATE: DEVELOPMENTS OF NOTE (2020)

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CONTRACT LAW UPDATE: DEVELOPMENTS OF NOTE (2020)

As many of you know, I publish this paper each year to update the law relevant to commercial contracting. My prior papers are available on the Lawson Lundell LLP website: https://www.lawsonlundell.com/team-Lisa-Peters#News-Publications. Attached to this paper is a chart tracking the topics I have covered in previous years.

In this, the year of the pandemic, I expected there to be numerous decisions dealing with *force majeure* and frustration of contract. However, there were few such decisions and none provided fodder for an in-depth discussion of those concepts in this paper.[1] If next year is, as we all hope, the year after the pandemic, then perhaps there will be a critical mass of cases on those topics for next year's paper.

I had also hoped that the Supreme Court of Canada ("SCC") would have issued its decisions on good faith in contract law prior to publication of this paper.[2] Since that has not happened, I expect to publish a supplement to this paper when they do.

This year's topics are:[3]

- Rectification vs. equitable rescission for mistake – different remedies with different tests and outcomes;
- This year's boilerplate clause: exclusive vs. non-exclusive forum selection clauses;
- The doctrine of unconscionability after *Uber Technologies Inc. v. Heller*, 2020 SCC 16;
- Reconciling inconsistent contract terms in related contracts; and
- Stipulated-consequence-on-insolvency clauses and the anti-deprivation rule.

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[1] There are a number of decisions of B.C.'s Civil Dispute Resolution Tribunal, most of them involving contracts for facilities or services for weddings; see, for example, *Bal v. Infinite Entertainment Sound and Lighting Inc.*, 2020 BCCRT 865. There is also a recent commercial decision out of Ontario where a plea of frustration based on the pandemic failed: *FSX (Annex) Limited Partnership v. ADI Prince Arthur L.P.*, 2020 ONSC 5055.

[2] *Greater Vancouver Sewerage and Drainage District v. Wastech Services Ltd.*, 2019 BCCA 66, leave to appeal granted 2019 CanLII 64820 (S.C.C.); *CM Callow Inc. v. Zollinger,* 2018 ONCA 896, leave to appeal granted, 2019 CanLII 58137 (S.C.C.). These appeals were heard on December 6, 2019.

[3] I wish to acknowledge the work of Ben Westerterp, who will graduate from Queen's Law School this year, for his assistance in identifying the topics for this year's paper.

Rectification vs. Equitable Rescission

In 2016, I wrote about the SCC decision in *Canada (Attorney General) v. Fairmont Hotels Inc*., 2016 SCC 56 ("*Fairmont*").[4]

In that case, Mr. Justice Brown, for the majority, held that rectification is an equitable remedy designed to correct errors in the recording of terms in written legal instruments and is limited to cases where a written instrument has incorrectly recorded the parties' antecedent agreement. In other words, rectification is not available where the basis for seeking it is that one or both of the parties wish to amend not the instrument recording their agreement, but the agreement itself.

The obvious impact of the decision in *Fairmont* is to circumscribe the circumstances in which the remedy of rectification can be obtained. Manifestly, one of the areas in which this circumscription had a chilling impact was tax planning.

In some subsequent cases involving tax planning gone wrong, the scope of the ruling in *Fairmont,* and its statement of the requirements to obtain rectification as a remedy, was put in issue and considered by appellate courts.

This July, in *Collins Family Trust v. Canada (Attorney General),* 2020 BCCA 196 ("*Collins*"), the B.C. Court of Appeal reviewed the jurisprudence from 2016 forward and provided guidance on both the scope of the ruling in *Fairmont* and the difference between the remedies of rectification and equitable rescission.[5] While this case is obviously important for tax practitioners, it is relevant beyond that context.

Collins dealt with the interplay between a prior decision of the BCCA, which allowed a taxpayer to rescind a tax-driven transaction on the basis of mistake, and the SCC decision in *Fairmont*.

Some understanding of the tax planning approach followed by the parties in *Collins*, the prior B.C. Court of Appeal ("BCCA") decision in *Re Pallen Trust*, 2015 BCCA 222 ("*Pallen*"), and the subsequent decision of the Tax Court of Canada in *Sommerer v. The Queen*, 2011 TCC 212, aff'd 2012 FCA 207 ("*Sommerer*"), is necessary in order to contextualize the BCCA's explanation of the remedies of rectification and rescission.[6]

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[4] The companion civil law decision decided at the same time was *Jean Coutu Group (PCJ) Inc. v. Canada (Attorney General)*, 2016 SCC 55.

[5] See my 2011 paper for a discussion of the different paths Canadian and U.K. law have taken in terms of whether there is an equitable doctrine of mistake.

[6] As will be obvious, I am not a tax lawyer. I am indebted to Nancy Diep, a tax partner in Lawson Lundell LLP's Calgary office, for her editorial input into the description of the facts and tax planning approach in these cases.

Both *Pallen* and *Collins* involved a tax planning approach devised by an accounting firm (MNP LLP) for the purported purpose of protection of the assets of an operating company from creditors while at the same allowing dividend income from the operating company to avoid being subject to tax.

The planning approach was devised to take advantage of two particular sets of rules under the *Income Tax Act*.[7] The first, referred to as the "attribution rules", are designed to prevent income shifting between certain related persons that would otherwise be achieved by having a higher-income person transfer assets to a lower-income person, with the latter paying tax on the assets at lower rates. The attribution rules operate to prevent such shifting by attributing income earned by the transferee back to the transferor, despite the fact that the transferor no longer owns the assets.

The second set of rules deals with the non-taxation of inter-corporate dividends. These rules are at the core of tax integration, a term used to describe the principle that income earned by an individual directly or indirectly through a corporation should attract the same amount of tax once in the hands of the individual. These rules operate to allow dividends to be received on a tax-free basis by a shareholder that is also a corporation (as contrasted with dividends received by an individual, which are subject to tax).

The plan in these cases, in general terms, involved the incorporation of a holding company ("Holdco") that purchased shares in the existing operating company, the creation of a discretionary family trust with Holdco as one of the beneficiaries, a loan from Holdco to the trust that was then used by the trust to purchase from Holdco the shares in the operating company and, ultimately, the payment of dividends on the purchased shares from the operating company to the trust.

Relying on the two rules described above, the intended result was for the dividends to reside in and be beneficially owned by the trust but be attributed as income to Holdco, who would not pay tax on this income (but for the attribution rules, the trust would pay tax on the dividends at personal tax rates).

At the time, it was widely believed that income paid to a discretionary trust would be subject to s. 75(2) of the *Income Tax Act* (*i.e.*, the attribution rules) regardless of how the trust obtained the property (*i.e.*, by purchase or gift). This view was shared by CRA in various publications and tax accountants and lawyers.

But in *Sommerer*, some three years after the plan was implemented in *Pallen*, the Tax Court adopted a narrower interpretation of s. 75(2). It held that if property was sold to a trust as opposed to gifted to (or settled on) the trust, then the attribution rules did not apply. The net result for the tax planning approach used in *Pallen* (and

[7] R.S.C. 1985 c. 1 (5th Supp.).

subsequently *Collins*) was that the dividends would be taxable in the hands of the trust, not the holding company.

In *Pallen*, dividends totalling $1.75 million were paid on shares that the trust purchased for $100. The CRA notified the trust it was going to reassess the tax years in which dividends were paid. The trust sought and obtained equitable rescission of the dividends and a related promissory note. That result was upheld on appeal.

In the BCCA, Madam Justice Newbury outlined the circumstances in which a mistake about a transaction will ground the remedy of equitable rescission. Citing U.K. Supreme Court authority,[8] she held that rescission will be available where "a causative mistake of sufficient gravity" occurs and the mistake is either one "as to the legal character or nature of a transaction or as to some matter of fact or law which is basic to the transaction."

She noted that other authority cited to the Court reflected the public policy perspective that taxpayers should not be encouraged to engage in aggressive tax planning and then invoke the "mistake" route to rescission when the approach failed, and endorsed the proposition that a mistake simply about the tax consequences of a transaction will not ground the remedy. On the particular facts of the case before the Court, however, where the plan fit squarely within an attribution rule that CRA had consistently stated would apply, the Court found that the chambers judge did not err in finding that rescission was available.

It is critical to note that the BCCA in *Pallen* was considering equitable rescission as applied to voluntary settlements and transfers of property. Madam Justice Newbury notes that rescission as a remedy is subject to more stringent rules in contract law, as the common law protects bargains. The CRA apparently did not take issue with the proposition that the declaration of dividends was akin to a voluntary transfer of property for which equitable rescission may be available, although Her Ladyship was not sure that was an apt characterization.

In *Collins*,[9] the tax plan was developed in or about 2008 (the same time frame as *Pallen*).

In 2012, an Aggressive Tax Planning Auditor with the CRA sent a letter to the trust indicating the CRA's intention to reassess the 2008 tax returns. Ultimately, the trust was reassessed for both 2008 and 2009. The trust's objection to the reassessment was unsuccessful and it filed a petition in the B.C. Supreme Court seeking to rescind the transaction leading to and including the payment of the dividends, on the basis of mistake.

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[8] *Pitt v. Holt*, 2013 UKSC 26.

[9] There was a second case, involving the Cochran Family Trust heard at the same time as *Collins*. I will refer to a single trust (the Collins trust) for ease of reading, but the Court applied the principles to both trusts.

The chambers judge considered the facts in *Pallen* to be virtually identical to those before him. His challenge was determining whether he was bound by *Pallen* or whether *Fairmont* overruled that decision. While his view was that *Fairmont* had significantly undermined the precedential value of *Pallen*, on the basis that statements made in *Fairmont* about taxpayers not being permitted to retroactively alter a transaction to achieve an intended tax objective should apply more generally, he did not consider it open to him to disregard the precedent of *Pallen*.

The Court of Appeal reconciled *Pallen* and *Fairmont* differently. In the BCCA's views, the cases deal with different equitable remedies, such that *Fairmont* does not modify or overrule *Pallen*:

> [45] In my opinion, neither *Fairmont* nor *Jean Coutu* have undermined the principles expressed and applied in *Pallen Trust*. While both rectification (as sought in *Fairmont*) and rescission (as sought in *Pallen Trust*) are equitable remedies, each has its own legal test, and each applies in a non-tax as well as a tax context. If applicants meet the legal test for the remedy sought, they are entitled to that remedy. *Fairmont* did not establish otherwise. […]
>
> [56] Contrary to the chambers judge's view, I see no principled reason why different equitable remedies may not have different results, especially since rectification and rescission serve different purposes and have different effects. Rectification is limited to a clearly-established disparity between the words of a legal document and the intentions of the parties, and is not concerned with consequences. Rescission considers consequences to be relevant to the gravity of a mistake: *Pitt v. Holt* at paras. 131–132. Rectification places the parties in the position they originally intended (which, in the tax context, achieves their tax plan), but rescission places the parties back in their original position (which does not): *Pallen Trust* at para. 57.

The BCCA in *Collins* had to deal with three tax cases cited by the CRA that were decided subsequent to *Fairmont*; the CRA took the position that these cases properly applied the principles in *Fairmont* to all forms of equitable relief, *i.e.,* not just rectification.

The BCCA disagreed. In two of these cases, the primary relief sought was rectification. The taxpayers resorted to alternative relief under the courts' general equitable jurisdiction, but were effectively seeking the same result that rectification would give them (amendment or correction of a document to achieve the original tax planning objective).[10]

[10] *Harvest Operations Corp. v. Canada (Attorney General),* 2017 ABCA 393; *BC Trust v. Canada (Attorney General),* 2017 BCSC 209.

In the third case,[11] the taxpayer had obtained rectification in the Ontario Superior Court before *Fairmont* was decided. On appeal by the Attorney General of Canada, all the parties acknowledged that *Fairmont* had undermined the basis for the original rectification order. Therefore, by way of a cross-appeal, the taxpayer sought a new order in substitution for the rectification order below that would still allow it to achieve the tax objective of the transactions in question. It cited the Court's inherent jurisdiction in equity and equitable rescission as the basis for the order sought.

The Ontario Court of Appeal held that the taxpayer was simply seeking rectification under another name – it was not seeking to unwind the transactions, but rather to alter them by substituting a lengthy and complicated series of orders. The Court described the "teaching" of the SCC in *Fairmont,* namely that the court cannot substitute one series of transactions for another to avoid an unintended tax result.

In considering the taxpayer's resort to equitable rescission, the Court held that it was unnecessary to determine whether *Pallen* was good law following *Fairmont* or whether *Pitt v. Holt* (the U.K. case cited in *Pallen*) should be followed in Ontario. It ruled that the case before it did not involve a gratuitous transfer (as in *Pallen* and *Pitt v. Holt*) and, in any event, that rescission was an all or nothing remedy and the taxpayer was seeking "partial rescission" only.

The Ontario Court reminded us (as Newbury J.A. alluded to in *Pallen*) that equitable rescission of a contract for mistake entails a more stringent test.[12]

That test requires the party seeking equitable rescission of a contract based on mistake to establish that: (a) the parties were under a common misapprehension as to the facts or their respective rights; (b) the misapprehension was fundamental; (c) the party seeking to set the contract aside was not itself at fault; and (d) one party will be unjustly enriched at the expense of the other if equitable relief is not granted.

And, as other authorities remind us, it must be possible to restore the parties substantially to their pre-contract position for rescission to be available.[13] Further, as the Ontario Court of Appeal noted, rescission is an all or nothing remedy; there is no partial rescission.

A detailed discussion of the circumstances in which the common law will grant rescission (primarily where the transaction was procured by misrepresentation or

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[11] *Canada Life Insurance Company of Canada v. Canada (Attorney General),* 2018 ONCA, leave to appeal ref'd [2018] S.C.C.A. No. 371.

[12] Citing *Miller Paving Limited v. B. Gottardo Construction Ltd.*, 2007 ONCA 422. This decision has been cited in B.C. with favour, as well as in subsequent cases in Ontario. The equitable remedy of rescission is also available for rescission of a contract where a false or misleading representation induced the contract: *Deschenes v. Lalonde*, 2020 ONCA 304, application for leave to appeal filed, 2020 CarswellOnt 12778 (S.C.C.).

[13] *PricewaterhouseCoopers Inc. v. Perpetual Energy Inc.*, 2020 ABQB 6.

duress) and where equity will direct rescission on the basis that the transaction was improperly procured is beyond the scope of this paper.[14]

There is no comprehensive Canadian textbook on rescission as a remedy. One must look for commentary in texts on contract law, misrepresentation, remedies and equity. This gap in scholarship is regrettable, since even the meaning and content of the word "rescission" gives rise to confusion.[15]

Bottom line: Rectification and equitable rescission are two different remedies addressing different factual scenarios and different desired outcomes.

If you are seeking to correct a contract or other document that does not reflect the parties' actual agreement, then you are seeking rectification. If you are seeking to unravel a transaction or contract on the basis of mistake or a misrepresentation that induced the contract, you are seeking rescission. The tests for and consequences of each remedy are different.

The SCC decision in *Fairmont* did not eliminate the potential availability of equitable rescission for mistakes affecting tax-driven and other transactions. Assuming that *Collins* is applied outside B.C., equitable rescission will be available in relation to voluntary transfers of property where "a causative mistake of sufficient gravity" occurs and the mistake is either one "as to the legal character or nature of a transaction or as to some matter of fact or law which is basic to the transaction."

However, the Attorney General of Canada recently applied for leave to the SCC[16] on *Collins,* so the law may be further developed or changed in 2021.

In addition, rescission (including equitable rescission) of a contract is still available in common law Canada if the more stringent test for that remedy can be met.

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[14] In his text *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011) at 762, Professor Fridman summarizes the circumstances in which equitable rescission may be sought as: (a) where the contract resulted from some fraud, which induced a mistake on the part of the defrauded party; (b) where the mistake in question was the result of an innocent, non-fraudulent misrepresentation; and (3) where the contract was procured without fraud in the common-law sense, but as a consequence of what in equity is regarded as fraud, *i.e.*, by the use of undue influence or some unconscionable conduct.

[15] There is an excellent comprehensive English text, which can help Canadian lawyers as long as they are alive to the differences in law in that jurisdiction: Dominic O'Sullivan, Steven Elliott and Rafael Zakrzewski, *The Law of Rescission,* 2nd ed. (Oxford: Oxford University Press, 2015).

[16] The application for leave was filed on November 10th.

Exclusive vs. Non-exclusive Forum Selection Clauses

There is more than one type of clause by which contracting parties may articulate their intention that disputes in relation to the contract[17] can or will be heard by a particular court or courts in a particular jurisdiction.

Understanding the differences among the variations, as well as the conflict of laws overlay on the interpretation and application of such clauses, is critical for solicitors advising clients of their strategic options.

For example, a contracting party who has attorned or submitted to the jurisdiction of the Supreme Court of British Columbia is in a different position than a contracting party who has named that Court as having exclusive jurisdiction over dispute arising under the contract.

It also helps to master the terminology. In jurisdictions that have enacted the *Court Jurisdiction and Proceedings Transfer Act* ("CJPTA") based on the ULCC uniform statute,[18] what is called jurisdiction *simpliciter* at common law is called territorial competence. In what follows, I will use B.C.'s CJPTA section numbers when addressing specific provisions. The numbering may vary in other provinces.

Clauses naming a jurisdiction for the resolution of disputes are variously referred to as forum selection clauses, jurisdiction clauses, and choice of jurisdiction or choice of venue clauses.

A choice of law clause sets out the proper law of the contract, *i.e.,* which jurisdiction's substantive law is to be applied. A choice of law clause is not the same thing as a choice of forum clause, although its presence will inform the application of the doctrine of *forum non conveniens*. Bundling choice of forum and choice of law clauses into a single clause may well create difficulties if the validity of the choice of forum clause is challenged under the jurisprudence I discuss later in this paper.

Attornment and submission clauses

The terms "attornment" and "submission", when used in this context, are synonyms. A clause by which a party attorns to the jurisdiction (without being otherwise qualified) has the effect of bestowing territorial competence (jurisdiction *simpliciter*) on the named court. Submission or attornment has long been a basis for jurisdiction *simpliciter* at common law and is an express basis for territorial competence under s. 3(b) of the CJPTA.

[17] There is a broad range of wording choices by which parties may seek to capture not only contractual disputes, but other related disputes, such as claims in tort. I will not cover those options here.
[18] B.C., Saskatchewan, Nova Scotia and Yukon.

An attornment clause does not mean that a party cannot sue elsewhere. All it means is that they cannot argue that the court named in the clause has no jurisdiction *simpliciter*/territorial competence. It also does not mean that the court to whose jurisdiction the parties submit to cannot decline jurisdiction in favour of a more appropriate forum (applying the doctrine of *forum non conveniens,* which is integrated into s. 11 of the CJPTA).

Forum selection clauses

Another way of bestowing jurisdiction *simpliciter*/territorial competence on a named court is by stipulating that the court has non-exclusive jurisdiction over disputes between the parties to the contract.

Parties may use the term "non-exclusive" to make their intent clear, but do not always do so.

As with an attornment clause, such a clause will found jurisdiction *simpliciter*/territorial competence but will not preclude a party from suing elsewhere or stop a court in the named jurisdiction from declining jurisdiction.

Contrast a clause that names a court as the *exclusive* venue for the resolution of disputes.

Such a clause not only bestows territorial competence/jurisdiction *simpliciter*: provided that the party asking the court to decline jurisdiction does not meet the strong cause test,[19] courts will enforce an exclusive forum selection clause and will not exercise their discretion to decline jurisdiction.

What are the magic words for an exclusive forum selection clause? The simplest rendition uses the word "exclusive" in tandem with naming the court or courts of a particular jurisdiction.

I have seen some clauses where the drafter pairs an attornment or submission clause with exclusive jurisdiction language. It is not clear to me what the purpose is for doing so. Either the drafter is concerned that the forum selection language will not suffice to give the court jurisdiction *simpliciter*/territorial competence (which makes no sense to me in a Canadian common law/CJPTA context) or is simply copying a precedent without understanding what the two types of clauses are effective to do.

Further confusion is caused by drafters blending choice of law and forum selection provisions in an incomprehensible way. I will review some recent cases to illustrate how the courts characterize clauses as exclusive or non-exclusive and the types of difficulties that can arise from muddled drafting.

[19] For a refresher on the strong cause test, see my 2018 paper.

Sleep Number Corporation v. Maher Sign Products Inc., 2020 ONCA 95

Maher, a Canadian sign company located in Ontario, supplied signs to the plaintiff corporation, a Minnesota company. The plaintiff sued Maher in Minnesota on the basis that some signs supplied were defective. Maher did not defend the Minnesota action and default judgment was granted in the amount of $756,236.56. The plaintiff then brought an action in Ontario to enforce the Minnesota judgment. Maher defended that action. One of the arguments it made was that the contract between the parties contained an exclusive forum selection clause and that the courts in Minnesota ought not to have taken jurisdiction as a result.

The relevant clause read as follows:

> This Agreement shall be construed in accordance with the laws of the Province of Ontario and the Customer hereby attorns to the jurisdiction of the Courts of Ontario for the purpose of pursuing any legal remedies here under.

The Ontario Court of Appeal described this clause as permissive rather than exclusive: it did not deprive another forum of jurisdiction *simpliciter* but was relevant as to whether the other forum should exercise its jurisdiction. It stated, in part:

> [7] The clause bears striking similarity to clauses that other courts have refused to characterize as conferring exclusive jurisdiction. It provides that the respondent "attorns" (in other words, accepts, submits or yields) to Ontario jurisdiction and says nothing that excludes the jurisdiction of another possible forum. We do not agree that the words in the clause applying it to the pursuit of "any legal remedies" amount to a conferral of exclusive jurisdiction. The word "any" refers to "legal remedies" and has no bearing on choice of forum. In *Old North State Brewing Company Inc. v. Newlands Services Inc.* (1998), 1998 CanLII 6512 (BC CA), 58 B.C.L.R. (3d) 144, at para. 35, the B.C. Court of Appeal held that an agreement that "the parties will attorn to the jurisdiction of the Courts of the Province of British Columbia" did not meet the standard of "clear and express language … required to confer exclusive jurisdiction" and that it would have been a simple matter to add the word "exclusive" if that was what was intended. See also *Hollinger International v. Hollinger Inc.*, 2005 CanLII 4582 (Ont. Div. Ct.), to the same effect with regard to an agreement that each of the parties "hereby irrevocably attorns to the jurisdiction of the courts [of Ontario]".

Canadian Pacific Railway Company v Hatch Corporation, 2019 ABQB 392

CP brought claims in Alberta against a number of defendants arising from an embankment failure along a railway spur under construction. The relevant clause that applied to contracts with some of the defendants (Hatch and Clifton) read as follows:

> **Governing Law**: This Agreement shall be governed by and interpreted in accordance with the laws of the Province of Alberta and the laws of Canada applicable therein, excluding any conflict of laws rules that may apply therein. The parties hereby attorn to the non-exclusive jurisdiction of the courts of the Province of Alberta, without prejudice to the rights of CP to take proceedings in any other jurisdiction. The parties hereby waive any right to a trial by jury.

Given the wording, there was no plausible argument that this was anything other than a non-exclusive forum selection clause. Hatch made a novel argument that this language fell short of establishing consent by Hatch to the jurisdiction of the court for the purpose of resolving the dispute in question. It posited that the provision needed to specify what disputes the parties agreed to submit to the non-exclusive jurisdiction of the Alberta Court for it to be effective to bestow jurisdiction *simpliciter* on that Court. The Court rejected that proposition, ruling that a reasonable interpretation of the clause was that the parties accepted that Alberta would have non-exclusive jurisdiction to adjudicate disputes arising from the contract in which the provision appears, including disputes that might otherwise be suitable for a jury.

Infinite Media Ltd. v. John Hancock Life Insurance Company (U.S.A.), 2019 ONSC 3502

The plaintiff ("Infinite") (an Ontario corporation) entered into a contract with the defendant (a U.S. financial services company headquartered in Boston) for a licence to its "Infonet" software platform. The contract contained the following provision:

> These Terms shall be governed by, and construed and enforced in accordance with, the laws in force in the Province of Ontario and the laws of Canada applicable therein. The parties hereto irrevocably attorn to the exclusive jurisdiction of the courts of the Province of Ontario. Any suit or claim hereunder will be brought solely in the courts located in the city or county of the Responding Party, and each party hereby submits itself and its property to the exclusive personal jurisdiction and venue thereof.

The challenge faced by the Court in light of the way the clause was drafted was reconciling the second and third sentences. The defendant argued that the second sentence was an agreement to attorn only and did not address whether Ontario should assume jurisdiction in a given case. The third sentence, the defendant said, meant that if it brought the claim, the proper forum would be Toronto, where the plaintiff was located, and if the plaintiff brought the claim, the proper forum would be Boston. Thus, it said, the Ontario Court had no jurisdiction over the claim brought by the plaintiff.

John Hancock was defined as the Customer in the Agreement and its address was given as 601 Congress Street, Boston MA.

Justice O'Brien interpreted the provision in the context of the agreement as a whole. She listed other provisions that indicated that the plaintiff was dealing with the "part" of the defendant located in Toronto, including the notice provision that gave a Bloor Street, Toronto address. She also noted that Securities Commission filings indicated that John Hancock had 13 executives at a Bloor Street Office at the time the Agreement was entered into (now an office of Manulife, the parent of John Hancock). But the most significant indicator of how the forum selection clause was to be read, she ruled, was the use of the word "exclusive" in the second sentence.

She concluded:

> [18] In reviewing the clause as a whole, as well as within the context of the Agreement as a whole and the factual matrix, I do not agree with John Hancock's interpretation. Rather, I accept Infinite Media's interpretation that the parties intended that all claims would be brought in Ontario, and that the parties agreed to submit to the exclusive jurisdiction of Ontario courts. I find that the last sentence of the forum selection clause was intended to reference where in Ontario the claim would be brought. At the moment, this would mean bringing the claim in Toronto. However, it could mean bringing the claim in, for example, Brampton, Mississauga or Hamilton, if the party's location within Ontario were to change.
>
> [19] In my view, this interpretation best captures the objective intention of the parties. Most importantly, it gives effect to the entire clause. It gives effect to the first sentence by according meaning to the statement that the parties would attorn to the "exclusive jurisdiction of the courts of the Province of Ontario," since all claims would need to be brought in Ontario. It gives effect to the second sentence, given that different counties and cities exist within Ontario.

Best Theratronics Ltd. v. The ICICI Bank of Canada, 2020 ONSC 2246

The plaintiff ("Best") was a manufacturer of medical devices in the field of nuclear medicine. The Republic of South Korea ("SK"), through its Public Procurement Services ("PPS"), issued a solicitation for bids for the provision of a cyclotron. Best was the successful bidder.

The contract contained somewhat complex provisions relating to various types of bonds that the parties were required to obtain. The details of those are not relevant to the conflict of laws issue.

A clause in the contract diplomatically described as "inelegant" by the motion judge provided as follows:

Article 31. JURISDICTION OF THE LITIGATION AND ARBITRATION

1. When legal proceedings are deemed to be necessary for the rights and obligation (sic) in connection with this contract, the First Trial Court for the concerned litigation shall be the court chosen by PPS among the competent courts by the law and one of the following courts:

    1. Seoul Central District Court;

    2. the Competent Court where the head office of PPS belongs.

2. However, the dispute may be settled by arbitration in Korea (sic – "without"?) the necessity of court proceedings, in accordance with the International Arbitration Rules of the Korean Commercial Arbitration Board and under the Laws of Korea only if an agreement is made between the parties to the dispute.

(embedded comments are from the motion judge's decision)

PPS took the position that this clause granted exclusive jurisdiction to the Courts of South Korea over any litigation under the contract.

Best had two arguments:

(a) The clause is defective because the process by which Best is to secure PPS's choice between the two Korean courts is not set out and there is no time frame for such a choice. PPS, therefore, could hold up a suit by Best indefinitely.

The Court rejected this argument, interpreting the clause such that Best could pick the Korean court in which to sue, with PPS then either attorning to the jurisdiction of that court or taking steps to have the suit transferred to the other court.

(b) The clause only requires PPS (not Best) to sue in Korea.

The Court also rejected this argument as being neither logical nor commercially reasonable. It noted that other provisions in the contract supported the proposition that the clause was meant to require all suits to be brought in Korea.

The Court then considered whether there was strong cause to refuse to enforce the forum selection clause. It held that strong cause was not made out, stating that Best must be deemed to have weighed the potential inconvenience and additional expenses it would experience in having to assert or defend its interests in South Korea and to have concluded that it was still in its interest to enter into this bargain (as the choice of forum clause was disclosed in the bidding documents).

Schuppener v. Pioneer Steel Manufacturers Limited, 2020 BCCA 19

This case illustrates how courts may conclude a forum selection clause is intended to be exclusive, even if that word is not used. The clause there read as follows:

> The parties agree that this contract and any dispute, cause of action, and any and all claims, whatsoever (hereinafter "Claims") with respect to the supply of the steel building shall be interpreted in accordance with the laws of Ontario, Canada. Any claims with respect to the supply of the steel building shall be resolved in the City of Mississauga, Province of Ontario. Any proceedings, which may be commenced pursuant to the Claims, shall be commenced in the City of Brampton, Province of Ontario, Canada;

Both the trial judge and the Court of Appeal jumped straight to the application of the strong cause test: Schuppener argued that the Court should exercise its discretion not to enforce the forum selection clause (although he also made arguments as to its applicability and validity).

Implicitly, the B.C. Courts found the wording of the clause to be sufficient to choose Brampton, Ontario as the exclusive forum.

While the lower court found strong cause not to enforce the clause, the BCCA overturned that result.

Bottom line: Clients need to be made aware of the differences between exclusive and non-exclusive forum selection clauses. If an exclusive forum is chosen, then Canadian common law courts that are not the chosen forum will almost invariably enforce the clause and decline jurisdiction (applying the strong cause test). Such a clause does provide a high degree of commercial certainty, just not much opportunity for an after-the-fact change of mind.

An attornment or non-exclusive forum selection clause (attornment and naming a court as having non-exclusive jurisdiction have the same effect – you do not need to include both) does not give you much in the way of commercial certainty. If it is important to ensure that a court has territorial competence/jurisdiction *simpliciter* even though it has little connection to the parties or likely claims, then such a clause will be useful.

Complex forum selection clauses that give multiple options often lead to more litigation, defeating the objective of commercial certainty.

As I will elaborate on below, forum selection clauses that favour the "stronger" party may be subject to attack on both public policy and unconscionability grounds.

The Doctrine of Unconscionability in *Uber Technologies Inc. v. Heller*

I last wrote about the doctrine of unconscionability (as a stand-alone topic) in my 2011 paper.

Earlier appellate authorities, including the two leading cases in B.C.,[20] tended to articulate the doctrine as consisting of two macro-elements: proof of inequality in the position of the parties arising from the ignorance, need or distress of one, which left him in the power of the stronger party, and proof of substantial unfairness in the bargain.

Some later appellate authorities were more specific about the components of the doctrine, as reflected in decisions of the Alberta and Ontario Courts of Appeal,[21] which listed the following elements:

1. a grossly unfair and improvident transaction;

2. a victim's lack of independent legal advice or other suitable advice;

3. an overwhelming imbalance in bargaining power caused by the victim's ignorance of business, illiteracy, ignorance of the language of the bargain, blindness, deafness, illness, senility, or similar disability; and

4. the other party's knowingly taking advantage of this vulnerability.

Of course, unconscionability is baked into the *Tercon*[22] test for assessing exculpatory clauses and was at the core of Madam Justice Abella's concurring judgment in *Douez v. Facebook, Inc*. ("*Douez*"),[23] so it was on all of our radar screens as a relevant doctrine after 2011.

Fast forward to June 2020 and the decision of the Supreme Court of Canada in *Uber Technologies Inc. v. Heller*, 2020 SCC 16 ("*Uber*").

In some ways this decision is a sequel to *Douez*: the latter dealt with forum selection clauses in contracts of adhesion between a large multinational corporation and an

[20] *Morrison v. Coast Finance Ltd.* (1965), 55 D.L.R. (2d) 710 (B.C.C.A.); *Harry v. Kreutziger* (1978), 9 B.C.L.R. 166 (C.A.).
[21] *Cain v. Clarica Life Insurance Co.*, 2005 ABCA 437; *Titus v. William F. Cooke Enterprises Inc.*, 2007 ONCA 573; *Phoenix Interactive Design Inc. v. Alterinvest II Fund L.P.*, 2018 ONCA 98, leave to appeal refused, 2019 CarswellOnt 288 (S.C.C.).
[22] *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways),* 2010 SCC 4. I have discussed the *Tercon* test multiple times – see my 2011, 2012, 2013, 2014, 2015, 2018 and 2019 papers.
[23] 2017 SCC 33. See my 2018 paper.

individual, *Uber* deals with arbitration clauses in standard form contracts between a large multinational corporation and an individual.

While the case deals with a number of issues relevant to arbitration practice, including the question of when a court, rather than the arbitrator, can assess the validity of an arbitration clause, I am going to focus on the SCC's discussion and application of the doctrine of unconscionability.

Heller signed up to be an Uber driver; to do so, he had to accept the terms of Uber's standard form services agreement. Under that agreement, Heller was required to resolve any dispute with Uber through mediation and arbitration in the Netherlands. The process in the Netherlands required up-front administrative and filing fees of US $14,500 (not taking into account legal fees and other costs). Heller's annual income was roughly equivalent to the amount of the fees.

Heller started a class proceeding in Ontario alleging that he was an employee and that Uber had violated the *Employment Standards Act*, *2000* ("ESA").[24] When Uber brought a motion to stay the class proceeding, Heller took the position that the arbitration clause was invalid, both because it was unconscionable and because it improperly purported to contract out of mandatory provisions of the ESA.

The motion judge (Perell J.) granted the stay, ruling that he did not have the authority to decide whether the arbitration clause was invalid, based on the competence-competence principle. In the alternative, he held that the arbitration agreement was not unconscionable and did not violate the ESA.

The Ontario Court of Appeal disagreed, finding it had authority to rule on the validity of the arbitration clause and found it invalid under the doctrine of unconscionability based on the inequality of bargaining power between the parties and the improvident cost of arbitration. The Ontario Court specifically cited the four-element test for unconscionability I outlined above.

Whereas in *Douez* the forum selection clause was found unenforceable by the majority under the strong cause test on public policy grounds, the seven-justice majority in *Uber* found the arbitration clause to be unconscionable and thereby invalid, a result more consistent with Abella J.'s concurring decision in *Douez* than with the majority decision in that case.

It is not that the majority in *Douez* ignored the doctrine of unconscionability. In formulating a modified strong cause test for assessing forum selection clauses in a consumer context, the majority noted that a plaintiff can raise unconscionability in the first part of the strong cause test as a basis on which the court should find a forum selection clause to be invalid or unenforceable. But the basis on which they

[24] S.O. 2000, c. 41.

found the forum selection clause in Facebook's contract of adhesion invalid was public policy.

Arbitration clauses, of course, are not subject to the strong cause test. That fact and the differently formulated bench in *Uber*[25] may explain why unconscionability is front and centre in this case.

The majority noted that the content of the unconscionability doctrine was uncertain and its application inconsistent, citing, *inter alia*, the appellate authorities I noted above.

The majority expressly rejected the four-part test articulated in decisions of the Ontario and Alberta Court of Appeal, taking the view that it made the doctrine "more formalistic and less equity-focused."[26]

Relying, in part, on the concurring decision of Abella J. in *Douez*,[27] they embraced a two-part test: (1) inequality of bargaining power stemming from some weakness or vulnerability affecting the claimant; and (2) an improvident transaction.

They then gave particulars of each of these elements.

<u>Inequality of bargaining power</u>

- Inequality of bargaining power exists where one party cannot adequately protect their interests in the bargaining process.

- There are no rigid limitations on the types of inequality that will qualify: they include differences in wealth, knowledge and experience but also things like cognitive disabilities or circumstantial disabilities (such as a desperately needy person who was disadvantaged by the contingencies of the moment).

- What matters in any given case is the presence of a bargaining context where the law's normal assumptions about free bargaining either no longer hold substantially true or are incapable of being fairly applied.

- Unequal bargaining power can be established in scenarios like those described above even if the legal requirements of contract formation have otherwise been met.

[25] The panel included four justices who were not on the panel in *Douez*. Three of them form part of the majority judgment in *Uber*.
[26] At para. 82
[27] Also *Norberg v. Wynrib*, [1992] 2 S.C.R. 226.

An improvident bargain

- A bargain is improvident if it unduly advantages the stronger party or unduly disadvantages the more vulnerable party.

- Improvidence is measured at the time the contract is formed and is assessed contextually.

- The exercise of assessing improvidence cannot be reduced to an exact science.

- The majority simply gave examples of how improvidence might be assessed: (1) for a person in desperate circumstances, almost any agreement will be an improvement on the status quo. Thus, the emphasis in such a case should be on whether the stronger party has been unduly enriched; (2) where the weaker party did not understand or appreciate the meaning and significance of important contractual terms, the focus is whether they have been unduly disadvantaged by the terms they did not understand or appreciate.

Turning back to the four-part test that the majority expressly rejected, they ruled:

- Independent legal advice is relevant only to the extent that it ameliorates the inequality of bargaining power. It might assist a weaker party in understanding the terms of a contract but might not ameliorate a weaker party's desperation or dependence on a stronger party.

- Unconscionability can be established without proof that the stronger party knowingly took advantage of the weaker.

They then zeroed in specifically on standard form contracts (contracts of adhesion), stating:

- While a standard form contract, by itself, does not establish inequality of bargaining power, there are many ways in which standard form contracts can impair a party's ability to protect their interests in the contracting process, giving rise to the potential for them to create an inequality of bargaining power.

- In the context of choice of law, forum selection and arbitration clauses, standard form contracts have the potential to enhance the advantage of the stronger party at the expense of the more vulnerable one, violating the adhering party's reasonable expectations by depriving them of remedies.

Applying the principles they articulated to the facts before them, the held that there was inequality of bargaining power between Uber and Heller based on the following facts:

- The arbitration agreement was part of a standard form contract; Heller was powerless to negotiate any of its terms.

- There was a significant gulf in sophistication between Heller, a food delivery person, and Uber, a large multinational corporation.

- The agreement contained no information about the costs of mediation and arbitration in the Netherlands and Heller could not be expected to appreciate the financial and legal implications of agreeing to arbitrate under ICC Rules or under Dutch law.

They held that the arbitration agreement was improvident based on the following facts:

- The process required a US$14,500 payment in upfront administrative fees. This amount was close to Heller's annual income (leaving aside the potential other costs including legal fees and travel).

- The arbitration clause, said the majority, modified every other substantive right in the contract and effectively made them unenforceable by a driver against Uber. Therefore, no reasonable person who had understood and appreciated the implications of the arbitration clause would have agreed to it.

- The unconscionability of the arbitration clause (and relief in relation to it alone) could be considered separately from that of the contract as a whole.

Justice Brown concurred in the result but would have found the arbitration clause to be invalid on the basis it was contrary to public policy, in that it undermined the rule of law by denying access to justice. Justice Côté dissented, taking the view that a stay of the court proceedings should be granted on the condition that Uber advance the funds needed to initiate the arbitration proceedings.

Both these justices were overtly critical of the treatment of the doctrine of unconscionability by the majority. Justice Brown states, *inter alia*, that "unreasoned intuition and *ad hoc* judicial moralism are *precisely* what will rule the day…under the analysis of my colleagues Abella and Rowe JJ." Justice Côté states that she is "concerned that their threshold for a finding of inequality of bargaining power has been set so low as to be practically meaningless in the case of standard form contracts."

The points Justices Brown and Côté make in their judgments are relevant to us because they underscore to the difficulty those seeking to apply the doctrine in the future will have:

- The effect of the majority ruling is that any standard form contract, in and of itself, denotes the degree of inequality of bargaining power necessary to trigger the doctrine, opening up the terms of every such contract for review on a measure of substantive reasonableness.

- The majority eliminated the requirement that the stronger party have knowledge (at least constructive knowledge) of the weaker party's vulnerability. This removes the counterbalance of the interests of commercial certainty and transactional security (balanced as against equity's interest in protecting those who are vulnerable).

- The majority ruled that a party who contracts exclusively with individuals who have received independent legal advice still cannot take comfort in the finality of their agreements.

- Contrary to the approach of addressing provisions of contracts through specific rules designed to address particular types of provisions, the majority chose a unified and unprincipled approach to enforceability, without providing concrete guidance for determining what substantive unfairness or an improvident transaction looks like.

- The majority applied unconscionability to a single provision (the arbitration clause) rather than to the contract as a whole. (Justice Côté disagreed with Justice Brown on this point).

In the consumer contracting context, the doctrine of unconscionability is modified in most jurisdictions by way of consumer protection states. For example, the B.C. and Newfoundland and Labrador statutes,[28] provide non-exhaustive factors that could feed a conclusion that a supplier has engaged in an unconscionable act or practice and reverse the onus so that a supplier who has been alleged to act unconscionably must disprove that proposition.

But clearly the analysis in *Uber* applies in non-consumer contexts, particularly where a standard form contract is at issue.

Bottom line: The more stringent and particularized test for the application of doctrine of unconscionability embraced by many appellate courts prior to *Uber* has been expressly rejected by the SCC.

In its place we have a more nebulous and impressionistic test made up of two elements:

[28] *Business Practices and Consumer Protection Act,* S.B.C. 2004, c. 2; *Consumer Protection and Business Practices Act*, S.N.L. 2009, c. C-31.1.

(1) inequality of bargaining power stemming from some weakness or vulnerability affecting the claimant; and (2) an improvident transaction.

While the majority said they were not ruling that every standard form contract will, in and of itself, satisfy the first element, on one view of their reasons that is exactly what they ruled.

In the face of *Douez* and *Uber*, forum selection clauses and arbitration clauses in standard form contracts and contracts of adhesion are at risk of being invalidated, particularly if the counterparty is an individual. Choice of law clauses may also be at risk.

The first line of attack going forward will be the doctrine of unconscionability. The second line of attack will be public policy, particularly where the cause of action a plaintiff seeks to pursue is quasi-constitutional in nature.

That the counterparty had independent legal advice can no longer give a contracting party comfort that forum selection or arbitration clauses are immunized from attack.

It is not surprising that multinational corporations include exclusive forum selection or arbitration clauses stipulating a venue for the arbitration in their standard form contracts. It becomes administratively much more complicated and expensive if they must litigate disputes in each of the jurisdictions in which they do business.

In light of *Uber* and *Douez*, corporations can no longer have confidence that such clauses will be enforced. They could opt for having different standard form contracts for counterparties in different jurisdictions that either name the counterparty's home jurisdiction as the forum for resolving disputes or do not exclude it. If arbitration is the preferred type of dispute resolution process, a corporation could reduce the risk of an arbitration clause being invalidated as unconscionable by funding associated costs for commencing the arbitration where the plaintiff is an individual or small business.

Other alternatives would be to leave in the exclusive forum selection clause or arbitration clause of the corporation's choice and be prepared for challenges to the clause's enforceability or include no forum selection clause or arbitration clause at all. With both these approaches, where the litigation would ultimately unfold will be uncertain.

The decision in *Uber* may also feed challenges to exculpatory clauses (such as limitation of liability clauses), given that unconscionability is an element in the three-part *Tercon* test for assessing such clauses.

Reconciling Inconsistent Contract Terms

While I usually avoid writing about contract interpretation (because so many cases are fact-dependent), other than when the SCC articulates governing principles, sometimes a case comes along that illustrates how courts will approach a particular interpretative issue. Such a decision was recently issued by the Ontario Court of Appeal and is worth reviewing.

We have known for some time that one of the core principles of contract interpretation requires the interpreter to construe the contract as a whole, giving meaning to all of its provisions, striving to harmonize apparent inconsistencies and ambiguities, and avoiding an interpretation that would render one or more term ineffective.

An extension of the principle that a contract should be interpreted as a whole requires the interpreter to consider related contracts entered into as part of a single overall transaction. Contracts entered in at the same time on the same or related topics should be interpreted, if possible, to work harmoniously to achieve the overall goal, and not to clash. [29] Additionally, where a transaction involves execution of a number of agreements that form components of the overarching transaction, even if they are executed at different times, assistance in interpretation of any given agreement may be drawn from the related agreements.[30]

But what happens if two provisions in related contracts are obviously inconsistent? What methodology should the court follow?

The Ontario Court of Appeal recently had occasion to consider such a scenario, and the methodology that a court should apply, in *Fuller v. Aphria Inc.*, 2020 ONCA 403.

In a Consulting Agreement dated June 2, 2014, the defendant Aphria granted Fuller and his corporation ("JPF") options to acquire common shares in Aphria (the "Options"), a medical marijuana business venture, at $0.60 per share. The Consulting Agreement had a two-year term that expired in June 2016. This agreement provided that the Options were to issue immediately upon Aphria's receipt of what was described as the "Final License". It also provided that the Options would expire five years after Aprhia completed a RTO that would result in it becoming a public issuer. Finally, the Consulting Agreement provided that the Options would be "subject to the terms and conditions of any option plan implemented by Aphria".

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[29] *Samson Cree Nation v. O'Reilly & Associés*, 2014 ABCA 268 at para. 82.

[30] *3869130 Canada Inc. (c.o.b. I.C.B. Distribution 2001) v. I.C. B. Distribution Inc.*, 2008 ONCA 396 at para. 33; *Salah v. Timothy's Coffees of the World Inc.,* 2010 ONCA 673 at para. 16.

The parties also entered into a Stock Option Agreement in December of 2014. In that agreement the parties confirmed that Fuller had been granted 200,000 Options to purchase common shares under the Consulting Agreement and confirmed the Option price. In the time period between June and December, the RTO was completed, Aphria received the Final Licence and it implemented an Option Plan. Fuller acknowledged in the Stock Option Agreement that he had read and understood the Option Plan.

The Option Plan was of more general application to directors, officers, employees or consultants of Aphria. Section 2.3(a) provided that the period during which an option could be exercised would be determined by the Board in place at the time the option was granted. Section 2.3(g)(iv) of the Option Plan provided that options would cease to be exercisable six months after a person ceased to be an Eligible Person "for any reason" other than a reason referred to in Section 2.3(i) to (iii) of the Option Plan (none of which were germane on the facts).

The Consulting Agreement's two-year term ended on June 2, 2016.

On December 6, 2017, JPF sought to exercise the 200,000 Options, taking the view that they did not expire until late 2019. The price of Aphria's shares was $13.30 at that date. Aphria rejected the exercise, taking the position that the Options had expired on December 2, 2016, six months after the Consulting Agreement expired, on the basis that Fuller and JPF had ceased to be consultants and therefore were not Eligible Persons under the Option Plan.

Fuller and JPF sought damages for Aphria's refusal to honour the exercise of the Options, a refusal that deprived JPF of the opportunity to sell the shares at a favourable price.

The application judge found that Section 2.3(g)(iv) of the Option Plan applied. Since Fuller and JPF were not Eligible Persons at the date of Option exercise and six months had elapsed since they were Eligible Persons, the Option exercise was invalid.

The Court of Appeal noted that accepting either party's position would mean rejecting a provision in the suite of agreements (including the Option Plan, which was incorporated by reference), rendering it ineffective. There was no way of reconciling the two provisions.

Justice Zarnett stated that effect could not be given to both a term that provided that the Options, granted in a two-year, non-renewable Consulting Agreement, can be exercised for five years, and a term (in the Option Plan incorporated by reference) that provided that the Options could not be exercised more than six months after the end of a consulting arrangement.

The Court identified the rule of last resort to be applied where a contract (or suite of contracts) contain actually inconsistent terms: the court must rule the "repugnant"

term ineffective. But it also explained that prior to applying the rule of last resort, it was incumbent on the interpreting court to attempt to reconcile the apparently inconsistent terms, by applying other principles of contract interpretation.

Principles identified by the Court that could be applied ahead of that rule of last resort for resolving a conflict between terms are:

- General terms will be viewed as being qualified by specific terms.

- A term inserted by the parties into a pre-printed form will be given effect over a conflicting term forming part of the original pre-printed form.

JPF and Fuller argued that there was another relevant principle that could be applied on the facts. Based on this principle, they said, the terms originally expressed in the Consulting Agreement and Stock Option Agreement must be given priority over those incorporated by reference from the Option Plan. Fuller and JPF relied on an earlier Ontario decision that canvassed the pre-existing, largely English authority, where Justice Perell stated that when terms are incorporated by reference into a contract, the terms of the host contract prevail over any inconsistent terms incorporated by reference.[31]

Justice Zarnell distinguished that earlier decision as follows:

> [64] An interpretive approach that views the terms of a "host" contract as a better reflection of the specific parties' intent than an apparently inconsistent term incorporated by reference, may be appropriate in cases where the incorporation by reference is effected by language that does not give the incorporated terms priority. However, I do not agree that the approach would necessarily apply if the incorporation by reference is effected by language that indicates the incorporated provisions have priority over, or at least are not all automatically subordinate to, those originally expressed. There can be good reasons why parties might choose to incorporate terms and specify that they wish those incorporated terms to govern in the event of a conflict with the host contract's provisions.
>
> [65] Unlike the cases cited in *Spina*, the "host" contracts in this case—the Consulting Agreement and the Stock Option Agreement—both used the phrase "subject to" when incorporating provisions of the Option Plan. They said the Options were "subject to" the Option Plan. To simply assert that the incorporated terms are automatically subordinate whenever they apparently conflict with the host contracts does not, in my view, account for that language. Accordingly, I do not

[31] *Spina v. Shoppers Drug Mart Inc.*, 2012 ONSC 5563 at para. 142. For a B.C. authority, see *Pass Creek Enterprises Ltd. v. Kootenay Custom Log Sort Ltd.*, 2003 BCCA 580.

> view the appellants' argument based on *Spina* as automatically resolving the issue in their favour.

Justice Zarnell went on to find that the inclusion of the "subject to" language did not automatically resolve the issue in favour of Aphria. He framed the question that had to be answered as whether the exercise period that was specified when the Options were created made Section 2.3(g)(iv) of the Option Plan inapplicable.

After reviewing the provisions in all three documents, he concluded:

> [83] The Option Plan was of general application to options issued and to be issued by Aphria. Many of its terms could be applied to the Options in issue here. But the terms of the grant of the Options in the Consulting Agreement, as confirmed in the Stock Option Agreement, were specific about the exercise period, and about the exact and only events that would shorten it. They were the reflection of the parties having specifically addressed the term and exercise period for these Options for this option holder. Section 2.3(g)(iv) of Option Plan did not displace the carefully-crafted specific provisions contained in the grant of the Options that defined the exercise period for them, when those specific provisions were, under Section 2.3(a) of the Option Plan, to be given priority.

There is, then, an interpretative principle that applies to terms incorporated by reference into a "host contract" provided that the parties have not otherwise stipulated which terms are to be given priority to the extent they are inconsistent. In a neutral scenario, the term in the host contract will prevail. But where there are other contractual indications suggesting either that the terms incorporated by reference should prevail or at least are not automatically subordinated to the terms in the host contract, this interpretative principle is ousted.

While there are various interpretative principles, including this one, by which courts may reconcile apparently conflicting clauses in an agreement or related agreements, the courts will construe the agreement or agreements as a whole to objectively determine what the parties intended.

Bottom line: When drafting multiple contracts that form part of the same transaction or are otherwise related, the drafter must be alive to potential conflicts between terms in the contracts. Avoiding such conflicts is obviously desirable and the solution may be to draft so as to eradicate them; however, this may not always be possible. Even in the absence of any obvious potential conflicts, the drafter should consider inserting provisions that signal which provision is meant to be paramount (particularly if there is a provision that is critical to their client).

Drafters should be aware of the interpretative principles courts will apply to reconcile apparently inconsistent terms in the absence of express provisions giving a given provision priority. They include: a specific provision prevails over a general

provision; a term added to preprinted form will prevail over a preprinted term; a term of a host contract will prevail over a term from another document incorporated by reference (absent internal indicators to the contrary).

Stipulated-Consequence-on-Insolvency Clauses and the Anti-Deprivation Rule

As I noted in last year's update, based on the dissenting reasons of Mr. Justice Wakeling in *Capital Steel Inc. v. Chandos Construction Ltd.*, 2019 ABCA 32 ("*Chandos*"), and the submissions made in the SCC hearing of that case, I thought the SCC might weigh in on the characterization of clauses as liquidated damages clauses or penalties and the consequences of that characterization at common law.

The SCC did not weigh in on this issue, but its treatment of the specific type of clause in *Chandos* (which Justice Wakeling referred to in the Court below as a "stipulated-consequence-on-breach" term) is nonetheless important to commercial practitioners.

Before moving to that issue, I note that Justice Wakeling's dissent and the factums of the parties at the SCC contain illuminating passages that outline the jurisprudence on the so-called "penalty rule" and its treatment in Canada and other jurisdictions.

The issue addressed by the SCC is more properly one of insolvency law (and I am not an insolvency lawyer). But as the decision involves the treatment of a particular type of clause commonly inserted in contracts, I would be remiss not to flag it here.

Chandos is a general construction contractor who entered into a subcontract with Capital Steel. The key condition in the subcontract (Clause VII Q) read in part as follows:

> In the event the Subcontractor commits any act of insolvency, bankruptcy, winding up or other distribution of assets, or permits a receiver of the Subcontractor's business to be appointed, or ceases to carry on business or closes down its operations, then in any of such events:
>
> […]
>
> (d) the Subcontractor shall forfeit 10% of the within Subcontract Agreement price to the Contractor as a fee for the inconvenience of completing the work using alternate means and/or for monitoring the work during the warranty period.
>
> (the "Clause").

Capital Steel completed most of the work under the subcontract and Chandos paid most of the subcontract price. On September 26, 2016, when

Capital Steel filed an assignment in bankruptcy, there was a balance owing by Chandos of $149,618.39.

Chandos completed the outstanding subcontract work at a cost of $22,800. Chandos offset this amount against the balance owing to Capital Steel. It then sought to rely on the Clause to offset the new balance of $126,818.30 against 10% of the subcontract price, relying on the Clause. This would effectively eliminate the debt it owed to Capital Steel and give Chandos a $10, 511.66 claim provable in the bankruptcy proceedings.

Deloitte applied to the Alberta Court of Queen's Bench seeking advice and directions on whether Chandos was entitled to rely on the Clause.

The chambers judge found that the Clause was a liquidated damages clause (as opposed to a penalty clause) and that such clauses do not violate the common law anti-deprivation rule. The majority of the Court of Appeal explained that whether a provision is a liquidated damages clause or a penalty clause is a separate and distinct analysis from whether the provision violates the anti-deprivation rule. Accordingly, a provision can be invalid if it violates either the anti-deprivation rule or the penalty clause rule. The majority then applied the anti-deprivation rule to invalidate the Clause.

The focus of the SCC decision is on the existence and content of the anti-deprivation rule. The SCC did not address the penalty rule and the law on liquidated damages vs. penalties. It held that the Clause violated the anti-deprivation rule, which formed part of Canadian common law since before federal bankruptcy legislation existed, and has not been eliminated by any decision of the SCC or by Parliament.

The SCC confirmed that the anti-deprivation rule renders void contractual provisions that, upon insolvency, remove value that would otherwise have been available to an insolvent person's creditors from their reach. Stated as a two-part test the rule is as follows: first, the relevant clause must be triggered by an event of insolvency or bankruptcy; and, second, the effect of the clause must be to remove value from the insolvent's estate.

The Court also flagged what it called nuances in the anti-deprivation rule, such as:

- Contractual provisions that eliminate property from the bankrupt's estate, but do not eliminate value, may not offend the rule.

- Provisions whose effect is triggered by an event other than insolvency or bankruptcy do not offend the rule.

- Commercial parties will not offend the rule when they protect themselves against a contracting counterparty's insolvency by taking security, acquiring insurance, or requiring a third-party guarantee.

Bottom line: When parties including a "stipulated-consequence-on-breach" clause that stipulates a monetary consequence on bankruptcy or insolvency, its validity will be assessed under the anti-deprivation rule.

If it survives the application of that rule, such a clause still may be attacked as a penalty.

If a party wishes to include a clause providing for stipulated consequence on bankruptcy or insolvency of their counterparty, the drafting solicitor should carefully review the decision in *Chandos* and the law on penalties vs. liquidated damages. Most such clauses will offend the anti-deprivation rule, but as always, careful drafting with the jurisprudence in mind may produce an enforceable clause.

CONTRACT LAW
DEVELOPMENTS OF NOTE SUMMARY OF TOPICS

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Acceptance by Conduct								X	
Anti-oral Amendment				X					
Arbitration Clauses		X	X			X	X		X
Automatic Renewal					X				
Best Effort Clauses									X
Binding Effect and Enurement Clauses							X		
Buy/Sell Clauses									X
Choice of Court (Forum Selection) Clauses		X				X			
Conditions Precedent							X		
Confidentiality Clauses					X				
Consideration in the Context of Contract Variations		X							
Continuing Breach of Contract				X	X				
Contract Interpretation				X					
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Duty of Good Faith				X	X	X	X		

HEADINGS	2019	2018	2017	2016	2015	2014	2013	2012	2011
Links to Contract Law Paper by Year	https://www.lawsonlundell.com/assets/htmldocuments/Contract%20Law%20Update%20-%20Developments%20of%20Note	https://www.lawsonlundell.com/assets/htmldocuments/Contract%20Law%20Update%20May%2024%202019.pdf	https://www.lawsonlundell.com/assets/htmldocuments/2017%20Contract%20Law%20Update.pdf	http://www.lawsonlundell.com/media/news/550_Lisa%20Peters_%20Contract%20Law%20Update%20November%2015%202016%20Final.pdf	http://www.lawsonlundell.com/media/news/502_Contract%20Law%20Update%202015%20_final_.pdf	/http://www.lawsonlundell.com/media/news/461_Contract%20Law%20Update%202014%20_LP_.pdf	http://www.lawsonlundell.com/media/news/396_2013%20developments%20in%20contract%20law%20paper%20_in%20house%20and%20website%20version%20as%20at%20October%2031_.pdf	http://www.lawsonlundell.com/media/news/323_ContractLawUpdate2012.pdf	http://www.lawsonlundell.com/media/news/76_ContractLawUpdateDevelopmentsofNote2011LisaPeters.pdf
Duty of Honesty in Contractual Performance					X	X			
Efficient breach						X			
Economic Duress									
Electronic Transactions and								X	
Entire Agreement Clauses	X								
Equitable Mistake									X
Exculpatory Clauses and Limitation of Liability Clauses		X			X	X	X	X	X
Forum Selection Clauses			X						
Frustration and *Force Majeure*		X							
Fundamental Breach									
Illegal Contracts									
Implied Terms and Implied Contracts	X				X			X	
Indemnity Clauses	X								
Legislative Developments of								X	X
Liquidated Damages Clauses								X	
No Suit Clauses			X						
Notional Consideration	X								
Options				X					
Pre-Incorporation Contracts									

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Privity of Contract									
Rectification									
Releases									
Rights of First Refusal									
Restrictive covenants									
Severability	X								
Smart Contracts					X	X			
Specific Performance						X			
Standard of Review on Contract Issues									
Statutory Illegality								X	
Statutory Warranties Under the *International Sale of Goods Act*									
Time of the Essence Clauses									X
Unconscionability in Commercial Transactions		X			X	X	X	X	X

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