A PRIMER ON CONTRACTUAL INTERPRETATION

GEOFF R. HALL
MICHAEL FEDER

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Geoff R. Hall is a partner in the Litigation Group based in our Toronto office. Mr. Hall's practice focuses primarily on corporate/commercial litigation, and he also has extensive experience in bankruptcy/restructuring litigation, constitutional and administrative law litigation.


Mr. Hall is a widely published author and teaches widely in both contract law and trial advocacy.

Author of Canadian Contractual Interpretation Law, 2nd ed. (Markham: LexisNexis Canada Inc., 2012).

Regarded as the leading text on contractual interpretation in Canada, the first edition has been cited by courts over 50 times, including three times by the Supreme Court of Canada.
Michael Feder is a partner in our Litigation Group in Vancouver. He has a general litigation practice encompassing both commercial disputes and public law matters.

Mr. Feder has experience as counsel at all levels of court in British Columbia, as well as in the Federal Court, the Federal Court of Appeal and the Tax Court. He has also appeared from time to time in the Superior Court of Quebec.

Mr. Feder is ranked in Benchmark Canada – The Definitive Guide to Canada’s Leading Litigation Firms & Attorneys, based on interviews with clients and peers.

Prior to joining the firm, Mr. Feder clerked for the Honourable Mr. Justice Major of the Supreme Court of Canada, and for the Honourable Madam Justice Huddart and Mr. Justice Oppal of the Court of Appeal for British Columbia.

Mr. Feder received his BA and LLB from the University of British Columbia, from which he graduated as a Wesbrook Scholar. He was called to the British Columbia bar in 2004.

Since 2011, Mr. Feder has served as an advocacy advisor to the Supreme Court Advocacy Institute, which provides advocacy advice to lawyers scheduled to appear in Supreme Court of Canada appeals. Mr. Feder is also Treasurer of the University of British Columbia Law Alumni Association and a director of Pivot Legal Society.
“The issue is what is chicken?”

"Plaintiff says ‘chicken’ means a young chicken, suitable for broiling and frying. Defendant says ‘chicken’ means any bird of that genus that meets contract specifications on weight and quality, including what it calls ‘stewing chicken’ and plaintiff pejoratively terms ‘fowl’.”


Issues of contract interpretation are pervasive – a civil litigator does not find it surprising that parties might litigate the meaning of the word “chicken”

Issues of contract interpretation have enormous commercial implications for the parties themselves – the meaning of the word “chicken” can involve large sums of money

At the same time, for the most part, issues of contract interpretation have no greater social implication – courts are simply concerned to get the intended meaning right

The Nine Fundamental Precepts

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<th>1</th>
<th>Words and their context</th>
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<td>Since contractual interpretation for the most part involves no greater social goals than getting the meaning right, courts are obsessed with interpretive accuracy</td>
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<td>The courts have increasingly recognized over the past 30 years that context is central to interpretive accuracy</td>
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<td>Context has two aspects</td>
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<tr>
<td>• The context of the document</td>
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<td>• The surrounding circumstances</td>
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<td>There can be a tension between text and context</td>
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The Nine Fundamental Precepts

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<th>Precept</th>
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<td>2</td>
<td>A contract is to be construed as a whole with meaning given to all of its provisions. “The normal rules of construction of a contract require that the various clauses of a contract cannot be considered in isolation but must be given an interpretation that takes the entire agreement into account.”: <em>Canadian Newspapers Co. v. Kanda General Insurance Co.</em> (1996), 30 O.R. (3d) 257 (C.A.) at 270, leave to appeal refused [1996] S.C.C.A. No. 553. Achieves interpretive accuracy. Eliminates ambiguities and inconsistencies. A good example is <em>McLelland &amp; Stewart Ltd. v. Mutual Life Assurance Co. of Canada</em>, [1981] 2 S.C.R. 6. “Any policy issued on this application shall become effective when delivered to and accepted by me” was interpreted to mean the effective date of a backdated policy.</td>
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<td>3</td>
<td>The factual matrix. A hugely important aspect of contextual interpretation, which is a legacy of Lord Wilberforce. “In order for the agreement of 6th July, 1960 to be understood, it must be placed in its context. The time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations. ... We must ...enquire beyond the language and see what the circumstances were with reference to which the words were used, and the object, appearing from those circumstances, which the person using them had in view.”: <em>Prenn v. Simmons</em>, [1971] 3 All E.R. 237 (H.L.). “The aggregate profits of R.T.T. earned” was interpreted not only to one specific holding company (R.T.T.) but also to the entire R.T.T. group. “No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as ‘the surrounding circumstances’ but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.”: <em>Reardon Smith Line Ltd. v. Hansen-Tangen</em>, [1976] 3 All E.R. 570 (H.L.) at 574. “Japanese flag …Newbuilding motor tank vessel called Yard No. 354 at Osaka Zosen” was interpreted to mean a vessel built at Osaka (as that was impossible, because the ship was too big) but rather as a means of identifying a particular tank to be built. The scope is broad and essentially includes everything except evidence of subjective intentions and negotiations leading up to the final contract. The factual matrix must not be allowed to overwhelm the words chosen by the parties: <em>Black Swan Gold Mines Ltd. v. Goldbelt Resources Ltd.</em> (1996), 25 B.C.L.R. (3d) 285 (C.A.) at para. 19.</td>
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## The Nine Fundamental Precepts

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<th>Interpretation is an objective exercise</th>
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| 4 | “The goal in interpreting an agreement is to discover, objectively, the parties’ intention at the time the contract was made.”: *Gilchrist v. Western Star Trucks Inc.* (2000), 73 B.C.L.R. (3d) 102 (C.A.) at para. 17  
“The contractual intent of the parties is to be determined by reference to the words they used in drafting the document, possibly read in light of the surrounding circumstances which were prevalent at the time. Evidence of one party’s subjective intention has no independent place in this determination.”: *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 at para. 54 |
| 5 | Commercial contracts must be interpreted in accordance with sound commercial principles and good business sense: *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744 (C.A.) at 770-1, leave to appeal refused [1993] 2 S.C.R. x  
Corollary: an interpretation which is commercially absurd is to be avoided |
| 6 | Every effort should be made to find a meaning  
“Business men often record the most important agreements in crude and summary fashion; modes of expression sufficient and clear to them in the course of their business may appear to those unfamiliar with the business far from complete or precise. It is accordingly the duty of the Court to construe such documents fairly and broadly, without being too astute or subtle in finding defects; but on the contrary, the court should seek to apply the old maxim of English law, verba ita sunt intelligenda ut res magis valeat quam pereat [words are to be understood that the object may be carried out and not fail]. That maxim, however, does not mean that the court is to make a contract for the parties, or to go outside the words they have used, except in so far as there are appropriate implications of law, as for instance, the implication of what is just and reasonable to be ascertained by the court as matter of machinery where the contractual intention is clear but the contract is silent on some detail.”: *Hillas & Co. Ltd., Arcos Ltd* (1932), 147 L.T. 503 (H.L.) at 514  
“[E]very effort should be made by a Court to find a meaning, looking at substance and not mere form, and that difficulties in interpretation do not make a clause bad as not being capable of interpretation, so long as a definite meaning can properly be extracted.”: *Marquest Industries Ltd. v. Willows Poultry Farms Ltd.* (1968), 1 D.L.R. (3d) 513 (B.C.C.A.) at 517-518 |

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### The Nine Fundamental Precepts

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| **7** | A contract is to be interpreted as of the date it was made | "It is a fundamental rule of contractual interpretation that the intention of the parties is to be determined as of the time when the contract is made": Davidson v. Allelix Inc. (1991), 7 O.R. (3d) 581 (C.A.) at 587  
Result: discussions in 1986 were irrelevant to the interpretation of a contract made in 1984  
Reason: a contract’s meaning should not depend on the time when someone goes to court to have it interpreted |
| **8** | The parol evidence rule | The basic concept: extrinsic evidence is not admissible to add to, subtract from, vary or contradict a written agreement  
However, the rule is hard to reconcile with the modern emphasis on context, and the exceptions tend to swallow it  
The rule does not apply when the written agreement is incomplete or there is a collateral oral agreement  
The rule does not apply where there is ambiguity in the written document  
The rule does not apply if there is a claim for rectification  
It basically only applies to preclude evidence of subjective intention and to preclude evidence which contradicts the written agreement |
There are some judicial statements that it should only be applied as a last resort or where the party seeking to rely on it did not have an opportunity to modify the terms of the contract  
Its only real effect in interpretation of guarantees and insurance policies |
# Types of Clauses: Arbitration clauses

Ordinary principles of contractual interpretation are the starting point

There is an important distinction between limited and universal arbitration clauses

Limited arbitration clauses provide a mechanism for the resolution of disputes concerned with working out the details of a contract (e.g., the determination of fair market rent upon a lease renewal)

Universal arbitration clauses submit to arbitration all disputes arising between the parties in respect of the contract

Determined by reading the language of the clause in the context of the contract as a whole

“Arising out of” and “arising in connection with” tend to indicate a universal arbitration clause

Arbitration clauses are to be given a large and liberal interpretation

Reflects policy goals outside of the law of contractual interpretation – encouraging private dispute resolution and the direction to the courts in modern Arbitration Acts not to interfere in arbitrations

Sweeps a lost of cases into arbitration, sometimes contract to the parties’ intentions

An arbitration clause implicitly includes the power to award damages unless a contrary intention appears: *Heyman v. Darwins Ltd.*, [1942] A.C. 356 (H.L.)

An arbitration clause is not rendered inoperative by the termination of the contract in which it is contained: *Heyman v. Darwins Ltd.*, [1942] A.C. 356 (H.L.)
Types of Clauses: Exemption: limitation of liability clauses

Until 1989, tended to be treated as unique and approached with a degree of hostility

The doctrine of fundamental breach was often used to preclude parties from relying on exemption clauses

_Hunter Engineering Co. v. Syncrude Canada Ltd.,_ [1989] 1 S.C.R. 426 attempted to abolish the doctrine of fundamental breach – not entirely successful, as hostility to limitation of liability clauses remained


_Tercon Contractors Ltd. v. British Columbia (Transportation and Highways),_ 2010 SCC 4, [2010] 1 S.C.R. 69 is the latest word

The Supreme Court of Canada declared (for the third time) that the doctrine of fundamental breach is no longer good law

Whether an exclusion clause applies requires three analytical steps:

As a matter of ordinary contractual interpretation, does the exclusion clause apply to the circumstances established in the evidence?

If yes, was the exclusion clause unconscionable at the time the contract was made?

If no, should the court decline to enforce the exclusion clause because of an overriding public policy concern which outweighs the very strong public interest in the enforcement of contracts?

But – the outcome in _Tercon_ was hard to distinguish from the former approach, showing hostility to the limitation of liability clause in question

What will be telling is what the lower courts do when applying _Tercon_
Types of Clauses: Entire agreement clauses

One of the most confusing areas of the law of contractual interpretation in Canada. No apparent overarching theory of how the courts should or do approach such provisions, so it is difficult to predict in any particular case whether an entire agreement clause will be enforced or not.

To the extent that there is a consistent theme, it appears to be that entire agreement clauses will only be enforced against a party who understood (or ought to have understood) the effect of the clause and whose attention was specifically drawn to the provision.

Result - much more apt to be enforced against a sophisticated party than against an unsophisticated one, and entire agreement clauses which are buried in fine print in standard form contracts are apt not to be enforced.

Put another way, entire agreement clauses tend only to be enforceable where contracting parties expressly turn their minds to them, or where they ought to have done so because of their sophistication and ability to obtain legal advice.

Seemingly unrelated principles appear to be at play.

An entire agreement clause will in general not be interpreted to be forward-looking, but rather will only be considered to apply to events occurring prior to contracting: Shelanu Inc. v. Print Three Franchising Corp. (2003), 64 O.R. (3d) 533 (C.A.).

In Shelanu, the following entire agreement clause was found not to apply on a forward-looking basis: “This agreement constitutes the entire Agreement between the parties with respect to all of the matters herein and its execution has not been induced by, nor do any of the parties hereto rely upon or regard as material, any representation or right not incorporated herein. Any representations, inducements, promises, and agreements, oral or otherwise not contained herein shall have no force or effect in the construction of the rights and obligations of the parties created by this Agreement.”

An entire agreement clause will not prevail over an oral agreement (especially a subsequent oral agreement) where the written agreement was not intended to encompass the entire relationship between the parties: “To be sure, courts have not always given effect to entire agreement clauses. … [T]hey have not done so where, for example, after signing a written contract, parties have entered into an oral agreement and by their conduct have shown that they did not intend to be bound by their previous written contract.”: Transamerica Life Canada Inc. v. ING Canada Inc. (2003), 68 O.R. (3d) 457 (C.A.) at para. 96 (per Laskin J.A., dissenting in part).

Easier to state in the abstract than it is to apply in practice, with the result that the application of this principle has been quite inconsistent.

An entire agreement clause will not apply to exclude false representations which induced a party to enter into a contract, unless the clause was specifically brought to the attention of the party to whom the representation was made: Zippy Print Enterprises Ltd. v. Pawliuk (1994), 100 B.C.L.R. (2d) 55 (C.A.).
Types of Clauses: Guarantees


The normal rules of interpretation apply, with four exceptions

The *contra proferentem* rule is more likely to apply

The interpretation of a guarantee takes into account that guarantors have a favoured position in the eyes of the law

Contracting out of protections afforded to a guarantor at common law or in equity is permitted but can only be accomplished by clear language

A guarantee must be interpreted in the context of the entire transaction, including the circumstances of the underlying transaction and any dealings with respect to it

Result – provisions binding guarantors tend to be strictly interpreted, with any doubt or ambiguity resolved in the guarantor’s favour

an example of the third exception is illustrative of the courts’ approach – in *Bank of Montreal v. Korico Enterprises Ltd.* (2000), 50 O.R. (3d) 520 (C.A.), guarantee language allowing the bank to deal with the secured assets “as [it] may see fit” was held not to be sufficient to relieve the bank of the common law duty not to sell the collateral improvidently
Types of Clauses: Injunction/irreparable harm clauses

Clauses providing for injunctive relief in the event of breach of contract

They can acknowledge that a breach will cause irreparable harm, or they can simply agree that an injunction is the appropriate remedy in the event of a breach.

There are two conflicting lines of authority.

The predominant line is rooted in the law of injunctions – no matter how clear the wording, the court must determine whether irreparable harm exists and whether an injunction is appropriate.

“The granting of an injunction is an equitable remedy. I do not believe that the parties to a contract can obviate or waive the usual requirements on which a court would need to be satisfied before exercising its equitable jurisdiction. While such a term in a contract might provide some evidence in favour of a finding of irreparable harm, I do not see that it can be a complete answer to that requirement and thereby preclude the court from inquiring into the issue, particularly in a case such as here where there is otherwise an absence of evidence that would lead to that conclusion.” Jet Print Inc. v. Cohen (1999), 43 C.P.C. (4th) 123 at para. 27 (Ont. S.C.J.)

The minority line is rooted in the law of contractual interpretation – on the basis that effect ought to be given to the intentions of the parties as expressed by the words they have agreed upon.

The predominant line seems sensible in light of the context and the rule that equity prevails over common law, but the issue has not been examined at the appellate level.