

## SCC rejects doctrine of fundamental breach in context of exclusion clauses

*Tercon Contractors v. British Columbia*, 2010 SCC 4, February 12, 2010

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In an important ruling arising out of a disputed public procurement process, the Supreme Court of Canada has unanimously rejected the doctrine of fundamental breach, substituting a three-stage test of the enforceability of an exclusion-of-liability clause that considers (i) whether the clause actually applies to the type of breach that is alleged, (ii) unconscionability, and (iii) public policy. However, before anyone celebrates the end of the ambiguity that has pervaded this part of Canadian law since the split decision in *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426, it must also be reported that the Court split five to four on the application of its new three-stage test to the facts. The distinction between the majority and minority reasons will be of interest to those drafting or negotiating exclusion clauses, particularly in the context of a request for proposals (RFP) or tendering process.

### Background

The Supreme Court's decision essentially restored the trial judge's ruling that the exclusion-of-liability clause contained in a request for proposals issued by the Province of British Columbia did not shield it from liability for breach of contract. Under the terms of the RFP issued on January 15, 2001, only six proponents – respondents to a previous Request for Expressions of Interest – were eligible to submit a proposal. The RFP contained the following exclusion of liability language:

[N]o Proponent shall have any claim for any compensation of any kind whatever, as a result of participating in this RFP, and by submitting a proposal each proponent shall be deemed to agree that it has no claim.

The Province proceeded to award the contract to a bidder that, while nominally compliant, proposed to enter into a partnership or joint venture with a second company that was not eligible to participate in the RFP. The Province was apparently fully aware of the situation and, according to the findings at trial, took steps to ensure that the involvement of the ineligible co-venturer was not disclosed.

Tercon, the fully compliant runner-up, brought an action against the Province and, having prevailed at the trial court level, was awarded approximately \$3.5 million in damages and prejudgment interest. The trial judge found that the Province breached the express provisions of the tendering contract with Tercon by accepting a bid from another party that was not eligible to bid and ultimately awarding the work to that ineligible bidder. The trial judge also found that this and related conduct by the Province breached the implied duty of fairness to bidders. Having established the breach, she concluded that the exclusion clause did not bar Tercon's recovery, finding that the clause was ambiguous and such ambiguity was resolved in Tercon's favour pursuant to

### INSIDE

Court of Appeal for Ontario reformulates the test for assuming jurisdiction over foreign defendants

*Van Breda v. Village Resorts Ltd.*

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the *contra proferentem* principle of contractual interpretation. However, in setting aside the trial decision, the British Columbia Court of Appeal recognized the Province's breach but found the exclusion clause to be clear, unambiguous and barred compensation for all defaults.

## New framework for analysis established by SCC

Like the trial judge, the Supreme Court rejected the Province's argument that, under such circumstances, a bid would be compliant provided that only the first (eligible) company's name appeared on the bid. The key issue was therefore the exclusion clause. As noted above, the Court agreed on the analytical framework but not on its application in this case. Rejecting the fundamental breach doctrine outright, Justice Binnie – author of the minority reasons but speaking for the entire Court on this issue – set out the three-part test in paragraphs 122 and 123 [bracketed numerals added for ease of reference]:

[1] The first issue, of course, is whether as a matter of interpretation the exclusion clause even *applies* to the circumstances established in evidence. This will depend on the Court's assessment of the intention of the parties as expressed in the contract. If the exclusion clause does not apply, there is obviously no need to proceed further with this analysis. [2] If the exclusion clause applies, the second issue is whether the exclusion clause was unconscionable at the time the contract was made, "as might arise from situations of unequal bargaining power between the parties" (*Hunter*, at p. 462). This second issue has to do with contract formation, not breach.

[3] If the exclusion clause is held to be valid and applicable, the Court may undertake a third enquiry, namely whether the Court should nevertheless refuse to enforce the valid exclusion clause because of the existence of an overriding public policy, proof of which lies on the party seeking to avoid enforcement of the clause, that outweighs the very strong public interest in the enforcement of contracts.

## Applying the new framework

The disagreement between majority and minority centred on element [1] of the test. The majority – in reasons authored by Justice Cromwell – responded to arguments that a sophisticated commercial party such as Tercon should be held to the terms of its bargain by stating that this presupposed the answer to the "real question," which was "what does the exclusion clause mean?" In its view, the clause either excluded this type of liability or (at best) was unclear, inasmuch as it encompassed only those claims that could be said to result from "participating in this RFP." On the terms of the RFP, it held, "participating in this RFP" implied participation in a process that included only those who were eligible to participate. The process that in fact ensued was therefore not the RFP referred to in the agreement, but a different and illegitimate process. Consequently the exclusion did not apply.

The majority considered this result – which was characterized by the minority as resting on a "strained and artificial interpretation" – to be reinforced by various other terms of the agreement, by the statutory context, and by the nature of the tendering process, particularly in the case of public procurement. As Justice Cromwell stated, "It seems unlikely, therefore, that the parties intended through this exclusion clause to effectively gut a key aspect of the approved process." He proceeded to note that other reported cases have involved exclusion clauses that, in the majority's view, were not at all ambiguous on this point, e.g. the clause in *Hunter Engineering* itself:

Notwithstanding any other provision of this contract or any applicable statutory provisions neither the Seller nor the Buyer shall be liable to the other for special or consequential damages or damages for loss of use arising directly or indirectly from any breach of this contract, fundamental or otherwise....

In any event, the majority held, the Province's exclusion of liability clause was at very least ambiguous, and on that basis alone – applying *contra proferentem* – Tercon's claim had to be upheld.

The minority view, as already noted, was that the majority had convinced itself that there was ambiguity where none in fact existed. It agreed with the B.C. Court of Appeal that "participation" in an RFP clearly included submitting a proposal in a process that involved an ineligible bidder. It appears to have considered this to be virtually self-evident and did not address the ambiguity and *contra proferentem* reasoning that its colleagues had offered in the alternative. It also rejected Tercon's arguments with respect to elements [2] and [3] of the test, finding that there was neither unconscionability or a public policy concern that would outweigh the public policy of enforcing freely negotiated contracts.

## What the decision means

The ruling is obviously highly significant in rejecting fundamental breach once and for all. However, the majority's position could be seen as bringing many of the same considerations in through the back door, if it is interpreted as meaning that the courts should be reluctant to interpret exclusion clauses in a manner that would exclude liability for breaches that go to the root of the agreement (i.e. because such an exclusion is unlikely to have been the

parties' intention). Nevertheless, it is clear – provided that the language used is sufficiently unambiguous and that the unconscionability and public policy tests are passed – that exclusion clauses can be as broad as the parties desire. Moreover, to the extent that the minority's view on the applicable law can be considered as having been adopted by the majority – something that is not entirely clear – it is useful to note that there is a good deal of generally applicable language in Justice Binnie's reasons strongly favouring the enforcement of contracts as made, regardless of concerns about "equity or reasonableness."

In general, providing that the applicability of the clause is clear, the ruling appears to suggest that Canadian common law courts have only a narrow jurisdiction to override contractual terms freely negotiated by parties and that, absent some compelling public policy reason (such as criminal conduct by the party claiming the benefit of the exclusion clause or egregious fraud), unambiguous exclusion clauses agreed to by sophisticated parties will likely be enforced. The most important thing to take from the ruling is that exclusion of liability clauses should be drafted with great care and with due attention to these reasons.

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## Court of Appeal for Ontario reformulates the test for assuming jurisdiction over foreign defendants

*Van Breda v. Village Resorts Ltd.*, 2010 ONCA 84, February 2, 2010

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A special five-member panel of the Court of Appeal for Ontario recently released its judgment in *Van Breda v. Village Resorts Ltd.* The ruling reconsiders and reformulates the test for determining when Ontario courts will assume jurisdiction over foreign defendants who are sued in Ontario.

### Jurisdiction and forum non conveniens before Van Breda

In *Morguard Investments Ltd. v. De Savoye*<sup>1</sup>, the Supreme Court of Canada moved away from traditional conflict-of-laws rules in favour of a more pragmatic approach to determining questions of jurisdiction centring on the principles of order and fairness, the need for judicial restraint and the existence of a "real and substantial connection" between the subject matter of the proceeding or the defendant and the forum. In a series of subsequent cases<sup>2</sup>, the Court of Appeal for Ontario clarified and provided guidance to courts as to how the "real and substantial connection" test should be applied in practice. In one of these, *Muscutt v. Courcelles*<sup>3</sup>, the Court of Appeal set out a non-exhaustive list of eight factors to be considered in assessing whether a real and substantial connection exists:

- i) The connection between the forum and the plaintiff's claim;
- ii) The connection between the forum and the defendant;
- iii) Unfairness to the defendant in assuming jurisdiction;
- iv) Unfairness to the plaintiff in not assuming jurisdiction;
- v) The involvement of other parties to the suit;
- vi) The Court's willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis;
- vii) Whether the case is interprovincial or international in nature; and
- viii) Comity and the standards of jurisdiction, recognition and enforcement prevailing elsewhere.

The *Muscutt* decision also set out a list of seven further factors to be considered, once jurisdiction was established, to determine if the Court should exercise its discretion not to assume jurisdiction in the matter in favour of another, more convenient forum. This *forum non conveniens* analysis included the following:

- i) The location of the majority of the parties;
- ii) The location of key witnesses and evidence;

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<sup>1</sup> *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 (C.A.).

<sup>2</sup> *Lemmex v. Bernard* (2002), 60 O.R. (3d) 54 (C.A.); *Sinclair v. Cracker Barrel Old Country Store Inc.* (2002), 60 O.R. (3d) 76 (C.A.); *Leufkens v. Alba Tours International Inc.* (2002), 60 O.R. (3d) 84 (C.A.); *Gajraj v. DeBernardo* (2002), 60 O.R. (3d) 68 (C.A.); *Muscutt v. Courcelles*, *supra* n. 1.

<sup>3</sup> *Morguard Investments Ltd. v. De Savoye* (1990), 76 D.L.R. (4<sup>th</sup>) 256 (S.C.C.).

- iii) Any contractual provisions that specify applicable law or accord jurisdiction;
- iv) The avoidance of a multiplicity of proceedings;
- v) The applicable law and its weight in comparison to the factual questions to be decided;
- vi) Geographical factors suggesting the natural forum; and
- vii) Whether declining jurisdiction would deprive the Plaintiff of a legitimate juridical advantage available in the Ontario Court.

## Reformulation of the *Muscutt* standard

The *Van Breda* appeal arose out of two separate actions in which foreign defendants with little or no presence in Ontario had been sued in the Ontario courts. Each action involved plaintiffs who had been injured while staying at vacation resorts in Cuba and who commenced proceedings in Ontario after returning home to Canada. In both instances, the lower courts found that Ontario had jurisdiction over most of the defendants in the action.

In upholding the rulings of the lower courts, the Court of Appeal took the opportunity to reformulate the *Muscutt* jurisdictional framework in light of eight years of subsequent jurisprudence on “real and substantial connection,” as well as the development of the model *Court Jurisdiction and Proceedings Transfer Act* (CJPTA) by the Uniform Law Conference. Justice Sharpe, writing for a unanimous Court, set out how the *Muscutt* analysis should now be applied by the courts.

The Court noted that the first step in assessing whether a “real and substantial connection” exists is to determine whether the claim falls under Rule 17.02 of the *Rules of Civil Procedure*, which sets out the circumstances in which a claim can be served on defendants outside of Ontario without leave of the courts. If one of the Rule 17.02 categories is engaged, then a real and substantial connection is presumed and the defendant bears the burden of showing that connection does not exist. If the Rule 17.02 categories are not engaged, then the plaintiff bears the onus of showing that a real and substantial connection exists. There are, however, two exceptions to this rule. The Court noted that the presumption will not operate where service outside the jurisdiction is based on (i) the plaintiff having suffered damages in Ontario (Rule 17.02(h)) or (ii) a foreign defendant being a necessary and proper party to a claim brought against defendants over whom Ontario has jurisdiction (Rule 17.02(o)).

At the second stage of the jurisdiction analysis, the central or core analysis of the reformulated *Muscutt* test is focused on the connections between (i) Ontario and the plaintiff’s claim and (ii) the defendant and Ontario, with a primary focus on the things that the defendant has done within the jurisdiction (though physical presence is not a requirement).

The Court proceeded to explain that the remaining *Muscutt* considerations are not independent factors of more or less equal weight, but rather are general legal principles that inform the overall jurisdictional analysis. For instance, what under the traditional understanding of *Muscutt* were separate considerations of fairness to the plaintiff and fairness to the defendant are now subsumed into a single analysis in which the concept of fairness is used to assess the “relevance, quality and strength” of the connections between the forum, the plaintiff’s claim and the defendant. As a consequence, fairness is not a free-standing factor capable of “trumping” weak connections. Similarly, considerations such as whether Ontario would recognize a foreign judgment rendered on the same jurisdictional basis, whether the matter is interprovincial or international in nature and general concerns of comity and the standards of recognition and enforcement prevailing elsewhere are no longer to be assessed as independent factors. Instead, they are to be treated as general principles of private international law that bear on whether a real and substantial connection exists.

Finally, the Court also stated that there is a residual discretion to assume jurisdiction even where there is no real and substantial connection to Ontario under the principle of “forum of necessity,” meaning that there is no other forum in which the plaintiff could reasonably litigate a claim.

## What the decision means

In the final analysis, the *Van Breda* decision stresses that the considerations and concerns that drive the analysis of the most convenient forum are separate and distinct from the matter of jurisdiction, and should therefore have no part to play in establishing whether Ontario has jurisdiction in a case. While it remains to be seen precisely what impact the *Van Breda* decision will have on the courts’ willingness to take jurisdiction over foreign defendants, it is clear that the Court of Appeal for Ontario has adopted a more streamlined approach to analyzing jurisdiction.