

Litigation - Canada

Supreme Court of Canada delivers landmark decision on contractual interpretation

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Introduction

The Supreme Court of Canada's decision in *Sattva Capital Corp v Creston Moly Corp*⁽¹⁾ is a watershed moment in the law of contractual interpretation. The Supreme Court unanimously abandoned the historical approach to contract interpretation and determined that it now "involves issues of mixed fact and law as it is an exercise in which the principles of contract interpretation are applied to the words of the written contract, considered in light of the factual matrix".⁽²⁾

Before *Sattva* there was some doubt as to the appropriate appellate standard of review regarding contractual interpretation. Historically, the courts had viewed this as a pure question of law, thus attracting a correctness standard. More recent cases (although not uniformly) adopted a 'contextual' approach that sometimes meant that the issue was one involving mixed fact and law and a more deferential reasonableness standard.

Appellate courts must now generally defer to trial judges and other decision makers at first instance on matters of contractual interpretation, unless the issue is limited to a pure question of law. As such, the standard of review to such appeals has changed to one of reasonableness, and the decision also suggests that it may be more difficult to appeal commercial arbitral awards because most appeals are restricted to questions of law (except where the parties' arbitration agreement states otherwise).

Facts

Sattva Capital Corporation introduced Creston Moly Corporation to an opportunity to acquire a mining property in Mexico. The parties entered into a finder's fee agreement under which Sattva Capital was entitled to be paid the fee of US\$1.5 million in the form of Creston Moly shares. A dispute arose regarding which date should be used to determine the price of the shares.

Sattva Capital took the position that the share price was based on the date set out in the 'market price' definition in the agreement and, as a result, it was entitled to approximately 11,460,000 shares at US\$0.15 a share. Creston Moly argued that the agreement's maximum amount clause prevented Sattva Capital from receiving shares valued at more than US\$1.5 million on the date when the finder's fee was payable. Under Creston Moly's interpretation, Sattva Capital was entitled to some 2,454,000 shares at US\$0.70 a share.

The parties agreed to resolve the dispute by way of arbitration pursuant to the British Columbia Arbitration Act.⁽³⁾ The arbitrator agreed with Sattva Capital and based his decision on the definition of 'market price'.

Creston Moly sought leave to appeal, and the British Columbia Supreme Court denied the application for leave. According to the application judge, the question on appeal was not a question of law, as was required under the Arbitration Act, but rather a question of mixed fact and law since the arbitrator relied on the surrounding circumstances in determining how the finder's fee was to be paid.

The British Columbia Court of Appeal reversed the lower court's decision and granted leave to appeal the arbitral award. The appeal court held that the arbitrator's failure to address the meaning of the maximum amount clause in the agreement raised a question of law which could be the subject of appeal, and sent the matter back to the lower court for a decision on the merits.

The British Columbia Supreme Court reviewed the arbitrator's decision on the standard of correctness and determined that the plain and ordinary meaning of the agreement provided that the finder's fee was to be paid in shares priced at US\$0.15 a share. The court held that the arbitrator's

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decision was correct.

The British Columbia Court of Appeal again reversed the lower court's decision, finding that the arbitrator had reached an absurd result. The appeal court applied the standard of correctness and found that the maximum amount clause in the agreement should be given overriding effect. Sattva Capital appealed to the Supreme Court.

Common issues in contract interpretation cases

The Supreme Court's decision in *Sattva* dealt with three issues that commonly arise in cases dealing with contract interpretation.

Contractual interpretation involves questions of mixed fact and law: standard of review is reasonableness

The Supreme Court reinstated the arbitrator's award and held that the valuation date of the Creston Moly shares was an issue of contractual interpretation that raised a question of mixed fact and law. The Arbitration Act limits appeals to questions of law, and therefore the appeal court erred in finding that the interpretation of the agreement constituted a question of law.

Traditionally, the determination of the legal rights and obligations under a contract was considered to be a question of law based on the view that, historically in England, illiteracy was common and only the judge could be assured to be literate and capable of reading and understanding the written contract. In *Sattva* the Supreme Court recognised that this approach was outdated and some Canadian courts were already treating the interpretation of contracts as an exercise of mixed fact and law.⁽⁴⁾

The Supreme Court's abandonment of the historical approach was based on two developments. First, "the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction".⁽⁵⁾ The primary objective in contract interpretation is to determine the intention of the parties. According to the Supreme Court, "a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract".⁽⁶⁾

Second, the historical approach to contractual interpretation is not easily reconcilable with the definition of pure questions of law as enumerated in *Canada (Director of Investigation and Research) v Southam Inc*⁽⁷⁾ – namely, "questions about what the correct legal test is".⁽⁸⁾ Contractual interpretation is a fact-specific inquiry. The goal is ultimately to understand the objective intention of the parties, and this exercise is generally a question of mixed fact and law, explained in *Housen v Nikolaisen*⁽⁹⁾ as "applying a legal standard to a set of facts".⁽¹⁰⁾

However, the decision in *Sattva* was not limited to appeals of arbitration awards. In *Sattva* the Supreme Court took the opportunity to clarify the law of contractual interpretation, which is now generally an issue of mixed fact and law whereby the principles of contractual interpretation are applied to the parties' bargain in the context of the "surrounding circumstances".⁽¹¹⁾ Thus, in most circumstances, the standard of review is reasonableness, not correctness; although there may be instances in which a pure question of law can be extricated from the interpretative process, the Supreme Court noted that such cases would be rare⁽¹²⁾ but would include "the application of an incorrect principle, the failure to consider a required element of a legal test, or the failure to consider a relevant factor".⁽¹³⁾ Such errors will still be reviewed by an appellate court on a correctness standard. The Supreme Court further added that the requirements of contract formation still engage substantive rules of law, including issues of capacity and that certain contracts be evidenced in writing.⁽¹⁴⁾

Surrounding circumstances have role in questions of contractual interpretation

As noted above, the Supreme Court confirmed in *Sattva* that "the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction".

Under the common law tradition, the factual matrix or surrounding circumstances is considered in interpreting the terms of a contract. The Supreme Court stated that:

"[t]he goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract."⁽¹⁵⁾

While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement.⁽¹⁶⁾

The nature of the surrounding circumstances will vary from case to case. However, the Supreme Court concluded that such evidence had its limits and it should consist only of objective evidence of the background facts at the time the contract was executed. This would limit the facts to what was known by both parties at the time of contracting. Subject to these limitations, the factual matrix or surrounding circumstances can include "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable [person]".⁽¹⁷⁾

Parole evidence rule does not preclude evidence of surrounding circumstances

Finally, the Supreme Court determined that consideration of the surrounding circumstances does not violate the parole evidence rule. As a matter of contractual interpretation, the parole evidence rule

precludes a party to a written contract from relying on extrinsic evidence that would effectively modify a contract that has been committed to writing. The parole evidence rule would, for example, prohibit evidence of the parties' subjective intentions. The parole evidence rule operates to achieve certainty in contractual obligations and to prevent a party from using false or unreliable evidence to challenge a written contract.⁽¹⁸⁾

According to the Supreme Court:

"[t]he parole evidence rule does not apply to preclude evidence of the surrounding circumstances. Such evidence is consistent with the objectives of finality and certainty because it is used as an interpretive aid for determining the meaning of the written words chosen by the parties, not to change or overrule the meaning of those words."⁽¹⁹⁾

Further, the Supreme Court noted that surrounding circumstances are facts that are known or reasonably ought to be known by both parties at or before the time of contracting. Therefore, concerns of unreliability do not arise.⁽²⁰⁾

Comment

Sattva stands for the proposition that contractual interpretation generally involves issues of mixed fact and law. The Supreme Court departed from the historical position that the interpretation of a contract is a question of law. *Sattva* will likely have significant implications as, moving forward, appellate courts must grant deference to trial judges in cases involving contractual interpretation.

The Supreme Court also reiterated important principles of contractual interpretation and clarified the role of the surrounding circumstances. In this latter regard, *Sattva* adopted an expansive approach to the surrounding circumstances and underscored the contextual nature of contractual interpretation.

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Endnotes

(1) *Sattva Capital Corp v Creston Moly Corp*, 2014 SCC 53. Ms Soucy has recently argued the application of *Sattva* in the context of a commercial lease case before the Court of Appeal for Ontario in *2249778 Ontario Inc v Smith*, 2014 ONSC 93. The reasons and decision of the Court of Appeal for Ontario have not yet been released, although further guidance on the application of *Sattva* is anticipated in the decision.

(2) *Ibid* at para 50.

(3) Arbitration Act, RSBC 1996, c 55.

(4) *Sattva*, *supra* note 1 at para 45.

(5) *Ibid* at para 47.

(6) *Ibid*.

(7) *Canada (Director of Investigation and Research) v Southam Inc*, [1997] 1 SCR 748, 144 DLR (4th) 1, 1996 CarswellNat 368.

(8) *Sattva*, *supra* note 1 at para 49, citing *Southam*, *ibid* at para 35.

(9) *Housen v Nikolaisen*, 2002 SCC 33, [2002] 2 SCR 235, 2002 CarswellSask 178.

(10) *Sattva*, *supra* note 1 at para 49, citing *Housen*, *ibid* at para 26.

(11) *Sattva*, *supra* note 1 at para 50.

(12) *Ibid* at para 55.

(13) *Ibid* at para 53.

(14) *Ibid* at para 53.

(15) *Ibid* at para 57.

(16) *Ibid* at para 58.

(17) *Ibid* at para 58, citing *Investors Compensation Scheme Ltd v West Bromwich Building Society*, [1998] 1 All ER 98 at 114.

(18) *Sattva*, *supra* note 1 at para 59.

(19) *Ibid* at para 60.

(20) *Ibid* at para 60.

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