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Commercial Litigation Update

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This newsletter is designed to bring news of changes to the law, new law, interesting decisions and other matters of interest to our commercial litigation clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Commercial Litigation group:

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IN THIS ISSUE:

"The Supreme Court in Sattva implicitly accepted the Ontario Court of Appeal's approach by adopting the factual matrix as an essential tool in contract interpretation, even in cases where there is not necessarily an ambiguity in the written contract."

WRITTEN IN STONE? THE SUPREME COURT OF CANADA SOLIDIFIES THE USE OF THE FACTUAL MATRIX IN CONTRACT INTERPRETATION CASES

Catherine MacInnis and Aaron Grossman

The goal of contract interpretation is to determine the intention of the parties at the time that they entered into the contract. The intention is to be determined on an objective basis (what the written contract means to reasonable people reading it), not a subjective basis (what each party individually thought they were agreeing to). There has been much ink spilled in the Commonwealth on the issue of whether or not factual circumstances surrounding the formation of a contract (often referred to as the "factual matrix") ought to be considered by a court when there is a dispute about the meaning of a written agreement. A recent decision of the Supreme Court has provided courts guidance on how to go about determining the parties' objective intention.

Background

This past summer, the Supreme Court of Canada released a unanimous decision in *Sattva Capital Corp v. Creston Moly Corp.* ("*Sattva*"), which solidified the use of the factual matrix in contract interpretation cases in Canada, and will ultimately limit the number of appeals from most arbitral awards. In the process, the Supreme Court of Canada has changed how trial and appellate courts across Canada will approach contract interpretation cases generally.

At issue in *Sattva* was the amount of a finder's fee owing to Sattva Capital Corp. by the defendant, Creston Moly Corp, in relation to the acquisition of a mining property. The *Sattva* decision was made in the context of an appeal from the decision of an arbitrator in British Columbia, but will have broad implications on contract disputes throughout Canada, whether being tried in arbitration hearings or before the courts.

Contract Interpretation and the Factual Matrix

In *Sattva*, the Supreme Court re-affirmed (from its previous decisions in *Eli Lilly v. Novapharm* and *Consolidated-Bathurst v. Mutual Boiler*), that the goal of contractual interpretation is to ascertain the intent of the parties at the time when the contract is entered into. *Sattva* added a new element to this exercise, requiring the trial judge to consider the circumstances surrounding the formation of the contract - such as the purpose of the contract, the background to the agreement and the relationship between the contracting parties.

The Supreme Court provided some guidance to courts on how to go about determining intention, and stated that the "factual matrix" is comprised of "objective evidence of the background facts at the time of the execution of the contract, that is, knowledge that was or reasonably ought to have been within the knowledge of both parties…" This "factual matrix" cannot be used to re-write the contract but a trial judge must consider it when interpreting a contract to ensure consistency between the

COMMERCIAL LITIGATION UPDATE

"[A]fter Sattva ... it will be much more difficult to appeal from contract cases..."

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written words of the contract and the intentions of the parties.

In the case of written agreements, evidence which purports to modify the meaning of a written contract cannot be considered by a trial judge hearing the case - this is known as the "parole evidence rule." Previously, the Supreme Court had allowed evidence of the factual matrix to be heard as an exception to the parole evidence rule, but limited the use of such evidence to cases where some ambiguity existed in the written words of the contract. The Ontario Court of Appeal had previously released several decisions modifying this approach and requiring that the factual matrix always be considered when interpreting a contract.

The Supreme Court in *Sattva* implicitly accepted the Ontario Court of Appeal's approach by adopting the factual matrix as an essential tool in contract interpretation, even in cases where there is not necessarily an ambiguity in the written contract. The result will be that trial judges will have a greater discretion to determine the true meaning of the contracts before them in the context of the relationship between the parties and the facts that existed at the time the parties signed the agreement. This may assist parties in obtaining relief from overly harsh contract provisions in certain agreements, but for the reasons set out below, will also make it more difficult for parties to appeal from arbitration and lower court decisions on issues of contract interpretation.

Standard of Review and Contract Interpretation

Generally speaking, commercial actors enter into arbitration to avoid the cost and delay associated with the traditional civil justice system, as well as to maintain a certain level of privacy – since unlike court proceedings, the information disclosed in arbitrations may be kept confidential. However, in recent years, more and more parties have been appealing arbitration decisions to traditional courts. This has the effect of diminishing the efficiencies of the arbitration process. The Supreme Court of Canada in *Sattva* seems intent on reversing this trend – and limiting the number of appeals from contract cases more generally.

The Supreme Court has done this by bonding the factual matrix to contract interpretation. Put simply: when any appellate court receives an appeal from either a lower court or an arbitration alleging that there was an improper factual finding, it will now defer to the decision maker (i.e. the lower court or arbitrator). This is because the Supreme Court has reclassified contract interpretation not as an issue of law, but as an issue of mixed fact and law. Whereas there is no deference given by an appeal court to a lower court on issues of law, deference is given on issues of mixed fact and law. This is because the decision maker has access to the best factual evidence – usually having seen witnesses give live testimony. Therefore, by stating that a court can and should interpret contracts within the factual matrix in every case, the court turned the exercise of interpreting a contract (an issue traditionally seen as a legal one), to a factual one (making findings relating to the factual matrix).

Traditionally, appeals involving contract interpretation were thought to be based on errors of law. The Honourable Justice Rothstein in *Sattva* sets out the historical rationale for this:

> "This rule originated in England at time when there were frequent civil jury trials and widespread illiteracy. Under those circumstances, the interpretation of written documents had to be considered questions of law because only the judge could be assured to be literate and therefore capable of reading the contract."

"A fundamental objective of class actions is to provide enhanced access to justice ... [However,] 'access to justice, even in an area that was specifically designed to achieve this goal, is becoming too expensive.'"

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The Supreme Court went on to state that this rationale no longer applies and that given that the overriding concern in contract interpretation cases is to determine the intent of parties to individual contracts, including a consideration of the factual matrix – contract interpretation as a rule is highly fact-specific. Accordingly, after *Sattva* most cases of contract interpretation will be treated as being issues of mixed fact and law. The result is that it will be much more difficult to appeal from contract cases generally. Appeals will likely only be allowed in the context of a clear error of law, where the principal at issue has wider application to the law in general rather than only application to the particular parties involved in the case being decided.

Conclusion

As a result of the *Sattva* decision, cases involving contractual interpretation will become less predictable (due to the inclusion of the factual matrix) and also more difficult to appeal. The benefit is hopefully fewer appeals, resulting in cases being brought to finality more quickly and at less cost. The decision re-enforces the importance of the trial and the oral evidence provided by the contracting parties. As a result, commercial parties are well advised to refer their contract interpretation cases to experienced and well prepared trial counsel. ■

LOWER COST AWARDS IN CLASS ACTIONS: WHAT DOES IT MEAN FOR ACCESS TO JUSTICE?

Alexandra Teodorescu

The general rule in civil cases is that "costs follow the event." In other words, the losing party pays a portion of the legal costs of the successful party. This rule also applies to class actions and is codified in section 31 of the *Class Proceedings Act, 1992*.

Despite parallel rules regarding costs, ordinary civil actions are quite different from class actions. A fundamental objective of class actions is to provide enhanced access to justice. One way class proceedings achieve this goal is by eliminating legal costs for representative plaintiffs and class members. Generally, class counsel act on a contingency fee basis and indemnify plaintiffs against adverse cost orders. In class actions, the risks of litigation are transferred from the client to the lawyer, making it easier and more affordable for individuals to access the legal system.

However, access to justice is undermined when class counsel are deterred from bringing meritorious actions by the risk of extremely high adverse cost awards. For example, in *Martin v. AstraZeneca Pharmaceuticals PLC*, plaintiff's counsel was on the hook for a $700,000 costs award after an unsuccessful motion to certify a claim as a class action. The costs order in *Martin* is particularly significant given the fact that the goal of certification is to determine if, procedurally, the case should be brought as a class action; the merits of the claim are not seriously considered on a motion for certification.

Justice Belobaba on Costs

In 2013, Justice Belobaba of the Ontario Superior Court of Justice released five costs decisions in which he criticized lawyers for filing voluminous materials, over-litigating issues and unnecessarily lengthening proceedings (*Brown v. Canada (Attorney General)*, *Sankar v. Bell Mobility*, *Crisante v. DePuy Orthopaedics*, *Dugal v. Manulife* and *Rosen v. BMO Nesbitt Burns*). The result, he states, is clear: "access to justice, even in an area that was specifically designed to achieve this goal, is becoming too expensive."

COMMERCIAL LITIGATION UPDATE

"The prospect of lower adverse cost orders could mean less risk for lawyers pursuing class action claims on behalf of their clients."

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In an effort to enhance access to justice and ascribe transparency to the decision-making process, Justice Belobaba developed a procedure for determining the costs of a certification motion. Justice Belobaba stated that he would generally accept costs outlines at face value, apart from obvious excesses in fees or disbursements, and would not require either side to submit actual dockets, time entries or disbursement receipts. He further stated that should the unsuccessful party want to argue that the successful party's cost submissions are unreasonable, it should submit its own costs outline. Finally, Justice Belobaba stated that he would consider historical costs awards in similar cases.

Justice Belobaba's procedure for calculating costs will likely lead to more modest cost orders. Justice Belobaba stated that he hopes his guidelines will result "in leaner and more focused certification motions, a greater measure of predictability for the participants, and in the overall, the continuing viability of the class action vehicle."

Practical Implications

The effect of Justice Belobaba's decisions on access to justice has yet to be seen. On the one hand, lower cost awards may have the desired effect of enhancing access to justice. The prospect of lower adverse cost orders could mean less risk for lawyers pursuing class action claims on behalf of their clients. Furthermore, third party investors may be more willing to help class counsel finance prospective class actions.

On the other hand, some members of the class actions bar have suggested that decreased costs could have a detrimental effect on access to justice. The certification motion, they argue, is a significant hurdle that, in practice, requires class counsel to invest considerable time and money to prove that the action is best prosecuted as a class proceeding. Well-resourced defendants often engage in "kitchen sink" tactics when opposing certification, and it is unclear whether a lower costs regime will curtail this practice. Without the possibility of recuperating at least a modest amount of their costs, plaintiffs' counsel may be more cautious in bringing class action law suits and agreeing to indemnify plaintiffs against adverse costs awards.

Defendants say that a more streamlined and conservative costs regime will increase the financial risks of litigation. Lower cost awards may mean that defendants will have to deal with more unmeritorious claims. Furthermore, defendants who are forced to litigate potentially questionable actions will recover less of their costs if they are successful in defending the certification motion. Without financial consequences for unsuccessful plaintiffs, defendants may be held captive by protracted litigation.

Towards a "No Costs" Rule?

In the five costs decisions outlined above, Justice Belobaba advocates against awarding costs in class proceedings all together. Similarly, in *Bayens v. Kinross Gold Corporation*, Justice Perell of the Ontario Superior Court of Justice questioned whether the loser-pays regime is applicable to class actions. In contrast to Ontario, there is a "no costs" rule in British Columbia, Saskatchewan, Manitoba and Newfoundland.

The Law Commission of Ontario is currently reevaluating the traditional cost rules as they apply to class actions. The Commission is particularly alive to concerns that adverse cost awards may frustrate access to justice. Whether the Legislature will adopt Justice Belobaba's cost guidelines or elect to implement a "no costs" regime remains to be seen. What is clear is that the Commission's recommendations on adverse costs will shape litigation strategies and equally impact plaintiffs, defendants and third party funders. ■

COMMERCIAL LITIGATION UPDATE

"A joint and several debt is payable by any of the debtors, and each can be liable for the full amount."

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JOINT DEBTS, JOINT TENANTS - INSOLVENCY LAW MEETS REAL PROPERTY LAW

Ivan Y. Lavrence

The decision of the Court of Appeal in *TD Bank v. Phillips* [2014 ONCA 613] involves a separated couple, their joint asset, a joint debt, and an outcome that is anything but, thanks to creditor protection afforded by the *Bankruptcy and Insolvency Act* ("*BIA*"). This decision highlights some of the intricacies of these legal areas, and a reminder that the consequences of legal decisions may not always be apparent.

The Facts

The Bank of Montreal ("BMO") granted a line of credit to Mr. Phillips, guaranteed by Mrs. Phillips. After default, BMO obtained judgment and filed a writ of seizure and sale in late 2012 to enforce the judgment. Mr. and Mrs. Phillips subsequently separated. Mrs. Phillips then filed a proposal to her creditors under the *BIA* to compromise her debts, which proposal was accepted by her creditors on March 18, 2013. BMO received partial payment under its judgment and writ as a dividend, but was not made whole under the accepted *BIA* proposal.

This settled state of affairs was upended when the Phillips' home was sold under power of sale by TD Bank, resulting in an unanticipated surplus ($52,295.14). The question before the Court in this case was simple: was that surplus to be paid to Mr. Phillips, Mrs. Phillips, or BMO pursuant to its judgment and writ? TD paid the surplus into court and exited, stage left.

Mr. and Mrs. Phillips settled BMO's claim for an additional payment of $19,327.50 out of the surplus proceeds of sale of the home, leaving them to fight over the remaining $32,217.64. Mr. Phillips argued that the remaining funds should be split equally, being payment of a joint debt, out of a joint asset. Mrs. Phillips argued that the *initial* surplus of $52,295.14 was to be divided equally, and that the BMO payment should come out of Mr. Phillips' share alone (resulting in most of the funds being payable to her). They had agreed that the payment to BMO was "without prejudice" to these positions.

The Court's Reasoning

The Court of Appeal sided with Mrs. Phillips, applying the *BIA*, the *Mortgages Act* and common law rules surrounding real property.

Mrs. Phillip's proposal under the *BIA* had a similar effect to an assignment into bankruptcy: pursuant to section 69.1 of the *BIA*, all claims, actions and enforcement proceedings against her were forever stayed (stopped). This included BMO's judgement and writ.

BMO could not execute on its judgment and writ against Mrs. Phillips; but it could still execute against Mr. Phillips, and the writ still attached to *his* interest in the property. This made BMO a "subsequent encumbrancer" within the meaning of under the *Mortgages Act*, which requires payment of "amounts due to the subsequent encumbrancers according to their priorities" (s.27).

But enforcement against Mr. Phillips' interest alone still did not settle the issue.

He correctly argued that an enforcement of his debt alone would still result in an equal division, *if the execution was taken against real property held in "joint tenancy."* At common law, a joint tenant has a right to the entire property, or possibly none of the property - since the *other* joint tenant *also* has a right to the entire property. To quote the obligatory latin, *totem tenet et nihil tenet*: a joint tenant holds everything and

"This decision emphasizes that joint debtors may be treated differently ... where one invokes the protection of the BIA (or similar insolvency statute), the remaining debtor(s) could be left with the entire liability, as happened in this case."

nothing. A tenant in common, on the other hand, has a fixed share of the property. If BMO's execution was made against one *joint tenant*, it would be taken against the *undivided property of both tenants* (despite the stay against Mrs. Phillips). The joint tenants would share the residue equally. BMO's execution against a *tenant in common*, on the other hand, would only be taken from Mr. Phillips' fixed share, leaving Mrs. Phillips' residue intact (because her proposal had resulted in her debt to BMO being discharged).

The issue became: "Was there a joint tenancy or was it severed?" Joint tenancies require unity of title, time and possession and interest. Should any of these unities be broken (intentionally or otherwise), the joint tenancy will be severed and a tenancy in common created.

Did the *BIA* proposal sever the joint tenancy? No. An assignment in bankruptcy can have this effect, since the debtor's property is assigned to the Trustee (breaking unity of title). In a proposal under the *BIA*, on the other hand, Mrs. Phillips' assets remained vested in her.

Did BMO's execution sever the joint tenancy? Yes. An execution can have this effect, if the creditor goes further than just filing a writ and takes a step to enforce the writ (breaking unity of interest). The Court found that BMO's actions, appearing in court to contest the matter and receiving a payment pursuant to a "without prejudice" settlement with Mr. and Mrs. Phillips, were sufficient to constitute an execution of the writ.

What is curious is that the court did not consider the *timing* of BMOs "action." In real property law, emphasis is placed on timing (prior registration governs and trumps a later interest – including payment of surpluses under s. 27 of the *Mortgage Act*). Had the Court considered the existence of a joint tenancy *at the time of the sale*, which was prior to BMO's enforcement "action," the result would have been different.

In the end, however, the joint tenancy was severed and BMO's payment was taken from Mr. Phillips' fixed share of the tenancy in common. Mrs. Phillips received her share in full.

The Lessons to be Learned

What lessons can we learn from this decision?

- This decision emphasizes that joint debtors may be treated differently. A joint and several debt is payable by *any* of the debtors, and each can be liable for the full amount. Thus, where one invokes the protection of the *BIA* (or similar insolvency statute), the remaining debtor(s) could be left with the entire liability, as happened in this case.

- The Court did not address the agreement between Mr. and Mrs. Phillips that payment to BMO was "without prejudice" to their positions. Although unstated, this is consistent with the rule that parties cannot contract out of the *BIA*, which is for the benefit of *all* creditors.

- The "unfairness" from this decision appears to be that while Mrs. Phillips keeps *her* share of the joint asset, Mr. Phillips' share was taken. Which raises the question: was "equity" considered? While the courts have broad powers to apply equity as well as law, the Court correctly notes that equity cannot override the statutory scheme in the *BIA*. On the other hand, the initial debt was Mr. Phillips' debt – maybe the decision was intended to be "fair" after all.

COMMERCIAL LITIGATION UPDATE

- Finally, "joint tenancies" and "tenancies in common" are different. On the death of a joint tenant, the property passes to the surviving tenant without falling into the estate (avoiding attachment by creditors and estate taxes). Not so in the case of a tenant in common. Should a joint tenancy be severed unintentionally during legal manoeuvers, as happened to Mr. and Mrs. Phillips, the surviving spouse's interest can be compromised if the spouses were counting on joint tenancy rules to protect the surviving spouse. ■

POLYZOGOPOULOS JOINS OBA SECTION EXECUTIVE

Blaney McMurtry LLP

Commercial Litigation Update editor, John Polyzogopoulos, has been elected to the Executive of the Commercial Litigation Section of the Ontario Bar Association (OBA) for the 2014-15 term. John will also serve as the co-editor of the Section's newsletter. ■

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Blaneys Ontario Court of Appeal Summaries (or Blaneys OCA Blog for short) is now live. The blog offers weekly summaries of all decisions released by the Court of Appeal for Ontario (other than criminal law decisions).

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