

Supreme Court Re-Opens the Door to Appeals on Questions of Contractual Interpretation: *Ledcor*, *Sattva* and the Interpretation of Standard Form Contracts

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Introduction

On September 15, 2016, the Supreme Court of Canada released its much anticipated decision in *Ledcor v. Northbridge Indemnity Insurance Company*. In its reasons, the Court assessed the scope of coverage under an insurance policy. In clarifying the standard of review that appellate courts should apply when interpreting standard form contracts, the *Ledcor* decision is of considerable importance not just to insurance law, but to contract law generally. Following *Ledcor*, appellate courts are no longer required to be deferential to the decisions of lower courts when interpreting the meaning of standard form contracts, whether they be banking, commercial, consumer or other standard form contracts. The result of *Ledcor* is that it should now be easier for parties involved in a dispute over the interpretation of a standard form contract to get meaningful appellate review.

The Facts of *Ledcor*

Bristol was retained to clean the windows of a newly constructed office tower in Edmonton. During the cleaning, Bristol scratched the windows by using inappropriate tools and cleaning methods. The windows had to be replaced at considerable expense. The owner of the building sought to recover the cost of the new windows under its Builders Risk insurance policy. The insurer denied coverage, relying on an exclusion clause in the policy.

The Alberta Court of Queen's Bench concluded that Bristol's work constituted "workmanship" and that it had been faulty, but that the policy's "faulty workmanship" exclusion was not broad enough to exclude the damage to the windows from coverage. The Court reasoned that the exclusion clause was ambiguous and thus it applied the *contra proferentem* rule against the insurers. That rule provides that if the meaning of a contractual term is ambiguous, it will be interpreted against the interest of the party that drafted the clause. Since the insurer drafted the insurance policy, the exclusion clause was interpreted in favour of the insured owner of the tower and against the insurer.

The Alberta Court of Appeal reversed this decision and declared that the damage to the tower's windows was excluded from coverage. In doing so, it applied a correctness standard of review to the interpretation of the exclusion clause. Under the correctness standard, a court will overturn a decision if it disagrees with the lower court's decision. Such a standard is thus not deferential and allows an appellate court to substitute its own decision for that of the lower court. The Alberta Court of Appeal's decision to apply the correctness standard seemed to conflict with the Supreme Court's 2014 decision in *Sattva Capital Corp. v. Creston Moly Corp.* In *Sattva*, the Supreme Court ruled that for questions of contractual interpretation, appellate courts should not apply the standard of review of correctness, but rather the "palpable and overriding" or "reasonableness" standard of review because issues of contract interpretation were not pure questions of law and instead questions of mixed fact and law. Under that more deferential standard, it is not enough for an appellate court to conclude that it would have decided the case differently in order to set aside the lower court's decision. Under the deferential standard, an appellate court will only overturn a lower court's decision if it finds that the lower court's decision was unreasonable and not within a range of acceptable outcomes.

The Supreme Court's decision in *Sattva* had created quite a debate among the bench and bar when it was released in 2014. The decision appeared to have overturned hundreds of years' worth of common law precedent which had long held that issues of contractual interpretation were issues of law to be reviewed on appeal on a standard of correctness (*i.e.* no deference). *Sattva* was seen by many as potentially sounding the death-knell of appeals involving contract cases. Since *Sattva* was released, several decisions of provincial courts of appeal took issue with the deferential *Sattva* standard and distinguished that case and applied a correctness standard to issues of contractual interpretation. The Alberta Court of Appeal's decision in *Ledcor* was one such decision.

The Supreme Court's Decision in *Ledcor*

Having lost at the Alberta Court of Appeal, the owner of the tower in *Ledcor* appealed to the Supreme Court of Canada. Before the Supreme Court, the owner was successful in setting aside the Alberta Court of Appeal's judgment and restoring the trial judge's judgment in favour of the owner. The Supreme Court agreed that that trial judge's interpretation of the exclusion clause was correct.

In coming to its decision, the Supreme Court took the opportunity to revisit and clarify its decision in *Sattva*. The Court recognized an exception to *Sattva* that contractual interpretation is a question of mixed fact and law subject to deferential review on appeal. The *Ledcor* Court cautioned that its statements in *Sattva* on the standard of review of contractual interpretation must be considered in their full context. *Sattva* concerned a complex commercial agreement negotiated between two sophisticated parties - as opposed to a standard form contract - and thus did not consider the unique issues that standard form contracts raise.

The *Sattva* Court had given two reasons as to why contractual interpretation was a question of mixed fact and law subject to deferential review on appeal:

- (i) the underlying “factual matrix” (*i.e.* that the surrounding circumstances of the making and purpose of a contract, the industry in question and other facts are important considerations in interpretation), and
- (ii) that contractual interpretation does not fit within the definition of a pure question of law.

In finding that the appropriate standard of review in the interpretation of standard form contracts was correctness, the *Ledcor* Court reasoned that the two factors explored in *Sattva* were not as relevant when reviewing standard form contracts.

(i) “Factual Matrix”

In *Ledcor*, the Court reasoned that the “factual matrix” factor carries less weight in cases involving standard form contracts. While a proper understanding of a contract’s factual matrix will always be integral to the interpretation of that contract, the Court reasoned that it is particularly less relevant for standard form contracts given that the parties do not negotiate the terms. It reasoned that, whereas the terms and conditions of contracts are negotiated and bargained for, standard form contracts are typically put to the receiving party as “take-it-or-leave-it” propositions. As a result, while factors such as the contract’s purpose, the nature of the relationships between the parties and the market or industry in which it operates should be considered when interpreting a standard form contract, these contracts are typically not inherently fact-specific and instead are usually uniform across all parties to such standard form contracts. As a result, the factual matrix factor is not paramount to the analysis of a standard form contract.

(ii) “Question of Law”

The *Sattva* Court had found that when interpreting contracts, Canadian courts apply the legal principles of contractual interpretation to determine the parties’ objective intentions. Thus, according to *Sattva*, contractual interpretation is a question of mixed fact and law, defined as “applying a legal standard” (the legal principles of contractual interpretation) “to a set of facts” (the words of the contract and the factual matrix). The *Ledcor* Court, however, found that while contractual interpretation is generally a question of mixed fact and law, in situations involving

standard form contracts, it is more appropriately classified as a question of law in most circumstances.

The Court reasoned that appellate courts typically need not review for correctness the interpretation given by a lower court to a non-standard form contract because decisions on such contracts generally have no impact beyond the parties to the dispute. In other words, in contracts negotiated between the parties, the precedents arising out of the interpretation of such contracts are, at best, of marginal persuasive value for future cases. There is therefore no need to review them on the more stringent correctness standard. On the other hand, standard form contracts are “highly specialized contracts that are sold widely to customers without negotiation of terms”. As a result, interpretations of standard form contracts have precedential value and can therefore fit under the definition of a pure question of law. Otherwise, it would be open to courts to interpret identical or very similar standard form provisions inconsistently, which would lead to uncertainty in the law.

It should be noted that Justice Cromwell dissented from the majority position in *Ledcor* and was of the view that the deferential *Sattva* standard of review should apply even to standard form contracts.

Implications of *Ledcor*

The Court in *Ledcor* acknowledged that there may be circumstances in which a standard form contract may nonetheless continue to attract the *Sattva* deferential standard of review on appeal. A deferential standard may apply, for example, where the standard form contract is specific to the particular parties or where amendments or additions to the standard form were negotiated by the parties. The result of this acknowledgement could be that two different standards of review could apply to the same contract. “Standard form” language would attract a less deferential “correctness” standard, whereas negotiated or custom portions of the same contract could attract the more deferential *Sattva* standard of review. The key question for counsel and their clients in considering an appeal on a question of contractual interpretation will now be: are the contractual provisions in question “standard form”?