Supreme Court of Canada Continues to Shape Contractual Interpretation Around Common-Sense Pragmatism

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Introduction

On May 31st, 2024, the Supreme Court of Canada (**SCC**) released a decision, *Earthco Soil Mixtures Inc. v. Pine Valley Enterprises Inc.*,[1] that affirmed the principles of contractual interpretation it set out in *Tercon* and *Sattva*.[2]

This 6-1 decision clarifies the manner parties can contract out of (i.e., override) certain statutorily implied terms. Specifically, the SCC addressed whether exclusionary clauses can override the implied conditions and warranties from Ontario's *Sale of Goods Act* (**SGA**),[3] and if so, what the language and wording requirements are for such clauses.

The SCC held that parties do not need to use any particular "magic words" or technical legal language for exclusion clauses to be given effect. Instead, courts should look at the objective intentions of the parties to assess whether they have agreed to contract out of statutory terms. This decision continues the evolution of contractual interpretation emphasizing a common-sense, practical, and pragmatic approach.

Legislative Framework

A sale of goods contract is an agreement between a seller and a buyer where goods are transferred in exchange for monetary consideration.[4] Such contracts are governed by a SGA,[5] with each province's laws being similar and generally sharing the same language and framework.[6] As such, while the SCC considered Ontario's SGA, this case will apply across Canada, including Alberta.

Background

The City of Toronto hired Pine Valley Enterprises Inc. (**Pine Valley**), a municipal parks contractor, to address flooding issues, which required topsoil with a specific chemical composition. Pine Valley approached Earthco Soil Mixtures Inc. (**Earthco**) to purchase the topsoil. Six weeks before the purchase, Pine Valley tested Earthco's topsoil and its composition matched Pine Valley's needs. Earthco advised Pine Valley that topsoil composition can change over time, and that tests ought to be done as close to purchase as possible. Pine Valley forwent additional tests due to time constraints.

As the topsoil was not going to be retested, Earthco added two exclusionary clauses to the purchase contract. These specified that if Pine Valley waived its right to retest the topsoil, Earthco would not be liable for the soil's "quality".[7] A

[1] *Earthco Soil Mixtures Inc v Pine Valley Enterprises Inc*, 2024 SCC 20 (***Earthco***).
[2] *Tercon Contractors Ltd v British Columbia (Minister of Transportation & Highways)*, 2010 SCC 4; *Sattva Capital Corp v Creston Moly Corp*, 2014 SCC 53.
[3] *Sale of Goods Act*, RSO 1990, c S.1
[4] *Earthco* at para 34.
[5] The operational SGA will depend on the province where the goods are being bought.
[6] *Earthco* at paras 1-2.
[7] The exclusionary clauses (clauses 6 and 7) in the contract are stated as follows: (1) [The buyer] has the right to test and approve the material at its own expense at our facility before it is shipped and placed. Please contact [the seller] to arrange; and (2) If [the buyer] waives its right to test and approve the material before it is shipped, [the seller] will not be responsible for the quality of the material once it leaves our facility.

month after Pine Valley purchased and installed the topsoil, it became apparent that the composition was inappropriate for their purposes due to water pooling. Pine Valley ultimately had to replace the topsoil and sued Earthco for breach of contract.

Lower Court Decisions

At trial, the judge determined that the exclusionary clauses in the contract overrode the SGA's implied conditions and warranties.[8] The trial judge rejected Pine Valley's argument that the topsoil failed to meet the implied conditions in the SGA. The trial judge found that Pine Valley had waived additional testing of the topsoil and understood the risk in accepting the exclusionary clauses. Based on a totality of the circumstances, the clauses were clear and unambiguous in excluding liability for Earthco.[9]

The Ontario Court of Appeal overturned the trial judge's decision on three extricable questions of law:

> 1) The trial judge failed to account for the "nature" of the SGA implied condition, which related to "identity", rather than "quality". The implied condition remained because the topsoil's composition did not match its description;
>
> 2) There was no language in the exclusionary clauses that unambiguously, clearly, and directly referred to any statutory conditions or to the "identity" of the topsoil; and,
>
> 3) The trial judge erred by reading in language that did not by itself explicitly exclude liability.[10]

In short, the Court of Appeal held the exclusionary clauses did not override the SGA. The exclusionary clauses lacked clarity between the identity (or type) of topsoil and the topsoil's quality, in the exclusionary clauses' language, and in the lack of the exclusionary clauses' direct reference to the SGA. Without such clarity, the clauses could not be upheld or enforced.

The SCC Decision

The SCC overturned the Court of Appeal's decision and restored the trial judge's conclusions that the exclusionary clauses were enforceable. Basing its decision on the jurisprudence established in *Tercon* and *Sattva*, the SCC held that an application of the "common-sense framework" showed that the clauses objectively overrode the SGA's implied warranty provisions.[11]

Justice Martin, writing for the majority, applied this modern framework to the clauses at issue. Pine Valley's argument over the term "quality" in the purchase agreement could not be read in isolation, and in the entire context of the transaction "quality" was used in a colloquial and commercial sense, rather than its legal meaning.[12]

Given that Earthco and Pine Valley were not represented by counsel, the Court of Appeal erred in attaching the strict legal meanings to terms such as "quality", "warranty", "identity", and "conditions". Specifically, the parties should not be assumed to understand the fine-grain (legal or technical) difference between such terms if they are not experienced or informed with such legal terminology. Imposing such differences on parties that did not contemplate them is inconsistent with determining the objective intentions and expectations of the parties.

The opt out provision of the SGA requires an "express agreement". To qualify as "express", it must be made in distinct and explicit terms and not be left to interpretation.[13] Before the SCC began re-evaluating principles of contractual interpretation, courts may have required specific or technical language to overcome the SGA's implied conditions. The SCC's decision continues the trend away from this outdated method of interpretation, stating that explicit language, or

[8] *Earthco* at para 17; Ontario SGA, s 14.
[9] *Earthco* at para 23.
[10] *Earthco* at para 24.
[11] *Earthco* at para 93.
[12] *Earthco* at para 87.
[13] *Earthco* at para 56.

specific "magic words" are not necessary. The necessary element is that the joint intention of the parties must be clear and based on the wording used and the surrounding circumstances known to the parties at the time of the agreement.[14]

In summary, an exclusionary clause will be valid if:

1) there is an "express agreement" for an exclusionary clause;

2) the exclusionary clause is not unconscionable; and,

3) there are no overriding policy concerns.

In this case, the SCC advances the approach of commercial certainty: the actual agreement and objective intentions of the parties should guide the analysis, rather than an "overly technical and legalistic interpretation".[15]

Key Takeaways

The SCC continues to advance modern contractual interpretation principles of common-sense, practicality and pragmatism. The focus is on the objective intentions of the contracting parties rather than on hyper-specific readings of the text. As such, there is no requirement for particular "magic words"; "express language" is not necessary, so long as the language makes clear the objective intentions of the parties.

Despite this added flexibility, an "express agreement" to contract out of a province's SGA must be unambiguous: the language used must clearly signal an intention to override the SGA. Notably, exclusionary clauses drafted by lay people may be held to less exacting standards than provisions negotiated by legal counsel.

If you would like any additional information, please contact any member of our **Business Law Group**.

[14] *Earthco* at paras 63, 98.
[15] *Earthco* at para 92.