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MR. JUSTICE TODD L. ARCHIBALD
SUPERIOR COURT OF JUSTICE (ONTARIO)

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Through the Scratched Looking Glass: *Sattva*, *Ledcor*, *Teal* and Developments in the Law of Contract

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I. INTRODUCTION

The 2014 *Sattva Capital Corp. v. Creston Moly Corp.*[1] decision of the Supreme Court of Canada resulted in two significant changes to the law of contract in Canada. First, *Sattva* broadened the scope and availability of the use of surrounding circumstances for the purpose of contractual interpretation. Second, recognising the factual nature of those surrounding circumstances, the Court held that questions of contractual interpretation were questions of mixed law and fact. A deferential, rather than the traditional correctness, standard of review now applies to appeals on questions of contractual interpretation.

In the two and a half years since *Sattva*'s release, Canadian courts have wrestled with how to apply these two changes, particularly as they relate to standard form contracts. The Supreme Court of Canada's *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*[2] decision represents the resolution of the different lines of thought which developed as Canadian courts dealt with the question of how to apply *Sattva*.

Ledcor added clarity to the issue of interpreting standard form contracts, but questions remain as to the scope of the surrounding circumstances to be considered, when they should be considered (particularly when addressing non-ambiguous standard-form insurance contracts), and the standard of review for questions of contractual interpretation. Given the *Ledcor* majority's express reliance upon the surrounding circumstances to arrive at its finding, and given *Sattva*'s clear, logical and unambiguous direction that contracts cannot be interpreted in a vacuum, this paper will argue that no special exception should arise for insurance contracts. It is hoped that future cases dealing with these issues will resolve this potential inconsistency in a principled manner, applying *Sattva* so that the surrounding circumstances will always have a role to play in the interpretive process, even absent a finding of ambiguity in the insurance policy language.

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1 *Sattva Capital Corp. v. Creston Moly Corp.*, [2014] 2 S.C.R. 633 (S.C.C.).

2 *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37 (S.C.C.).

The above questions are discussed in this paper, along with an examination of the British Columbia Court of Appeal's *British Columbia (Ministry of Forests) v. Teal Cedar Products Ltd.*[4] decision. The appeal of *Teal* was recently heard by the Supreme Court of Canada, and the Court rendered its judgment in June 2017.[5] *Teal* may provide further clarity in terms of the appropriate standard of review in light of the fact-specific surrounding circumstances.

II. *SATTVA* AND THE INTERPRETATION OF CONTRACTS

1. Redefining Interpretative Principles

The interpretation of contracts has always been an exercise in determining the intent of the contracting parties. *Sattva*, however, placed a greater emphasis on the use of the surrounding circumstances — the extrinsic factual matrix surrounding the creation of an agreement — as part of the interpretive process.

Before *Sattva*, the leading case on the interpretation of contracts was *Eli Lilly & Co. v. Novopharm Ltd.*[6] According to *Eli Lilly*, an agreement was to be interpreted based on the objective intentions of the parties, "by reference to the words [the parties] used in drafting the document, *possibly* read in light of the surrounding circumstances which were prevalent at the time."[7] Reference to the surrounding circumstances was possible, not mandatory. For an agreement that was "clear and unambiguous on its face", the Supreme Court of Canada explained it was "unnecessary to consider any extrinsic evidence".[8] Accordingly, the "surrounding circumstances", pre-*Sattva*, were not to be considered if the contract could be interpreted based on its clear and unambiguous wording.

With respect to contracts of insurance, this interpretive paradigm was used as recently as 2010 by the Supreme Court of Canada in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada.*[9] In *Progressive Homes,* Justice Rothstein identified a three-step process for the interpretation of insurance contracts:

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4 *British Columbia (Ministry of Forests) v. Teal Cedar Products Ltd.*, 2015 BCCA 263 (C.A.), leave to appeal allowed *Teal Cedar Products Ltd. v. British Columbia*, 2015 CarswellBC 4074 (S.C.C.).

5 *Teal Cedar Products Ltd. v. British Columbia* , 2017 SCC 32 (S.C.C.).

6 *Eli Lilly Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129 (S.C.C.).

7 *Ibid.* at para. 54 [emphasis added].

8 *Ibid.* at para. 55.

9 *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, [2010] 2 S.C.R. 245 (S.C.C.).

- First, he held: "The primary interpretive principle is that when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole."[10]
- Second, he went on to explain that, in the face of ambiguity, courts will move on to "rely on general rules of contract construction."[11] These rules include interpretations that are consistent with the reasonable expectations of the parties, that avoid unrealistic results, and that ensure that similar policies are construed consistently.[12] The rules of construction are "applied to resolve ambiguity," and "do not operate to create ambiguity where there is none in the first place."[13]

Third, he noted further "that where these rules of construction fail to resolve the ambiguity",[14] the Court will:

- Firstly, construe the policy against the insurer (or *contra proferentem*); and
- Secondly, interpret coverage provisions broadly and exclusion clauses narrowly.[15]

In *Progressive Homes*, the Court recognized that these interpretative principles had been "canvassed by this Court many times".[16] These same interpretative principles are recognized in *Ledcor*.[17]

Prior to *Sattva*, principles of contractual interpretation arising from *Eli Lilly*, therefore, appeared consistent with the authorities that developed and delineated the appropriate fashion in which to interpret insurance law contracts. *Sattva* represented a significant departure from the approach endorsed in *Eli Lilly* as *Sattva* expanded when and how the surrounding circumstances are to be considered. While the Supreme Court reaffirmed "the goal of the exercise is to ascertain the objective intent of the parties — a fact specific-goal — through the application of legal principles of interpretation",[18] *Sattva* also significantly expanded the role of the factual matrix.

The factual matrix would no longer only be referenced in cases of ambiguity, as provided for by *Eli Lily* and *Progressive Homes*. The old rule, expressed by the Supreme Court of Canada in 1951 that "where the language in a contract is

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10 *Ibid*. at para. 22.
11 *Ibid*. at para. 23.
12 *Ibid*. at para. 23.
13 *Ibid*. at para. 23.
14 *Ibid*. at para. 24.
15 *Ibid*. at para. 24.
16 *Ibid*. at para. 21.
17 *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*., 2016 SCC 37 (S.C.C.) at paras. 49-52.
18 *Sattva Capital Corp. v. Creston Moly Corp*., [2014] 2 S.C.R. 633 (S.C.C.) at para. 49.

clear and unambiguous it alone can be looked at to ascertain the intent of the parties", was no longer applicable.[19] Rather, the surrounding circumstances were to be used in all cases (ambiguity or no ambiguity) to "deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract."[20] The Court explained that "consideration of the surrounding circumstances recognises that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning."[21]

The interpretive process outlined in *Sattva* is, as follows (emphasis added, illustrating *Sattva*'s modification of the *Eli-Lilly* test):

> The overriding concern is to determine "the intent of the parties and the scope of their understanding" [. . .] To do so, 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*.[22]

No reference is made by the Supreme Court in *Sattva* to its own line of authorities delineating the appropriate principles of interpretation applicable to insurance law contracts. While insurance law contracts may have some specific interpretive rules related to the very nature of the contract (for example, the doctrine of *contra proferentem*, coverage clauses being given wide scope and exclusion clauses being given narrow scope, etc.), insurance policies are nonetheless contracts. In a post-*Sattva* world, the question then arose as to how to reconcile *Sattva* with the long line of insurance authorities from the Supreme Court of Canada, culminating in *Progressive Homes*.

2. Shifting the Standard of Review

The new focus on the factual matrix provided the Supreme Court of Canada with an opportunity to finalize a "shift away from the historical approach" in Canada, which mandated that questions of contractual interpretation were questions of law and were to be reviewed on a standard of correctness.[23] The use of the surrounding circumstances, an inherently factual question, to ascertain the intent of the parties for the purposes of interpretation was seen to be "closer to a question of mixed fact and law".[24] The *Sattva* Court held that contractual interpretation was, therefore, a question of "mixed fact and law as it is an

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19 *Indian Molybdenum Ltd. v. The King*, [1951] 3 D.L.R. 497 (S.C.C.) at pp. 502-503 [D.L.R.].
20 *Sattva Capital Corp. v. Creston Moly Corp.*, [2014] 2 S.C.R. 633 (S.C.C.) at para. 57.
21 *Ibid.* at para. 47.
22 *Ibid.* at para. 47.
23 *Ibid.* at para. 46.
24 *Ibid.* at para. 49.

exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix."[25]

Accordingly, *Sattva* represented a significant departure from the traditional and historical standard of review of contractual interpretation questions by appellate courts. A deferential, palpable and overriding error standard is now to be used, rather than the traditional correctness standard.

III. RECONCILING *SATTVA* WITH THE INTERPRETATION OF STANDARD FORM CONTRACTS

Sattva's emphasis on surrounding circumstances, and its conclusion that contractual interpretation was a question of mixed law and fact, raised challenging issues with respect to the interpretation of standard form contracts.

The contract under consideration in *Sattva* was a "bespoke" contract negotiated between two sophisticated commercial parties. By contrast, standard form contracts — be they contracts of insurance, real-estate transaction contracts, CCDC building contracts, mortgages, or otherwise — make up the considerable bulk of day-to-day commercial dealings between various parties in Canada. These contracts often apply industry-wide, with little to no party-specific negotiations or other party-specific factual matrix coming in to play. Parties to these contracts use them, in great measure, because of their availability and convenience, in order to create certainty and predictability over their affairs. Often, they are contracts of adhesion, in which one party has little to no input into the standard terms, beyond questions of property, price and term.

Prior to *Sattva,* parties to standard form insurance contracts relied on decades of jurisprudence, with *Progressive Homes* being the most recent example, in which a correctness standard of review was used, and in which ambiguity was a pre-requisite to reference to the "surrounding circumstances" and reasonable expectations of the parties arising therefrom.

Given *Sattva*'s conclusions about the factual matrix and the standard of review, Canadian courts differed on how its principles should apply to standard form contracts. Should *Sattva* apply strictly, meaning that appellate review of these types of agreements would be limited? Alternatively, did the need for certainty and predictability mean that the "correct" interpretation of any given term should not vary from case-to-case based on a factual matrix that is independent of the specific circumstances of any given set of litigants? After *Sattva*, appellate courts across Canada, and in some cases across panels of the same appellate court, differed in their answers to these questions, and as to how *Sattva* ought to apply to the interpretation of standard form contracts.

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[25] *Ibid.* at para. 50.

Some appellate courts concluded that *Sattva*'s mixed fact and law standard of review did not apply to standard form contracts. For example, the Alberta Court of Appeal decision of *Vallieres v. Vozniak*,[26] and the Ontario Court of Appeal decision of *MacDonald v. Chicago Title Insurance Co. of Canada*[27] both held that a correctness review was appropriate for standard form contracts.

Vozniak involved the interpretation of a standard form residential real estate purchase agreement. The Alberta Court of Appeal observed that this type of agreement was "used continuously by vendors, purchasers and realtors in Alberta." Given its wide-usage, the interpretation of any given term in that standard form agreement would be of great precedential value. As such, the Court of Appeal concluded that its "interpretation is of general importance beyond this dispute", meaning that it would be "untenable for this contract to be given one interpretation by one trial judge, and another by a different one".[28]

As to the surrounding circumstances leading up to the *Vozniak* agreement, the Court of Appeal concluded that:

> . . . attempting to inject the circumstances surrounding the formation of the contract into the analysis, or any attempt to identify the intention of the parties, is nothing but a legal fiction.[29]

The Court of Appeal recognized that there were no party-specific surrounding circumstances to speak of. There were no party-specific negotiations, no pre-contractual drafts, and no factual matrix focused solely on the parties themselves to illustrate their intentions. This was, of course, because the parties chose to make use of an already well-established widely used standard form contract.

Consequently, given the need for certainty, and the lack of any genuine party-specific factual matrix, the Alberta Court of Appeal concluded that a correctness standard applied, rather than a strict application of the *Sattva* deferential approach.[30]

In *MacDonald,* the Ontario Court of Appeal addressed the interpretation of a standard form title insurance policy. Applying the same type of reasoning as the Alberta Court of Appeal in *Vozniak*, the Ontario Court of Appeal determined that it would be "untenable for standard form insurance policy wording to be given one meaning by one trial judge and another by a different trial judge".[31]

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[26] *Vallieres v. Vozniak*, 2014 ABCA 290 (C.A.), additional reasons 2014 CarswellAlta 2096 (C.A.).

[27] *MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842 (C.A.), leave to appeal refused *Chicago Title Insurance Co. of Canada v. MacDonald*, 2016 CarswellOnt 16419 (S.C.C.).

[28] *Valliers v. Vozniak*, 2014 ABCA 290 (C.A.) at para. 13, additional reasons 2014 CarswellAlta 2096 (C.A.).

[29] *Ibid.*

[30] *Ibid.*

To hold otherwise would give rise to "unpredictable outcomes" that would "only serve to encourage litigation" on the theory that "the more a given result depends on the particular trial judge, the greater the chance that litigants will risk going to trial".[32]

The Ontario Court of Appeal also concluded that the factual matrix for standard form agreements "does not meaningfully assist in interpreting them".[33] That is, there was no meaningful party-specific factual matrix to speak of, in a case in which the parties' pre-contractual negotiations and dealings simply involved the adoption of a standard form agreement.

Like the Alberta Court of Appeal in *Vozniak*, rather than apply the deferential *Sattva* standard, the Ontario Court of Appeal concluded that a correctness standard applied. The need for consistency, the precedential value to the interpretation of standard form contracts, and the lack of any party-specific factual matrix all pointed towards a correctness, rather than a deferential standard of review. The Ontario Court of Appeal observed that a correctness review of standard form agreements would "ensure consistency in the law and greater predictability in litigation outcomes", and would further allow appellate courts to "fulfil their responsibility of ensuring consistency in the law".[34]

The *Vozniak* and *MacDonald*, treatment of standard form agreements was not uniformly applied by Canadian courts. Other appellate courts — including panels in Alberta and Ontario — applied a *Sattva* deferential review to standard form contracts.

For example, in *Van Camp v. Laurentian Bank of Canada*,[35] the Alberta Court of Appeal interpreted a bank's standard form conditional sales contract. The deferential *Sattva* standard of review was applied, despite the standard form nature of the agreement at issue. Similarly, in *Kassburg v. Sun Life Assurance Company of Canada*,[36] the Ontario Court of Appeal applied a deferential standard of review to a trial judge's interpretation of a standard form life insurance policy.

We then have the example of *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Company*,[37] where the British Columbia Court of Appeal applied a deferential standard of review to a standard form insurance contract. In *Acciona*, the British Columbia Court of Appeal deferred to a trial

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[31] *MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842 (Ont. C.A.) at para. 40, leave to appeal refused *Chicago Title Insurance Co. of Canada v. MacDonald*, 2016 CarswellOnt 16419 (S.C.C.).

[32] *Ibid.* at para. 40.

[33] *Ibid.* at para. 41.

[34] *Ibid.* at paras. 40 and 42.

[35] *Van Camp v. Laurentian Bank of Canada*, 2015 ABCA 83 (C.A.) at para. 17.

[36] *Kassburg v. Sun Life Assurance Company of Canada*, 2014 ONCA 922 (C.A.).

[37] *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Company*, 2015 BCCA 347 (C.A.) at para. 35.

judge's interpretation of an all-risks construction property insurance policy.[38] The case dealt with the question of whether the cost of repairs to deficient concrete slabs was excluded by a defective workmanship exclusion in the policy. The British Columbia Court of Appeal held that the *Sattva* deferential standard of review applied.

The first question in *Acciona* involved whether an over-deflected, cracked and bent concrete slab (which met applicable loading and safety standards) was direct physical loss or damage to insured property. The Court of Appeal concluded that whether or not that was so was "entirely answered" by the trial judge's "uncontested findings of fact".[39]

The second question in *Acciona* involved whether the physical damage was excluded from coverage by a defects exclusion clause. The policy excluded costs rendered necessary by defects of workmanship, design, plan or specification. The trial judge concluded, and the Court of Appeal agreed, that the exclusion only excluded the costs of implementing proper workmanship immediately before the defective workmanship caused the over-deflection, bending and cracking (i.e. the resulting damage, which was not excluded).[40] The Court of Appeal held that this determination was "a question of first impression" based on "matters of fact and degree", and hence, a question of mixed fact and law.[41] As such, a deferential standard of review, rather than one of correctness, applied.

Acciona's reasoning is the opposite of that in *Vozniak* and *MacDonald* (in which the need for certainty and consistency in the law, and the public interest in the precedential value of the interpretation served as justification for a correctness standard of review). Specifically, according to the British Columbia Court of Appeal in *Acciona*, the law concerning the interpretation of insurance contracts was "so well-settled as to need no repetition", and the questions surrounding whether the specific loss was captured by the exclusion at issue were "matters of fact and degree".[42] Even though the Court was dealing with a standard form insurance agreement, the reasoning in *Acciona* suggests that the Court of Appeal was of the view that the interpretation was not one that created a need for the court to impose certainty and consistency in the law (given that the law was well settled), and the fact-specific nature of the inquiry was such that the public interest in certainty did not come into play (and hence the matter would be of little precedential interest).

As will be seen in the discussion on *Ledcor* below, *Acciona* dealt with very similar facts and issues to the *Ledcor* decision, but came to opposite conclusions.

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38 *Ibid.* at para. 35.
39 *Ibid.* at para. 36.
40 *Ibid.* at para. 77.
41 *Ibid.* at para. 34.
42 *Ibid.* at paras. 42 and 34.

This result is not helpful for parties to standard form contracts, seeking the certainty and consistency referred to above.

The British Columbia Court of Appeal's approach in *Acciona* was the subject of a leave to appeal application before the Supreme Court of Canada. In *Allianz Global Risks US Insurance Company v. Acciona Infrastructure Canada Inc., et al*,[43] the Supreme Court remanded the case back to the British Columbia Court of Appeal for a disposition in accordance with *Ledcor*.[44] This is a clear message from the Supreme Court that the standard of review and interpretative principles adopted in the British Columbia Court of Appeal's *Acciona* decision do not accord with those embraced by the Court in *Ledcor*.

IV. *LEDCOR* AND THE INTERPRETATION OF STANDARD FORM AGREEMENTS

1. Summary and Analysis of *Ledcor*

As discussed, *Sattva* resulted in different appellate courts approaching the review of standard form contracts in different ways. *Sattva* also left open questions as to how, specifically, insurance contracts should be interpreted. That is, on a correctness standard, making use of surrounding circumstances only when there was ambiguity (as per *Progressive Homes*), or using the deferential *Sattva* test and looking at the surrounding circumstances, even in the absence of ambiguity. *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*.[45] was the Supreme Court of Canada's opportunity to resolve these post-*Sattva* questions.

Ledcor involved the interpretation and appellate review of a standard form builders' risk insurance policy. A window cleaning subcontractor scratched the windows of a newly constructed Edmonton high rise during cleaning. The project was covered by a standard form builders' risk insurance policy. A dispute arose as to whether the cost of replacing the scratched windows was faulty workmanship, and excluded by the policy in issue, or resulting damage, an exception to the faulty workmanship exclusion, and thereby, covered by the policy.

The facts and issues in *Ledcor* are very similar to those in *Acciona*. Both involved standard form builders' risk property insurance policies, and an issue as to whether or not certain defective work was covered or excluded. In *Acciona*, as discussed above, the British Columbia Court of Appeal applied *Sattva* and its deferential standard of review. In *Ledcor*, the Alberta Court of

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[43] *Allianz Global Risks US Insurance Company v. Acciona Infrastructure Canada Inc., et al,* 2016 CarswellBC 2937 (S.C.C.).

[44] *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*., 2016 SCC 37 (S.C.C.).

[45] *Ibid.*

Appeal (following its reasoning in *Vozniak*) came to the opposite conclusion, and held that a correctness standard applied. The Supreme Court of Canada used *Ledcor* as an opportunity to resolve this inconsistency, and to set forth how *Sattva* should apply to the interpretation of standard form contracts.

The majority of the Court determined that standard form contracts gave rise to an exception to *Sattva*, with the standard of review being correctness. The Court gave two reasons for this exception.

First, the majority observed that the surrounding circumstances for standard form contracts will often carry less weight, given the lack of negotiation, and will usually be the same for everyone who may be a party to the typical standard form. That is, according to the majority, for standard form contracts, "there is no meaningful factual matrix that is specific to the parties to assist the interpretation process".[46] As such, "while a proper understanding of the factual matrix is crucial to the interpretation of many contracts, it is often less relevant for standard form contracts."[47]

The lack of party-specific surrounding circumstances, particularly negotiations, put less emphasis on the factual matrix, justifying a review on a correctness standard. This approach is consistent with the *Vozniak* and *MacDonald* line of reasoning discussed above.

Second, the majority recognized that industry-wide standard form contracts would be of interest beyond the resolution of any given dispute between any given set of litigants. That is, the "interpretation itself has precedential value" that could be of interest in "future cases involving identical or similarly worded provisions".[48] This again is consistent with the approach advocated for in *Vozniak* and *MacDonald*.

The majority recognized that contractual interpretation, as explained by *Sattva*, is generally "a question of mixed fact and law, which is 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)".[49] However, for situations involving standard form contracts, the majority recognized that a correctness standard "may be necessary for appellate courts to fulfil their functions": namely, ensuring consistency in the law, and reforming the law.[50] Given that a standard form contract "could affect many people," the need for "ensuring the consistency of the law" would be "advanced by permitting appellate courts to review the interpretation of standard form contracts for correctness".[51]

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46 *Ibid*. at para. 24.
47 *Ibid*. at para. 28.
48 *Ibid*. at para. 43.
49 *Ibid*. at para. 33.
50 *Ibid*. at para. 39.
51 *Ibid*. at para. 39.

Recognizing that any given court's interpretation of a standard form contract may be applied to similarly worded agreements, the majority held that the interpretation also has precedential value. The majority of the Court, therefore, held that "establishing the proper interpretation of a standard form contract amounts to establishing the 'correct legal test'", further justifying a correctness standard of review.[52] The Supreme Court's comments are consistent with *Vozniak*'s holding that the interpretation of standard form contracts would be of general importance beyond the dispute, and *MacDonald's* emphasis on the need for consistency in the law.

The Supreme Court's decision in *Ledcor* provides further guidance in terms of the scope of the surrounding circumstances and standard of review, but also raises further questions about those two issues. Each will be discussed below, in turn.

2. *Ledcor* Clarifying the Surrounding Circumstances for Standard Form Contracts

Ledcor is important as it provides further guidance as to how Canadian courts and arbitrators ought to make use of the factual matrix and surrounding circumstances when interpreting agreements. *Ledcor* puts some limits on the broad and wide ranging scope of what makes up the factual matrix as defined by the Supreme Court of Canada in *Sattva*.

Sattva resulted in the factual matrix taking on a much more significant role in the interpretation of agreements, and it also provided a broad and expansive scope as to what might make up that factual matrix. The *Sattva* Court held that the factual matrix will "vary from case to case", and consists of the "objective evidence of the background facts at the time of the execution of the contract."[53] The surrounding circumstances included "knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting."[54] Factors such as the commercial purpose of the agreement, the genesis of the transaction, the background and context of the market in which the parties are operating were identified as some of the factors comprising the factual matrix.[55]

The *Sattva* Court also explained that the surrounding circumstances "must never be allowed to overwhelm the words" of the agreement, or be used to "deviate from the text such that the court effectively creates a new agreement".[56] In addition, the Court explained that the factual matrix must be limited to evidence of the objective, and not subjective, intentions of the parties. The Court

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52 *Ibid.* at para. 43.
53 *Sattva Capital Corp. v. Creston Moly Corp.*, [2014] 2 S.C.R. 633 (S.C.C.) at para. 58.
54 *Ibid.* at para. 58.
55 *Ibid.* at para. 47.
56 *Ibid.* at para. 57.

noted that the parol evidence rule would function to preclude, "among other things, evidence of the subjective intentions of the parties."[57]

Despite those expressed limitations, the scope of what possible information could be the "surrounding circumstances" was defined by the Supreme Court of Canada in an extremely broad manner. Notably, the Supreme Court of Canada relied on the seminal 1998 English House of Lords decision, *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, to define the surrounding circumstances as: "*absolutely anything* which would have affected the way in which the language of the document would have been understood by a reasonable [person]"[58] [emphasis added].

The Court's reference to and adoption of the "absolutely anything" *Investors Compensation Scheme* standard represented a significant change to the law of contract in Canada. *Sattva* was the first time this important English decision was referenced by Supreme Court of Canada.

Before *Sattva*, *Investors Compensation Scheme* was not part of the law of contract in Canada. Its potential to negatively affect commercial disputes, however, had received scholarly comment. *Investors Compensation Scheme* has been described as a "revolutionary expansion of the factual matrix rule" with the potential to increase "uncertainty and cost associated with litigation."[59] The expansive and broad *Investors Compensation Scheme* approach to the surrounding circumstances was thought to be a dangerous concept that would "add to the length and complexity of proceedings", and was "not desirable."[60]

An interpretive approach in which the language plus "absolutely anything" else that would have affected the parties' understanding of the language could result in adding needless complexity to the resolution of contractual disputes. This would give rise to broad and expansive pre-trial discovery related to trying to find out what that "absolutely anything" could be. This, in turn, could give rise to parties spending a great deal of time during trials or arbitration hearings presenting evidence about what that "absolutely anything" is or is not. An overly broad and expansive definition of the surrounding circumstances could give rise to added legal costs, inefficiencies, and ultimately impact upon access to justice (putting disputes over contractual issues out of the reach of ordinary litigants who cannot afford to pay the legal fees related to discovering just what that "absolutely anything" might be). Such an expansive concept, of course, results in less certainty for the contracting parties. This is particularly so at the

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57 *Ibid.* at para. 59.

58 *Investors Compensation Scheme Ltd. v. West Bromwich Building Society* (1997), [1998] 1 All E.R. 98 (H.L.) at 114 [All E.R.].

59 Ronald Podolny, A Pragmatic Approach to Contractual Interpretation, 55 C.B.L.J. 428 (2014).

60 Geoff Hall, "A Curious Incident in the Law of Contract: The Impact of 22 Words from the House of Lords", 40 C.B.L.J. 20 (2004).

time of contract formation when parties will be concerned that "*absolutely anything* which would have affected the way in which the language of the document would have been understood by a reasonable [person]" could be used to give rise to future, subjectively unintended, interpretations. Finally, difficulties will be faced in trying to maintain an objective standard when "absolutely anything" might be of significance.

A focus on "absolutely anything" also has, to paraphrase the Ontario Court of Appeal (in *MacDonald*), the potential to give rise to "unpredictable outcomes" that would "only serve to encourage litigation" on the theory that "the more a given result depends on the particular trial judge [and in particular, "absolutely anything" evidence], the greater the chance that litigants will risk going to trial".[61]

Given the "absolutely anything" definition of the factual matrix adopted by *Sattva*, *Ledcor* appears to represent a welcome and necessary limitation on what might make up the surrounding circumstances (at least in the context of standard form agreements).

The majority of the *Ledcor* Court explained that, in the case of a standard form insurance policy, "there is no factual matrix here that would assist in ascertaining the parties' understanding of and intent regarding" the agreement at issue.[62] That is, vis-a-vis the individual litigants, "there is no meaningful factual matrix that is specific to the parties to assist the interpretation process."[63] *Ledcor* was not a case involving sophisticated commercial actors engaging in complex, face-to-face negotiations to arrive at a bespoke commercial arrangement reflecting their intentions arising from the circumstances in play at the time of contract creation. Rather, it involved a standard-form insurance policy, with standard-terms, which apart from price, would likely not have varied much from similar policies issued on other similar projects.

That is not to say that the factual matrix played no role in the majority's determination. Rather, only that there were no meaningful party-specific negotiations, interactions or other party-specific surrounding circumstances. As observed by Justice Cromwell, in his dissenting opinion, "all contracts, whether standard form or not, have important contextual elements — elements of their surrounding circumstances — that are generally considered in applying the contractual language to a specific set of occurrences".[64]

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[61] *MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842 (C.A.) at para. 40, leave to appeal refused *Chicago Title Insurance Co. of Canada v. MacDonald*, 2016 CarswellOnt 16419 (S.C.C.).

[62] *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*., 2016 SCC 37 (S.C.C.) at para. 65.

[63] *Ibid*. at para. 24.

[64] *Ibid*. at para. 107.

The majority of the *Ledcor* Court agreed with Justice Cromwell that "factors such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates should be considered in interpreting a standard form contract".[65] The majority was of the view that these factors, however, would "usually be the same for everyone who may be a party to a particular standard form contract".[66]

Or, to put another way, as did Justice Cromwell in his dissent:

> [. . .] standard form contracts generally do not have relevant surrounding circumstances relating to their negotiation because there was in no real sense any negotiation of their terms. However, standard form contracts, like all contracts, have many other surrounding circumstances: they have a purpose, they create a relationship of a particular nature and they frequently operate within a particular market or industry. These factors are all part of the context — of the surrounding circumstances — that must be taken into account in interpreting the text of the contract [. . .][67]

The majority in *Ledcor* used those non-party-specific surrounding circumstances to interpret the builders' risk insurance policy in question. The "purpose behind" the contract was held to be "crucial in determining the parties' reasonable expectations" as to the meaning of the contract.[68]

As to the non-party-specific surrounding circumstances, the *Ledcor* majority looked at how builders' risk policies were "the norm, if not a requirement, on construction sites in Canada" to deal with "the most common source of loss on construction sites".[69] It also looked at the "commercial reality" in which builders' risk policies were obtained, and "the purpose underlying builders' risk policies and their spreading of risk on construction projects" where "multiple contractors work side by side and where damage to work or the project as a whole commonly arises from faults or defects in workmanship, materials or design".[70]

As such, while the majority in *Ledcor* held that, for standard form contracts, "there is no meaningful factual matrix that is specific to the parties to assist the interpretation process",[71] and that the factual matrix "is often less relevant for standard form contracts",[72] it would be a mistake to conclude that the factual matrix played no role in the majority's determination. To the contrary, the factual matrix was critical to the majority's determination; however, only to the

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65 *Ibid*. at para. 31.
66 *Ibid*. at para. 31.
67 *Ibid*. at para. 106.
68 *Ibid*. at para. 66.
69 *Ibid*. at para. 70.
70 *Ibid*. at paras. 78 and 79.
71 *Ibid*. at para. 24.
72 *Ibid*. at para. 28.

extent that factual matrix applied industry-wide to the particular type of contract at issue:

(1) the purpose;
(2) the nature of the relationship created;
(3) the commercial reality, and,
(4) the market involved.

While critical to the interpretative process, evidence of what this industry-wide factual matrix might comprise will be less wide-ranging, and less all-encompassing than the "absolutely anything" party-specific factual matrix. As such, *Ledcor* provides guidance as to what type of surrounding circumstances should be considered when a dispute over interpretation arises involving a standard-form contract. *Ledcor* also removes the uncertainty and difficulty surrounding the production and presentation of "absolutely anything" that might, in other cases involving non-standard form contracts, make up the party-specific factual matrix.

Accordingly, general evidence about the commercial purpose, the background and context of the market in which the parties are operating, and other general, industry-wide circumstances will be important. This type of background and context evidence will not be as wide-ranging and potentially all-encompassing as the party-specific factual matrix, which could be "absolutely anything" for non-standard form agreements. It will also, in most cases, not be the focus of a dispute, and will be easier to discover and present than the "absolutely anything" party-specific matrix. This, in turn, will limit discovery to only the pertinent industry-wide circumstances, which ought to encourage efficiency, reduce litigation costs, and enhance access to justice.

3. The *Ledcor* Inconsistency: Standard Form Insurance Contracts and Ambiguity

The majority in *Ledcor* found that the policy language was ambiguous, which in turn raised the following question: for standard form insurance contracts, are the surrounding circumstances only looked at in cases of ambiguity (as per *Progressive Homes*), or at all times? Given this question, a potential inconsistency, which *Ledcor* could have resolved, between *Sattva* and *Progressive Homes* exists.

When considering this inconsistency, it is important to observe how the *Ledcor* majority's analysis proceeded. They first found the exclusion clause to be ambiguous, and *then* went on to examine, in great detail, the non-party-specific surrounding circumstances and other general principles of insurance contract interpretation. This method of analysis accords with principles of insurance contract law interpretation previously set out by the Court (as per *Progressive Homes*). That method of analysis, summarized in *Progressive*

Homes, was such that only with ambiguity does reference to those general principles of contractual interpretation become necessary (*i.e.* to resolve the ambiguity found).

The majority in *Ledcor* also appears to have equated the *Progressive Homes* and other insurance law cases "reasonable expectations" of the parties with the surrounding circumstances. The majority expressed the view that the reasonable expectations "can often be gleaned from the circumstances surrounding the contract's formation" as discussed in *Sattva*.[73] However, *Sattva* mandates reference to the surrounding circumstances in all cases, not just in cases of ambiguity.

The majority appears to have blurred the line between consideration of "surrounding circumstances" as mandated in *Sattva*, and the consideration of "reasonable expectations" as set forth in *Progressive Homes*. *Sattva* mandates examination of the surrounding circumstances, regardless of any finding of ambiguity on plain reading of the language of the contract. *Progressive Homes* clearly set forth that "reasonable expectations" (or the apparent equivalent of "surrounding circumstances") can only be considered where there is ambiguity.

The interpretative inconsistency created by *Sattva* is not resolved in *Ledcor*. In *Ledcor*, the Court found the clause in question to be ambiguous, and the Court then resolved that ambiguity with reference to the interpretative principles identified in the authorities culminating in *Progressive Homes*. As noted above, the Court appeared to equate "surrounding circumstances" and "reasonable expectations". The question which arose following *Ledcor* was whether a *Sattva* analysis or consideration of the "surrounding circumstances" would need to be undertaken where a clause in a standard form contract was found to be unambiguous. The *Progressive Home* line of authorities would suggest not, and *Sattva* would suggest that such an analysis would need to be undertaken.

Unfortunately, the Supreme Court of Canada's recent decision of *Sabean v. Portage La Prairie Mutual Insurance Co*.[74] failed to answer these interpretive questions. In *Sabean,* without any reference to *Sattva* or the use of surrounding circumstances, the Court cited *Ledcor* as authority that, for standard-form insurance contracts, the "overriding principle is that where the language of the disputed clause is unambiguous, reading the contract as a whole, effect should be given to that clear language".[75]

While no express reference was made to the role of the non-party-specific, industry-wide factors in the interpretive process, the Court's decision does make reference to the purpose, nature of relationship and cross-country market in which the type of standard-form family protection endorsement policy at issue existed. Hence, the non-party-specific surrounding circumstances did play a

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[73] *Ibid*. at para. 65.

[74] *Sabean v. Portage La Prairie Mutual Insurance Co*., 2017 SCC 7 (S.C.C.).

[75] *Ibid*. at para. 12.

role, albeit an unstated role, in the Court's decision. However, the *Sabean* Court does not squarely resolve the interpretive inconsistency between *Sattva* and *Ledcor*, given its strong language about simply giving effect to the clear language of the contract, without any regard to the surrounding circumstances. In fact, the Court's analysis in *Sabean* is reminiscent of the analysis set forth in *Eli Lilly*.

The question then arises as to how to reconcile this interpretative inconsistency. There are likely two reasonable approaches which can be advocated for.

The first approach would be that all insurance contracts (and other standard form contracts) must always be interpreted with reference to the surrounding circumstances, which for standard-form contracts would be limited to the non-party-specific, industry-wide factors. Both *Ledcor* and *Sabean* refer to these types of factors, which are the surrounding circumstances for the particular standard form policies that were at issue. This approach would accord with *Sattva*.

The first approach proposed finds support in *Sattva's* holding that the surrounding circumstances must be looked at at all times, even absent ambiguity (which the *Ledcor* majority did not say was wrong). The majority in *Ledcor* further held that the surrounding circumstances were "crucial" to the interpretive process. There does not appear to be anything "special" about insurance contracts (apart from the decades of insurance-specific jurisprudence, which supports the second approach introduced below) which would remove them from the general rule that the surrounding circumstances need to be looked at in order to "deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract."[76] Nor would the words used in an insurance contract be so special so as to "have an immutable or absolute meaning" divorced from their surrounding circumstances.[77] Rather, for standard form contracts, those circumstances are limited to the non-party specific, industry-wide factors.

Alternatively, a second approach would recognize the long line of authorities culminating in *Progressive Homes* which set forth specific interpretative principles for insurance standard form contracts, and would hold to those principles — regardless of *Sattva* — in a post-*Sattva* world. This approach appears to accord with the Supreme Court's analysis in both *Ledcor* and *Sabean*, although it would have been helpful if the Court had expressly identified insurance law cases as an exception (within the exception it carved out for standard form contracts), or alternatively, if the Court had expressly stated that it had no intention to interfere with its own long line of authorities setting forth

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[76] *Sattva Capital Corp. v. Creston Moly Corp.*, [2014] 2 S.C.R. 633 (S.C.C.) at para. 57.
[77] *Ibid.* at para. 47.

relevant principles pertaining to the interpretation of insurance law contracts. Unfortunately, neither *Ledcor*, nor *Sabean* was that clear.

The second approach identified herein would not be reasonably applicable to standard form contracts arising outside of the insurance context , and accordingly, the first approach identified herein is likely that applicable to other standard form contracts. To recap, the surrounding circumstances as limited by non-party specific industry wide factors must always be taken into consideration when examining non-insurance standard form contracts, regardless of any finding of ambiguity on reading of the plain language of the contract.

The question remains whether, for standard-form insurance contracts, the surrounding circumstances have any role to play at all in the interpretive process, absent a finding of ambiguity in the insurance policy language. Given the *Ledcor* majority's express reliance upon the surrounding circumstances to arrive at its finding, and given *Sattva*'s clear, logical and unambiguous direction that contracts cannot be interpreted in a vacuum, no special exception should arise for insurance contracts. It is hoped that future cases dealing with these issues will resolve this potential inconsistency in a principled manner, clearly applying *Sattva* so that the surrounding circumstances (or at least the non-party-specific, industry-wide circumstances) will always have a role to play in the interpretive process, even absent a finding of ambiguity in standard-form insurance policy language. The surrounding circumstances in the case of a standard-form insurance policy, of course, would be of the narrow, non-party-specific, industry-wide variety, as used by the Court in its interpretation of both the *Ledcor* and *Sabean* policies. Such a solution makes sense, given the standard-form nature of those types of contracts, and would recognize that insurance contracts are themselves contracts to which *Sattva* applies.

4. *Ledcor*'s Clarification as to the Standard of Review of Standard Form Contracts

Ledcor has settled, to some extent, the question of which standard of review applies to the interpretation of standard form contracts. *Ledcor*'s conclusion that these types of agreements should be subject to a correctness standard has resolved the differences of opinion of appellate level courts on this point.

The majority recognized that, "depending on the circumstances", the interpretation of a standard form contract might be a question of mixed fact and law.[78] Arguably, the door was left open for a *Sattva* deferential review to be applied to standard-form contracts in certain circumstances.

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78 *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37 (S.C.C.) at para. 48.

The majority explained that if, for example, the standard form agreement was negotiated or modified, or if a factual matrix exists that is "specific for the particular parties" so as to assist in the interpretation, then the interpretation will not be on a correctness standard.[79] This line between a correctness, and a mixed fact and law standard "is not always easily drawn," and will depend on whether any given dispute involves a general proposition, or a very particular set of circumstances that will not be of much precedential value in the future.

While this is a principled exception- based on the reality that certain situations involving standard-form contracts may have party-specific surrounding circumstances, it does create the potential for future disputes over standard of review. Contract law disputes may now begin, at least at the appellate level, to resemble administrative law disputes that engage in disputes over both the standard of review and the substantive merits. This, in turn, gives rise to uncertainties in terms of when appellate review might or might not be available for any given situation, and adds an additional issue for parties to litigate (with the added cost and risk).

V. ENTIRE AGREEMENT CLAUSES AS A MEANS TO CHANGE THE STANDARD OF REVIEW

Ledcor uses the lack of party-specific surrounding circumstances (and hence a reduced emphasis on the facts) as one of the justifications for a correctness standard. While not discussed by the Supreme Court of Canada, this raises an interesting question as to whether a properly worded entire agreement clause, in which the parties agree to restrict the factual matrix, could also justify the use of a correctness standard of review for a non-standard form agreement.

Could a properly worded entire or whole agreement clause expressly exclude the party-specific surrounding circumstances, such as pre-contractual negotiations, discussions, and other collateral conditions or representations?

Solicitors often include these types of clauses for that very purpose: to limit reference to pre-contractual circumstances as a means of imposing contractual obligations not expressly set out in the written contract. For example in *Houle v. Knelsen Sand and Gravel Ltd*, the Alberta Court of Appeal explained that "the point of the whole agreement clause is that the obligations of the parties will be determined in accordance with the written terms of the contract, not extraneous negotiations and discussions that have not been reduced to writing, and thus formally acknowledged by the contracting parties."[80]

Would an entire agreement clause that expressly excludes the party-specific surrounding circumstances, and that expressly says that any such circumstances

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[79] *Ibid*. at para. 48.

[80] *Houle v. Knelsen Sand and Gravel Ltd.*, 2016 ABCA 247 (C.A.) at para. 23, leave to appeal refused *Knelsen Sand and Gravel Ltd. v. Houle*, 2017 CarswellAlta 381 (S.C.C.).

are "superseded by the language finally adopted by the parties and embodied in the written agreement to express their common intention"[81] be capable of justifying a correctness standard of review? In such a case, the parties agreed that the only surrounding circumstances would be those non-party specific ones: that is, general evidence about the commercial purpose, the background and context of the market in which the parties are operating, and other general, industry-wide circumstances.

Such a situation would be one in which, to use the words of the majority in *Ledcor* "there is no meaningful factual matrix that is specific to the parties to assist the interpretation process".[82] This was one of the factors used to justify a correctness review of standard form contracts in *Ledcor*, and could apply equally to a non-standard form contract in which the parties have agreed to eliminate the "specific to the parties" factual matrix as having anything to do with their common intention.

The *Ledcor* majority, of course, also used the precedential value relating to the interpretation of standard form agreements as the second reason to justify a correctness review. Non-standard form agreements, even with party-specific-factual-matrix limiting entire agreement clauses, might not be of sufficient precedential value to justify a correctness review. Nevertheless, depending on the specific contractual term at issue, perhaps parties could argue their non-standard form language could be of interest in "future cases involving identical or similarly worded provisions".[83] Given that contract law jurisprudence is filled with thousands of examples of non-standard form contractual language being of some interest and precedential value (say, for example, the very particular Carbolic Smoke Ball advertisement language, as but one example of many), perhaps such a situation is not so rare.

VI. CORRECTNESS, SURROUNDING CIRCUMSTANCES AND NON-STANDARD CONTRACTS — *TEAL*

Ledcor does not represent the end to the possible changes in the law of contractual interpretation being developed by the Supreme Court of Canada. The *Teal Cedar Products Ltd. v. British Columbia* case just rendered by the Supreme Court of Canada deals with questions related to the surrounding circumstances and standard of review, but this time, in the context of non-standard-form agreements.[84]

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[81] *Indian Molybdenum Ltd. v. The King*, [1951] 3 D.L.R. 497 (S.C.C.) at pp. 502-503 [D.L.R.].

[82] *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*., 2016 SCC 37 (S.C.C.) at para. 24.

[83] *Ibid*. at para. 43.

[84] *Teal Cedar Products Ltd. v. British Columbia* , 2017 SCC 32 (S.C.C.).

Teal is a British Columbia case involving the appeal of an arbitral award.[85] The dispute in *Teal* arose out of provincial legislation reducing a forest company's licences harvesting rights. The parties entered into a settlement agreement which dealt with the issue of compensation, but only in part, for lost harvesting rights. One of the provisions of that agreement provided that no interest would be payable in respect of any compensation. The parties submitted the remainder of their compensation dispute to arbitration.

The arbitrator rendered a decision, awarding over $8 million in compensation, plus interest (which amounted to millions of dollars on its own). The award was appealed, worked its way up to the British Columbia Court of Appeal (in 2013), and was then appealed to the Supreme Court of Canada. The case was remanded back to the British Columbia Court of Appeal (in 2015) for reconsideration in light of *Sattva*.

The 2015 British Columbia Court of Appeal decision involved that reconsideration, and concerned two issues: one of statutory interpretation (over the degree of compensation), and one of interpretation of a contractual provision relating to interest.

The Court of Appeal's treatment of the contractual interpretation issue is what is of interest to this analysis. More particularly, the British Columbia Court of Appeal concluded that a correctness standard would apply to a non-standard-form agreement.

The Court of Appeal's 2015 decision upheld its earlier 2013 decision. That earlier 2013 decision relied on earlier British Columbia jurisprudence, in which the British Columbia Court of Appeal concluded that the interpretation of a contract becomes a question of law, reviewable on a standard of correctness, once the facts and circumstances are fixed and determined. *Teal* relied on the pre-*Sattva*, *269893 Alberta Ltd. v. Otter Bay Developments Ltd.* decision which explained:

> . . . a trial judge's determination of the factual matrix is entitled to deference, but whether by arbitrator or court, the final determination of the meaning of a contractual provision is a question of law. This is not altered by the fact the process leading to the determination may involve questions of mixed fact or mixed questions of fact and law. As noted, the construction of a contractual provision becomes a question of law as soon as the true meaning of the words and the surrounding circumstances have been ascertained.[86]

This suggests that, for cases in which the surrounding circumstances are not in dispute, the "final determination of the meaning of a contractual provision"

[85] *British Columbia (Ministry of Forestry) v. Teal Cedar Products Ltd.*, 2015 BCCA 263 (C.A.), leave to appeal allowed *Teal Cedar Products Ltd. v. British Columbia*, 2015 CarswellBC 4074 (S.C.C.).

[86] *269893 Alberta Ltd. v. Otter Bay Developments Ltd.*, 2009 BCCA 37 (C.A.) at para. 15.

— that is, the interpretation itself applying the undisputed factual matrix-becomes a question of law.

The pre-*Sattva* 2013 *Teal* appeal panel held that an error in law arose when the arbitrator allowed the "context", as he called it, to change the unambiguous meaning of the agreement. The arbitrator was found to have erred at law because while "the surrounding context can properly be considered to interpret a contract, the context or factual matrix cannot be used to "drown out" or overwhelm the plain and ordinary meaning of the words of the contract when the words are unambiguous".[87] In its 2013 decision, the Court of Appeal framed the question of whether or not the surrounding circumstances were used to overwhelm the plain language of the contract as a "question of whether the proper legal methodology or legal principles were applied", and hence an error of law.[88]

Upon being ordered to reconsider its original opinion, in light of *Sattva*, the Court of Appeal, in 2015, concluded that "*Sattva* in no way undermine[d]" their initial conclusion that the interpretation of the interest provision was a question of law. The Court of Appeal went on to hold that, "if the arbitrator's award of interest were permitted to stand on the basis that his reasoning gives rise to no question of law, it would be at the expense of certainty which lies at the heart of the common law of contract", and that "indeed it would impair the confidence of parties to commercial transactions must have" that their disputes "will be resolved according to law".[89]

This "certainty" at the "heart of common law of contract" reasoning suggests the potential for a future two-step contractual review process. First, a deferential review of the underlying factual circumstances, and second, a correctness review with respect to final construction of the agreement. The *Teal* Court's discussion about certainty is in line with *Ledcor*'s focus on precedential value as a justification for a correctness review.

However, the British Columbia Court of Appeal's attempt in *Teal* to separate the factual matrix from the interpretation (in particular, by looking at whether the factual matrix overwhelmed the language of the agreement), seems inconsistent with *Sattva*'s recognition that contractual interpretation is a matter of mixed fact and law. *Ledcor* too recognized that, in most cases, this was true, except for the limited exception it carved out for the review of standard-form agreements.

Would not the trial judge, or arbitrator, aware of the factual matrix, and aware of the language of the agreement, be in the best position to determine how

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87 *British Columbia (Ministry of Forestry) v. Teal Cedar Products Ltd.*, 2013 BCCA 326 (C.A.) at paras. 124 and 125, affirmed 2015 CarswellBC 1550 (C.A.), leave to appeal allowed *Teal Cedar Products Ltd. v. British Columbia*, 2015 CarswellBC 4074 (S.C.C.).

88 *Ibid.*

89 *Ibid.*

that factual matrix ought to be applied to shine light on the parties' intentions? Should not that application of the facts to the law be treated like the question of mixed fact and law that it is? Would an appellate court be unduly infringing into the domain of the trial judge or arbitrator by substituting its opinion as to when, specifically, the factual matrix has overwhelmed the appellate court's opinion of what the agreement says? These are all questions concerning the appropriate standard of review in light of *Sattva*'s emphasis on the role of the fact-specific surrounding circumstances.

The Supreme Court of Canada rendered its decision in *Teal* on June 22, 2017.[90] The majority decision of Gascon J. (on behalf of five of nine Justices) dealt with, among other things, the factual matrix issue considered by the British Columbia Court of Appeal. Gascon J.'s decision affirmed *Sattva*'s shift from the historical approach towards contractual review (being non-deferential), and re-emphasized the law of contract's new emphasis on a more deferential standard. The majority came to two conclusions with respect to the contract interpretation issue in *Teal*.

First, the majority held that whether or not an arbitrator put excessive weight on the factual matrix was a question of mixed fact and law, not law.[91] Gascon J. explained that "the fact that [the arbitrator] may have placed significant weight on" the factual matrix "does not engage a legal question".[92]

Second, the majority explained that while the interpretation of the factual matrix in isolation from the words of the contract was a legal question, such a question lacked "arguable merit" and did not arise in that case.[93] Gascon J. explained that "the use of the factual matrix in contractual interpretation is limited by the legal principle that contractual interpretation must remain grounded in the text of the contract so as to avoid effectively creating a new agreement between the parties".[94] In the majority's view, such an error of law "will be very difficult to extricate in practice".[95] That is, "to extricate a question of law based on the alleged error of having overwhelmed the contract, a reviewing court must be satisfied that the decision-maker interpreted the factual matrix isolated from the words of the contract; an approach which could effectively create a new agreement".[96]

Teal has re-affirmed the move towards a more deferential, context specific, contractual interpretation process. In doing so, it has added to the potential for uncertainty (and increased litigation costs) associated with questions of

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90 *Teal Cedar Products Ltd. v. British Columbia* , 2017 SCC 32 (S.C.C.).
91 *Ibid*. at para. 4.
92 *Ibid*. at para. 58.
93 *Ibid*. at para. 4.
94 *Ibid*. at para. 63.
95 *Ibid*. at para. 65.
96 *Ibid*.

contractual interpretation. The contractual interpretation at issue in *Teal* is a perfect example. It contained a "no interest" provision. Despite the "no interest" provision, and the apparent re-writing of the agreement between the parties to provide for interest based on the factual matrix, no extricable error of law was found to exist. The implications are troublesome when one considers the need for certainty and predictability expected of the words that are used in a contract.

VII. CONCLUSION

Canadian contractual interpretation remains in flux. The Supreme Court of Canada's decision in *Sattva* adopted a new standard of review, and delineated new interpretative principles with respect to the analysis of contractual terms. Specifically, the Supreme Court held that a deferential standard of review applied as opposed to one of correctness. Fundamentally, the shift away from the "historical approach" in terms of the standard of review was mandated by the Court's view that questions of contractual interpretation were ones of mixed fact and law as opposed to questions only of law.

Further, the Supreme Court adopted a much more expansive view of contractual interpretation holding that the "surrounding circumstances" or factual matrix underlying the formation of the contract was a necessary part of the analytical paradigm, even in the absence of ambiguity on a plain reading of the language of the contract. The search for intention is to encompass the "surrounding circumstances", viewed through an objective as opposed to a subjective standard. "Absolutely anything" which would have affected how a reasonable person would have understood the contract is to be considered.

Sattva expanded the scope of the "factual matrix" rule, and has created the potential for uncertainty, and increased litigation costs as parties are now required to explore the "surrounding circumstances" each time parties seek to determine contractual intention, and resolve questions of contractual interpretation.

While the contract in *Sattva* was one which had been negotiated between two sophisticated commercial consumers, *Sattva* was silent as to how its standard of review and interpretative principles might be applicable to standard form contracts. The bulk of Canadian commercial transactions involve some form of standard form contract. Further, *Sattva* did not address the Supreme Court of Canada's own line of jurisprudence addressing the interpretation of insurance law contracts culminating in *Progressive Homes*.

Appellate courts across Canada were confronted with interpreting standard form contracts in accordance with *Sattva*. Diverging lines of authority emerged. Ultimately, the Supreme Court in *Ledcor* carved out an interpretative exception for standard form contracts, recognizing the value of certainty and consistency,

and the precedential value of interpretation of standard from contracts (as advocated for by the Alberta and Ontario Courts of Appeal in *Vozniak* and *MacDonald*).

While maintaining the deferential standard of review, *Ledcor* created an exception for standard-form contracts, and limited the non-party-specific factors or surrounding circumstances to the following:

(1) the purpose,
(2) the nature of the relationship created,
(3) the commercial reality, and
(4) the market involved.

The *Ledcor* exception specifically recognizes the limited role that parties to standard form contracts play in negotiation of the same. That said, consideration of the "surrounding circumstances" based on the aforesaid limited factors was important to the interpretation of the contract.

Ledcor adopts the principles of insurance contract interpretation delineated in *Progressive Homes,* and the Court's analysis is carried out after a determination of ambiguity. As part of this analysis, the Court explores the factors identified above as part of the "surrounding circumstances", and as part of how they informed the reasonable expectations of the parties.

However, *Ledcor* does not specifically address the appropriate interpretation where the language of the standard form insurance contract is not ambiguous. In the pre-*Sattva* analysis, a court would interpret the plain language of the contract, and apply it in accordance with *Eli Lilly*. The Supreme Court of Canada's *Sabean*[97] decision also failed to answer these interpretive questions, giving rise to two potentially reasonable approaches.

The first approach, consistent with *Sattva*, is that, in all instances, the surrounding circumstances are looked at (ambiguity or no ambiguity). Under this first approach, for a standard-form insurance contract, those surrounding circumstances would be the non-party-specific, industry-wide factors enumerated above. The second approach, consistent with the historical insurance-contract interpretation paradigm set out in *Progressive Homes* (and *Ledcor* and *Sabean*), is that the surrounding circumstances are only looked at when the language is ambiguous. Otherwise, for standard-form insurance contracts, the "overriding principle is that where the language of the disputed clause is unambiguous, reading the contract as a whole, effect should be given to that clear language".[98]

Given the *Ledcor* majority's express reliance upon the surrounding circumstances to arrive at its finding, and given *Sattva*'s clear, logical and unambiguous direction that contracts cannot be interpreted in a vacuum, the

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97 *Sabean v. Portage La Prairie Mutual Insurance Co.*, 2017 SCC 7 (S.C.C.).
98 *Ibid.*

Court should resolve the ambiguity by applying the first approach. That is, there should be no special exception for insurance contracts when it comes to the surrounding circumstances. They are contracts, and should be treated like all other contracts. It is hoped that future cases dealing with these issues will resolve this potential inconsistency in a principled manner, clearly applying *Sattva* so that the surrounding circumstances will always have a role to play in the interpretive process, even absent a finding of ambiguity in standard form insurance policy language

The recent evolution of interpretive principles remains in development. The Supreme Court of Canada recently heard an appeal from the second decision of the British Columbia Court of Appeal in *Teal*. At issue again in *Teal* is the appropriate standard of review, and how the factual matrix or surrounding circumstances are to be reviewed by an appellate court, or for that matter, applied by a trial court or arbitrator. The majority of the Court used *Teal* as an opprotunity to reaffirm the move towards a more deferential, fact and context-specific interpretive process.

As each case proceeds to appeal, we are better able to discern how these new standards and interpretative principles ought to apply. While the current state of the law is in flux, *Ledcor* represented a welcome limitation to the potentially over-broad ''absolutely anything" *Sattva* definition of the surrounding circumstances. *Ledcor* was also a welcome recognition of the precedential value arising from the interpretation of standard form contracts, and the need for certainty related thereto. However, *Ledcor* did not reconcile the inconsistency between *Sattva* and *Progressive Homes*, and whether, for standard-form insurance contracts, ambiguity is required before reference is had to the surrounding circumstances.

Teal could have been used by the Court as an opportunity to put even more limitations on the *Sattva* deferential standard (as it had done in *Ledcor* by creating the standard-form exception). It wasn't. Instead, it gives rise to the potential for more uncertainty in terms of the surrounding circumstances being used to give unintended meaning to the words used by parties in their contracts.

We would hope that we are not now at the point where parties who choose to use plain and unambiguous language in their contracts are left scratching their heads after an arbitral hearing or trial, like Alice, when she encountered Humpty Dumpty on the other side of the looking glass, who said:

> "When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean — neither more nor less."[99]

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[99] *Through the Looking Glass*, by Lewis Carroll.