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CIA Study Note

Canadian Contract Law

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Introduction

Canadian contract law is composed of two parallel systems: a common law framework outside Quebec and a civil law framework within Quebec. Outside Quebec, Canadian contract law is derived from English contract law, though it has developed distinctly since Canadian Confederation in 1867. While Quebec contract law was originally derived from that which existed in France at the time of Quebec's annexation into the British Empire, it was overhauled and codified first in the Civil Code of Lower Canada and later in the current Civil Code of Quebec, which codifies most elements of contract law as part of its provisions on the broader law of obligations. Individual common law provinces have codified certain contractual rules in a Sale of Goods Act, resembling equivalent statutes elsewhere in the Commonwealth. As most aspects of contract law in Canada are the subject of provincial jurisdiction under the Canadian Constitution, contract law may differ even between the country's common law provinces and territories. Conversely, as the law regarding bills of exchange and promissory notes, trade and commerce (including competition law), maritime law and banking among other related areas is governed by federal law under Section 91 of the Constitution Act, 1867; aspects of contract law pertaining to these topics (particularly in the field of international shipping and transportation) are harmonised between Quebec and the common law provinces.

Interpretation

Contracts in all Canadian jurisdictions are generally interpreted in a manner that balances giving the fullest possible effect to the intent of the parties while protecting the public interest and contracting parties with less bargaining power. Canadian courts, particularly each province's superior court, are responsible for the interpretation of contracts in legal disputes. Outside Quebec, the rules of contractual interpretation are established by judicial precedent and broadly resemble those in other Commonwealth jurisdictions. Within Quebec, the rules of contractual interpretation are codified in the Civil Code.

In Quebec, the Civil Code provides several specific rules regarding contractual interpretation in Book Five, Title One, Chapter 2, Division 4, Section 1425 provides that the common intention of the contracting parties shall be prioritised over the literal meaning of the words in a written document purporting to embody the contract. Section 1426 requires courts to take into account a contract's nature, the circumstances in which it was formed, customs and usages and any prior interpretation it may have received. Each clause of a contract is required by Section 1427 to be interpreted in the context of the others so that each is given a meaning derived from the contract as a whole. While Section 1430 provides that a clause intended to eliminate doubt as to the application of the contract to a specific situation does not restrict the scope of a contract otherwise expressed in general terms, Section 1431 provides that the clauses of a contract cover only what it appears that the parties intended to include, however general the terms used.

Quebec

The rules governing the formation of a contract under Quebec law are codified in Book Five, Title One, Chapter 2, Division 3 of the Civil Code. Except where a specific provision of law requires otherwise, a contract is formed by the exchange of consent between persons with the capacity to enter a contract. Additionally, a valid contract must have a cause and an object. The cause of a contract is the reason that determines each of the parties to enter into the contract and does not need to be explicitly expressed in the contract. The object of a contract is the juridical operation (i.e., exchange of one or more legal rights) contemplated by the parties at the time of the contract's formation. An object is only valid if it is not prohibited by law or on grounds of public policy. A contract that does not meet the conditions of its formation may be annulled.

The exchange of consent required for the formation of a contract is generally accomplished in the form of an offer and acceptance. An offer to contract is a proposal that contains all the essential elements of the proposed contract and in which the offeror signifies his willingness to be bound if it is accepted. An offer to contract is made by the person who initiates the contract, who determines its content or presents the last essential element of the proposed contract. An offer to contract may be made to a determinate or an indeterminate person, and a fixed time period for its acceptance may, but is not required to, be included. Where a term is attached, the offer may not be revoked before the period expires; if none is attached, the offer may be revoked at any time before acceptance is received by the offeror. Where the offeree receives a revocation before the offer, the offer lapses, even though a term is attached to it. An offer expires if an acceptance is not received by the offeror before the stated time period (if one is provided) or within a reasonable time period (if none is provided), as well as if the offeror receives a rejection or if either the offeror or the

offeree die or enter insolvency before an acceptance is received by the offeror. Where a purported acceptance is received either after the expiry of the applicable time period or which substantially modifies the terms of the proposed contract, it instead constitutes a counter-offer.

Consent in Quebec contract law may only be given by an individual with the legal capacity to bind themselves and must be "free and enlightened." It may be vitiated by error, fear or lesion (i.e., unconscionability). A person whose consent is vitiated has the right to apply for annulment of the contract; in the case of error occasioned by fraud, of fear or of lesion, they may, in addition to annulment, also claim damages or, where they prefer that the contract be maintained, apply for a reduction of their obligation equivalent to the damages they would be justified in claiming. Error vitiates the consent of the parties or of one of them where the error relates to the nature of the contract, to the object of the prestation or to any essential element that determined the consent; but inexcusable error may not constitute a defect of consent. Error induced by the other party's fraud or with the other party's knowledge vitiates a party's consent. Fear of serious injury to the person or property of one of the parties vitiates their consent if the fear is induced by violence or threats exerted or made by or known to the other party or induced by abuse of power or a threat thereof. Lesion results from the exploitation of one of the parties by the other, which creates a serious disproportion between the prestations of the parties; the fact that there is a serious disproportion creates a presumption of exploitation. In cases involving a minor or a protected person of full age, lesion may also result from an obligation that is considered to be excessive in view of the patrimonial situation of the person, the advantages he gains from the contract and the circumstances as a whole.

Common law provinces

Offer and acceptance

An offer must be some indication of the offeror to the offeree that they are prepared to form a binding legal agreement. Intention is measured objectively. Commercial deals are presumed to be of a legal nature while an agreement made between family members or in a social engagement is presumed not to be of a legal nature. Acceptance is the promise or act on the part of an offeree indicating a willingness to be bound by the terms and conditions contained in an offer. An acceptance must be an absolute and unqualified acceptance of all the terms of the offer: Sec.7(1). If there is any variation, even on an unimportant point, between the offer and the terms of its acceptance, there is no contract. An acceptance is only contractually valid if the proposal to which response is made is an offer capable of acceptance.

Often, when two companies deal with each other in the course of business, they will use standard form contracts. Often these standard forms contain terms that conflict (e.g., both parties include a liability waiver in their form). The “battle of the forms” refers to the resulting legal dispute arising where both parties accept that a legally binding contract exists but disagree about whose standard terms apply. Such disputes may be resolved by reference to the 'last document rule', i.e., whichever business sent the last document, or 'fired the last shot' (often the seller's delivery note) is held to have issued the final offer and the buyer's organisation is held to have accepted the offer by signing the delivery note or simply accepting and using the delivered goods.

An offer must also be distinguished from an invitation to treat, which is where one party invites another party to consider a deal. Advertisements are also considered invitations. Exceptions are made in circumstances where a unilateral contract for performance is offered or where the advertisement is sufficiently serious about its promise such as in the famous Carlill v. Carbolic Smoke Ball Co. In the similar case of Goldthorpe v. Logan, [1943] 2 DLR 519 (Ont. CA) an "absolute and unqualified" guarantee to safely remove all hair by electrolysis, was found to be an offer as the plaintiff paid for the treatment based on the offer. The display of goods in store is typically an invitation. The quotation of the lowest price is also considered an invitation. However, in some circumstances a quotation will be an offer. In Canadian Dyers Association Ltd. v. Burton, [1920] 47 OLR 259 (HC), a quotation followed by the statement "if it were anyone else I would ask for more" was considered an offer. A call for tenders is usually considered an invitation. In R. v. Ron Engineering & Construction Ltd., [1981] 1 S.C.R. 111, however, the Supreme Court found that a call was an offer where there the call was sufficiently "contract-like." Later, in M.J.B. Enterprises Ltd. v Defence Construction (1951) Ltd., the Court again found a call to be an offer which was accepted with the tender submission (known as Contract A). In Tercon Contractors Ltd. v British Columbia (Transportation and Highways), the trial judge summarised the factors to be considered in deciding whether a matter constitutes a call for tenders or a non-binding request for proposals:

- the irrevocability of the bid
- the formality of the procurement process
- whether tenders are solicited from selected parties

- whether there was anonymity of tenders
- whether there is a deadline for submissions and for performance of the work
- whether there is a requirement for security deposit
- whether evaluation criteria are specified
- whether there was a right to reject proposals
- whether there was a statement that this was not a tender call
- whether there was a commitment to build
- whether compliance with specifications was a condition of the tender bid
- whether there is a duty to award contract B
- whether contract B had specific conditions not open to negotiation

The label or name of the tender document is not a determinative factor. Neither is the requirement for a security deposit or the existence of established timelines.

Consideration

In common law jurisdictions, consideration is required for simple contracts but not for special contracts (contracts by deed). This means that each party to a contract is required to exchange something of value and that a gratuitous contract is not valid in Canada's common law provinces and territories. Where one party retains discretion over the performance of an obligation under a contract, that obligation constitutes a "mere option" and therefore cannot serve as valid consideration. While the purpose of the doctrine was ostensibly to protect parties seeking to void oppressive contracts, this goal is currently accomplished using legal principles enabling the recission or annulment of contracts on the grounds of unconscionability, through purposive interpretation of contracts by the courts and through equitable remedies. In practice, the doctrine of consideration has resulted in a phenomenon like that of Ḥiyal in Islamic contracts, whereby parties to a contract use technicalities to satisfy requirements while in fact circumventing them in practice. Typically, this is in the form of "peppercorn" consideration, i.e., consideration that is negligible but still satisfies the requirements of law, although Canadian courts may evaluate consideration for "sufficiency."

The requirement for consideration is the most significant difference between contract law in Quebec and the common law provinces. At the international level, it is expressly rejected by the UNIDROIT Principles of International Commercial Contracts on the grounds that it yields uncertainty and unnecessary litigation, thereby hindering international trade. Similarly, the United Nations Convention on Contracts for the International Sale of Goods does not require consideration for a contract to be valid, thereby excluding the doctrine about contracts covered by the convention even in common law jurisdictions where it would otherwise apply. Consequently, the continued existence of the doctrine in common law jurisdictions is controversial.

In Canadian common law jurisdictions, like in England and Wales but unlike in India, the performance of pre-existing duties has not traditionally been regarded as good consideration. This can create uncertainty where parties to a contract agree to amend its terms after it has been concluded since such post-contractual modifications may run afoul of the requirement for fresh consideration. Court rulings in New Brunswick and British Columbia have abrogated this rule with regards to post-contractual modifications, while courts in Ontario have continued to require fresh consideration.

Duties and equitable doctrines

In Canadian contract law, there are two distinct duties requiring parties to act in good faith. The first, pertaining to pre-contractual relations, is a duty to negotiate in good faith, while the second is a duty to act honestly in the performance of contractual obligations. The two duties are equally relevant to both Quebec's civil law and the other provinces' and territories' common law approaches to contract law, representing an attempt by the Supreme Court of Canada to extend the duties of good faith embedded in Quebec law to the jurisprudence of the country's common law jurisdictions. Additionally, in the common law provinces and territories, the doctrine of estoppel is another way in which the courts restrict the ability of parties in a contract to act in bad faith. Another important equitable doctrine in Canadian contract law is that of unconscionability, whereby the enforceability of a contract or of one or more terms in a contract is restricted on the grounds that it would be unjust to enforce it.

Duty to negotiate in good faith

The duty to negotiate in good faith is enshrined in Quebec contract law by the broader obligation on individuals to exercise their civil rights in good faith and has been recognised in certain circumstances in the common law jurisdictions. In Quebec, this right is grounded in Section 1375 of the civil code, which provides that parties to a

contract must act in good faith not only at the time an obligation is performed but also "at the time the obligation arises." While English common law did not traditionally recognise a duty to negotiate in good faith, Canadian contract law recognises the duty where an imbalance in bargaining power exists between the parties to a contract. Circumstances giving rise to this duty include: negotiations between franchisors and franchisees, insurers and insured parties, contracts pertaining to marriages and separation agreements, invitations to tender and fiduciary relationships. Courts may also recognise a duty to negotiate in good faith in situations involving a pre-existing relationship between the parties, particularly where the negotiation pertains to collateral terms in an otherwise complete contract, as well as in situations where parties to an oral contract have agreed to negotiate the terms to be recorded in a written contract. In circumstances where one party has incurred expenses in anticipation of a contract and the other party withdraws, in bad faith, from negotiations; the violation of the duty to negotiate in good faith may entitle the aggrieved party to restitutionary damages.

With regards to invitations to tender, this duty is applied in the form of the Contract A doctrine. A "process contract," referred to as "Contract A," is formed between the owner (person, company or organisation tendering the project) and each bidder when a "request for proposal" is responded to in the form of a compliant bid, sometimes also known as submission of price. The owner must deal fairly and equally with all bidders and must not show any favouritism or prejudice towards any bidder(s). In essence, this concept boils down to the right of an individual to have equal opportunity to be successful with their bid for work. A breach of Contract A may occur if the owner (or an owner's officer or representative, see vicarious liability), provides information, changes specification during the tendering process to unfairly benefit a particular bidder, enters closed negotiations with an individual bidder in an effort to obtain more desirable contract conditions, etc. The most common situation in which an owner is accused of having breached Contract A occurs when a bidder is selected who is not the lowest bidder. This contravenes established custom and practice, which would normally dictate that the lowest bid be awarded the subsequent contract to perform the work, Contract B, but is not normally a source of a breach if handled properly. Successful suits for breach typically occur where the lowest bidder is excluded based on a clause or stipulation that is either not clearly outlined in the tender documents (such as preference for local bidders) or is deemed by the courts to be too broadly worded to have any meaning.

Duty of honest contractual performance

The duty of honest contractual performance (referred to in Quebec as the doctrine of abuse of rights) is a contractual duty and implied term of a contract. In Quebec, it is rooted in Sections 6 and 7 of the Civil Code which provide that "every person is bound to exercise his civil rights in accordance with the requirements of good faith" and that "no right may be exercised with the intent of injuring another or in an excessive and unreasonable manner, and therefore contrary to the requirements of good faith." It was extended to Canada's common law provinces and territories as a result of the decision of the Supreme Court of Canada in the case of Bhasin v. Hrynew. In essence, this duty requires parties to a contract to act in good faith and with honesty in exercising their rights under a contract and in delivering their obligations under a contract. This duty prohibits parties to a contract from "[lying] or otherwise knowingly mislead[ing] each other about matters directly linked to the performance of the contract." While it is also currently an integral part of the jurisprudence of Canada's common law provinces and territories, the duty of honest contractual performance is rooted in the civil law doctrine of abuse of rights and the Supreme Court of Canada has established that precedent from Quebec contract law is applicable to interpreting this duty in cases arising in the country's common law jurisdictions and vice-versa. Consequently, in all Canadian jurisdictions, this duty is rooted in articles 6, 7 and 1375 of the Civil Code of Quebec; with article 7 providing that "no right may be exercised with the intent of injuring another or in an excessive and unreasonable manner." While this duty does not serve to extinguish or negate a party's rights under a contract, it serves to limit the manner in which parties to a contract may exercise their rights by mandating that parties must act in "good faith both at the time the obligation arises and at the time it is performed or extinguished."

Estoppel

Estoppel is an equitable remedy whereby a contracting party may not rely on the terms of a contract if, "by its words or conduct," it led the other party to believe that certain terms in the contract will be ignored, interpreted in a particular way, or given a less strict construction. One type of estoppel recognised in Canada's common law jurisdictions is estoppel by convention, which operates where three criteria are satisfied: 1) a "manifest representation" of a "shared assumption of fact or law" pertaining to the application or construction of a contractual term, 2) one party acts in reliance of the "shared assumption" in a manner that alters its legal position, 3) the party that acted in reliance shows that it did so reasonably and would be significantly harmed if the term is strictly enforced. The Ontario Court of Appeal has held that the "shared assumption" required to invoke estoppel by convention does not need to arise as a representation by the party seeking enforcement of the contractual term. Two distinct but related types of estoppel recognised in Canada are promissory estoppel or estoppel by representation, which enables courts to enforce a promise or representation by one party to a contract stating that it will not invoke a particular term of a contract or rely

upon a particular provision of law if the other party has acted to its own detriment in reliance on such a promise or representation. In Canada's common law provinces and territories, these categories of estoppel serve to require parties to a contract to act in good faith in invoking contractual terms.

Unconscionability

Unconscionability is a doctrine in Canadian contract law that restricts the enforceability of "unfair agreements that resulted from an inequality of bargaining power." The test for unconscionability applied by Canadian courts is to determine whether there was an inequality of bargaining power between the parties to the contract and, if so, whether this inequality resulted in the contract being an "improvident bargain" for the party with lesser bargaining power. The inequality criterion is satisfied where one party is unable to sufficiently protect its interests while negotiating the contract, while the improvidence criterion is satisfied where the contract "unduly advantages the stronger party or unduly disadvantages the more vulnerable." Improvidence must be measured with reference to the time of the contract's formation and involves a contextual assessment of "whether the potential for undue advantage or disadvantage created by the inequality of bargaining power has been realised." Unlike the duty to negotiate in good faith; the doctrine of unconscionability, which applies to contracts in all contexts, does not require the party with greater bargaining power to have intentionally taken advantage of the weaker party or otherwise have acted in bad faith. It is particularly relevant in the context of standard form contracts; especially with regard to choice of law, choice of court or forum selection clauses. Where the disadvantaged party understood the improvident terms of the contract, the contract is unconscionable if they were so reliant on the advantaged party that they assented out of perceived necessity; meanwhile, where the disadvantaged party did not understand the improvident terms, "the focus is on whether they have been unduly disadvantaged by the terms they did not understand or appreciate." The intended purpose of the doctrine of unconscionability is "the protection of vulnerable persons in transactions with others."

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