Terra Firma No More: Supreme Court Changes The Ground Rules On Contracts

The recent Supreme Court decision in *Sattva Capital Corp v Creston Moly Corp* ("*Sattva Capital*") signifies a major shift in the judicial approach to contract interpretation. Although the case itself dealt with a dispute over mining rights, the reasons of the Court will likely have far-reaching repercussions, including in labour and employment matters.

Where We Were

Historically, courts intentionally treated the interpretation of a contract as a "question of law". This meant, quite simply, that courts, arbitrators and other adjudicators were concerned with the legal meaning and effect of the words used in a relatively strict sense. Any other contextual information was ordinarily irrelevant.

There was one notable, yet narrow, exception – the "parol evidence rule". Boiled down, this rule provided that extrinsic evidence is relevant and may be admitted to assist the court's interpretation exercise if the contract is ambiguous in words or in practical application (often called patent or latent ambiguity).

The parol evidence rule, in most cases, acted to prohibit evidence of what the parties *intended* for the contract to say. As such, Courts and arbitrators routinely rejected such parol evidence on the ground that the contract was unambiguous.

The Ground Shifts

In *Sattva Capital,* the Supreme Court rejected this historic approach, finding that the modern approach should be that contractual interpretation is a question of "mixed fact and law". It held that courts should *in all contractual interpretation cases* take notice and use evidence of the "surrounding

circumstances" in which a contract was signed in order to determine the intent of the parties. In effect, the Court stated that contracts must always be evaluated in the context that they were signed, and courts must look beyond simply the plain words of the agreement.

"Surrounding circumstances" was summarized by the Court as being "objective evidence of the background facts at the time of the execution of the contract."

The Court went on to state that this new formulation does not offend the parol evidence rule. The Court characterized (and quite downplayed) the intended purpose of the parol evidence rule, as primarily precluding evidence of the **subjective** intent of the parties. In the Court's reasoning the inclusion of evidence that would affect what a "reasonable person" would perceive was being agreed to is acceptable and does not run afoul of that rule.

Aftershocks

Following *Sattva Capital,* in any case involving a contract, including every labour and employment law case, evidence of the "surrounding circumstances" that existed on the signing of a contract will be admissible in an attempt to prove a different objective intention from the plain words of a contract.

No doubt, employers will take as much advantage of this new modern approach when litigating contract cases as will employees and unions. However, the decision furthers the trend in the courts of infusing greater room for interpretation and determinations based on the specific facts of a case.

Parties previously negotiated (and litigated) on the understanding that they would not be permitted to call evidence to aid in interpretation of unambiguous language. In our experience, this motivated parties to take exceptional care when crafting contractual language, which gave rise to a presumption that having taken such exceptional care the parties were presumed bound to the plain meaning of the words they chose. This reinforcing circle provided a measure of certainty. Why bother contracting if not for certainty?

In the authors' view, regardless of the utility of this new modern approach for any particular party on any particular day, it will likely introduce greater uncertainty in contractual relations.

We will be providing more information on this new world of contractual interpretation, among other current hot topics in labour and employment law, at our 28th Annual Employers' Conference. Attendees receive 6 CPD Credit Hours toward HRPA Recertification and this may apply toward 6 substantive CPD hours with LSUC.

What Employers Should Do

The Court did not comment on the effect of recitals (which often set out the context at the outset of a contract), "entire agreement" provisions (which often specifically exclude any representations and understandings not express in the contract), or agreements to exclude extrinsic evidence (which may very well become common place after *Sattva Capital*).

Consider then:

Two parties have expressly agreed that understandings not express in their contract may not be used to interpret the plain words of their agreement. Will a court admit extrinsic evidence that they didn’t really mean they didn’t want to admit extrinsic evidence of unwritten understandings?

Of course, we pose the rhetorical scenario above, somewhat facetiously, to illustrate an important point – only time will tell what contractual tools, language and schedules of contextual records will best provide certainty of interpretation when contractual relations sour.

Now, more than ever, it is critical to take care when contracting with employees and unions. This new, modern approach should motivate parties to look at a contract as a process, not just an end unto itself. As such, evidence of the process and context becomes as important as the words on the page.

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Article by Jeremy Schwartz and Frank Portman