September 2016

Rolling Back *Sattva*: Appeal Courts Can Second Guess Contractual Interpretation

A window washer's ill-advised cleaning of the windows of a recently constructed tower not only necessitated the costly replacement of all of the tower's windows, but opened the door for the Supreme Court of Canada to reframe its earlier jurisprudence on standard of review.

Background

The immediate dispute in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, concerned the interpretation of a standard form exclusion clause in an all-risk property insurance policy. At issue was whether a faulty workmanship exclusion in the insurance policy excluded coverage for the $2.5 million cost to replace all of the windows or only the $45,000 cost to clean the windows. Against this backdrop, the Court's judgment focuses on how appellate courts should approach their review of a trial court's interpretation of standard form contracts.

Standard Form Contracts

A standard form contract is a highly specialized contract sold widely to customers without negotiation of terms. They are generally offered on a "take it or leave it" basis and examples include a contract with a bank, a telephone company, or an insurance contract. Given how pervasive standard form contracts are in daily business transactions, many contractual disputes that end up before the courts involve these contracts.

Review By Appellate Courts

The law of standard of review creates a division of labour between trial and appellate courts. As the Supreme Court of Canada explains in *Ledcor*, the main function of trial courts is to resolve the particular disputes before them. On the other hand, appellate courts operate at a higher level of legal generality. They ensure that the same legal rules are applied in similar situations and their mandate is to ensure consistency of the law. In exercising these different functions, the term standard of review is used to describe the amount of deference that an appellate court will give to findings by the trial court.

The *Sattva* Decision Brings Clarity to Standard of Review

In 2014, the Supreme Court of Canada issued a significant decision, *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633, regarding the standard of review to be applied by appellate courts when deciding matters of contractual interpretation. The Court in *Sattva* abandoned the historical approach of treating contractual interpretation as a question of law and directed that appellate courts should treat contractual interpretation as a matter of mixed fact and law. This limits intervention by appellate courts to only those cases where the trial judge has made a palpable and overriding error. A palpable error is one that is plainly seen. An overriding error is one that is in regards to a matter that was determinative in resolving an issue. This means that a successful appeal on a matter of contractual interpretation requires meeting the very high standard of showing that the trial judge made both a palpable and an overriding error. Even if the appeal court would have come to a different conclusion, that is not enough to overturn the decision of the lower court.

According to *Sattva*, an appellate court can only conduct a correctness review where there is an extricable question of law (for example, failure to consider a required element of a legal test). The *Sattva* decision was an important advance in the law because of its direction that appellate courts play a very limited role in reviewing matters of contractual interpretation.

Ledcor Introduces an Exception

The *Sattva* decision was said to bring clarity to the law on standard of review. However, just two years later the Supreme Court of Canada's *Ledcor* decision, described above, has reintroduced uncertainty. The *Ledcor* decision carves out an exception to the holding in *Sattva* that contractual interpretation is a question of mixed fact and law subject to deferential review on appeal on the basis that standard form contracts raise unique issues. As the interpretation of a standard form contract is of precedential value and there is no meaningful factual matrix specific to the parties, the interpretation of a standard form contract should be characterized as a question of law subject to a correctness review.

After seemingly drawing this bright line for standard form contracts, the Court in *Ledcor* goes on to say that depending on the circumstances, the interpretation of a standard form contract may still be a question of mixed fact and law (as it would be under *Sattva*). Appellate judges are directed to consider whether the dispute is over a general proposition or a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future.

Coming back to those damaged windows that gave rise to the underlying dispute in *Ledcor*, the Court concluded that the insurance policy was a standard form contract and the standard of review applicable to the trial judge's interpretation of the policy was correctness. The Court sided with the insureds and found that the $2.5 million cost of replacing the damaged windows was covered by the insurance policy.

Implications of *Ledcor*

In carving out an exception for standard form contracts, and then carving out an exception to that exception, the Court has reopened the window to parties arguing about the standard of review that applies to their particular contractual interpretation dispute. Should the agreement be categorized as standard form or negotiated? Is it a negotiated agreement, but with a particular interpretation issue that is likely to have wider precedential value? Or is it a standard form

contract with a particular factual matrix that is relevant to its interpretation?

In addition to reviving the debate over the appropriate standard of review, there is also the possibility that further exceptions will be created. While *Sattva* was intended to streamline the question of deference by appeal courts, *Ledcor* has opened the door to additional exceptions whenever a matter of interpretation can be said to have precedential value.

by Melanie J. Harmer

For more information on this topic, please contact:

Vancouver Melanie J. Harmer 604.691.6851 melanie.harmer@mcmillan.ca

a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

© McMillan LLP 2016