What's Left to Dispute?
A Review of Exclusion Clauses, Liability Caps, and Sole Remedy Clauses

Prepared for: Legal Education Society of Alberta
Business Disputes

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For presentation in:
Lake Louise, May 5, 2018

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INTRODUCTION

The interpretation of exclusion, limitation of liability, and sole remedy clauses is often of key importance in any business dispute. This paper will canvas the law surrounding the interpretation of these provisions and address their impact on dispute resolution.

In general terms, an exclusion clause excludes all liability, or a specific type of liability. Limitation clauses, by contrast, limit the quantum of damages that can be awarded for liability. That said, courts often refer to exclusion and limitation clauses in the same breath, using the two terms interchangeably. Similarly, sole remedy provisions, which restrict the remedies available to a contracting party to the remedies set out in the contract, are often characterized as terms of exclusion or limitation.

Although these provisions vary in their effect, it seems that the Canadian courts have adopted a more or less uniform approach to determining their applicability and enforceability—namely, the three-step test established by the Supreme Court of Canada ("SCC") in *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)*.[1] The test provides a relatively straight-forward, flexible framework, which courts have applied to a wide range of contractual terms that have the effect of limiting (or altogether excluding) a contracting party's liability. Despite the fact that the test emerged in the context of an exclusion clause, subsequent cases have applied it to limitation of liability clauses,[2] sole remedy clauses,[3] liquidated damages clauses,[4] entire-agreement clauses,[5] "no-fault" (also known as "knock for knock") agreements,[6] and even a "no subsequent amendments" term.[7]

This paper will begin with a discussion of *Tercon* and the three-step analytical approach introduced by Binnie J., as he then was. The three sections that follow will consider these steps in more detail, highlighting some of the key issues that arise in their deliberation. The final section offers some practical advice with respect to drafting.

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[1] *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)*, 2010 SCC 4 (S.C.C.) [***Tercon***]

[2] *Swift v. Eleven Eleven Architecture Inc.*, 2012 ABQB 764, varied by 2014 ABCA 49, leave to appeal refused [2014] S.C.C.A. No. 135 [***Swift***]

[3] *Roy v. 1216393 Ontario Inc.*, 2014 BCCA 429 [***Roy***]

[4] *Spartek Systems Inc. v. Brown*, 2014 ABQB 526 [***Spartek***]

[5] *Manorgate Estates Inc. v. Kirkor Architects and Planners*, 2017 ONSC 7154 [***Manorgate***]

[6] *Precision Drilling Canada Limited Partnership v. Yangarra Resources Ltd.*, 2017 ABCA 378 [***Precision***]

[7] *Becker v. Jane Doe No. 1*, 2015 ABQB 144

Note that terms "exclusion" and "limitation of liability" will occasionally be used interchangeably to refer generally to contractual terms which limit liability in some way, either entirely or in some more limited fashion.

TERCON AND THE MODERN APPROACH

As noted, the leading authority on the enforceability of exclusion and limitation of liability clauses is the SCC decision, *Tercon Contractors Ltd. v. British Columbia (Minister of Transportation & Highways)*.

The case concerned a dispute between a construction contractor, Tercon, and the British Columbia Ministry of Transportation and Highways. The decision is important for two reasons: first, it laid to rest the unclear and inconsistently applied doctrine of fundamental breach, and, second, it established a workable three-part test for determining the enforceability of terms that limit, or exclude, liability.

Prior to *Tercon*, there was considerable uncertainty in Canadian case law with respect to the doctrine of fundamental breach and its impact on contractual terms meant to limit liability. The prevailing view was that when a contract is fundamentally breached, the breaching party cannot rely on the terms of the contract—including any exclusions or limitations of liability therein.[8] This proved to be problematic, in both practice and principle. Besides the difficulties in determining what constitutes a "fundamental" breach, the doctrine was inherently inconsistent with principles of modern contractual interpretation and freedom of contract. In practice, there are good reasons for including terms that allocate risk by limiting liability. By invalidating these provisions, the doctrine of fundamental breach sometimes had the effect of overlooking the intentions of the contracting parties and giving one of them an undue right to damages.[9] Thankfully, the SCC unanimously did away the doctrine in *Tercon*.

The facts in *Tercon* are straight-forward. The province issued a request for expressions of interest for designing and building a highway. Six parties made submissions, including Tercon Contractors Ltd. and Brentwood Enterprises Ltd. The province subsequently decided to design the highway itself and issued a request for proposals ("RFP") for the highway's construction. Under the terms of the RFP, only the six parties who responded to the initial request were eligible to submit a proposal.

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[8] Cynthia L. Elderkin and Julia S. Shin Doi, *Behind and Beyond Boilerplate: Drafting Commercial Agreements*, 3rd ed. (Toronto, ON: Thomson Reuters Canada Limited, 2011) at p. 130

[9] For a helpful summary of the historical context of *Tercon*, see: Geoff R. Hall, *Canadian Contractual Interpretation Law*, 3rd ed. (Toronto, ON: LexisNexis Canada, 2016) at 9.12.2.2

Brentwood was unable to submit a competitive bid on its own, however, so it teamed up with another company, who was not a qualified bidder, and together they submitted a bid in Brentwood's name. When Brentwood was named the winning bidder, Tercon brought an action against the province for entertaining the ineligible bid. At issue before the SCC was whether the exclusion clause in the RFP barred Tercon's claim for damages.[10]

With respect to the doctrine of fundamental breach, all nine members of the Court rejected the doctrine. As Cromwell J. (writing for the majority) stated, "On the issue of fundamental breach in relation to exclusion clauses, my view is that the time has come to lay this doctrine to rest".[11]

The nine members also agreed on the three-step analytical approach for determining the applicability of exclusion clauses, which was set out by Binnie J. in his dissent:

> The present state of the law, in summary, requires a series of enquiries to be addressed when a plaintiff seeks to escape the effect of an exclusion clause or other contractual terms to which it had previously agreed.
>
> The **first** issue, of course, is whether as a matter of interpretation the exclusion clause even applies to the circumstances established in evidence. This will depend on the Court's assessment of the intention of the parties as expressed in the contract. If the exclusion clause does not apply, there is obviously no need to proceed further with this analysis. If the exclusion clause applies, the second issue is whether the exclusion clause was unconscionable at the time the contract was made, "as might arise from situations of unequal bargaining power between the parties" (Hunter, at p. 462). This second issue has to do with contract formation, not breach.
>
> If the exclusion clause is held to be valid and applicable, the Court may undertake a third enquiry, namely whether the Court should nevertheless refuse to enforce the valid exclusion clause because of the existence of an overriding public policy, proof of which lies on the party seeking to avoid enforcement of the clause, that outweighs the very strong public interest in the enforcement of contracts. [bold font added]

This approach can be reduced to three questions:

1. Does the exclusion clause apply in the circumstances?
2. If yes, was the exclusion clause unconscionable at the time it was made? and
3. Should the court refuse to enforce the valid exclusion clause because of the existence of an overriding public policy that outweighs the very strong public interest in the enforcement of contracts?[12]

[10] *Tercon* at 9-13

[11] *Tercon* at 62