ESSENTIALS OF CANADIAN LAW

THE LAW OF CONTRACTS

SECOND EDITION

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In this case, the Supreme Court avoided an interpretation of an insurance policy that, in the Court's view, "would render the endeavour on the part of the insured to obtain insurance protection nugatory."[95]

The principle is often expressed in terms of avoiding "absurdity" or "absurd consequences."[96] In this context, however, the concept of absurdity appears to be used interchangeably with the notion of commercial unreasonableness. It is not necessary to establish that the unattractive interpretation of the agreement produces a result that is, in some sense, an outrageous one. Thus, in *Guarantee Co. of North America v. Gordon Capital Corp.*,[97] for example, the Supreme Court of Canada was confronted with a choice between two plausible interpretations of a fidelity insurance bond under which a brokerage was insured against losses caused by dishonest and fraudulent acts of its employees. The dispute concerned, first, the proper interpretation of a provision that enabled "rescission" of the agreement by the insurer in the event that false statements had been included in the application for the bond and second, the effect of an improper exercise of the right to rescind by the insurer on the contractual limitation periods stipulated elsewhere in the bond as binding on the insured. The insured had notified the insurer of a substantial loss. The insurer, having discovered what it considered to be a material misrepresentation in the original application, purported to "rescind" the bond. The insured then commenced this action. The insurer defended the insured's claim, however, on the basis that the insured had not commenced its claim within the applicable two-year limitation period stipulated in the bond. For purposes of a preliminary motion on the limitations point, it was accepted by the parties that the insurer had engaged in an improper rescission of the bond. The interpretation preferred by the insured was that the insurer, having improperly purported to rescind the bond, had committed a repudiatory breach[98] and could not rely on the procedural protections — including the stipulated limitations period for claims by the insured — otherwise available to it under the bond. The Ontario Court of Ap-

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[1893] A.C. 351 [*Glynn*].

95 *Consolidated Bathurst Export*, *ibid.* at 59.

96 See, for example, *Tillmanns & Co. v. S.S. Knutsford Ltd.*, [1908] 2 K.B. 385 at 402, Farwell L.J. ("there is a presumption that business men do not intend to do anything absurd, which is some slight guide; but in all cases it is a matter of construction"); *Toronto (City) v. W.H. Hotel Ltd.*, [1966] S.C.R. 434 at 440 (court's duty is to avoid an "interpretation as would result in commercial absurdity").

97 (1999), 178 D.L.R. (4th) 1 (S.C.C.), rev'g (1998), 157 D.L.R. (4th) 643 (Ont. C.A.) [*Gordon Capital*].

98 See generally, Chapter 15.

peal agreed with the position of the insured on this point.[99] The interpretation preferred by the insurer, however, was that the procedural protections of the limitation period, at least, remained in place. The Supreme Court of Canada reversed the Court of Appeal and accepted the insured's interpretation on the basis that the consequences of the insured's interpretation would lead to a commercial absurdity because it would mean that in any case where the insurer mistakenly attempted to rescind the agreement, such protections would be lost. The insurer "would be exposed to a longer period of uncertainty concerning future claims from an insured who has purportedly engaged in misrepresentation than one who has complied with all the statutory terms."[100] Although the term "absurdity" is employed here, the interpretation offered by the insured was at least a plausible one — as the decision of the Court of Appeal would tend to suggest — but the Supreme Court was evidently of the view that the insurer's interpretation was the more commercially reasonable one.

As one would expect, the more unreasonable or absurd a particular interpretation appears, the greater will be the judicial effort expended in attempting to find a more reasonable interpretation. Indeed, where a literal reading of an agreement leads to "a conclusion that flouts business common sense, it must be made to yield to business common sense."[101] In *L. Schuler A.G. v. Wickman Machine Tool Sales Ltd.*,[102] for example, a German manufacturing firm had retained an English distributor under an agreement that required the distributor, as a "condition" of the agreement, to visit the six largest British car manufacturers once a week. The manufacturer purported to terminate the agreement on the basis that the distributor, having missed a few visits, had breached a "condition" of the agreement, thereby entitling the manufacturer to terminate the relationship. The manufacturer's position was a plausible one. As we have seen,[103] if the term is, indeed, properly characterized as a condition — and a stipulation to that effect would normally be dispositive — the manufacturer would be entitled to terminate for any breach of the term in question. The result, however, was plainly unattractive. Lord Reid characterized the idea that the term should be interpreted in such fashion that even one failure to make a visit could lead to termination was

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99 *Gordon Capital*, above note 97 (Ont. C.A.).

100 *Ibid.* at para. 62 (S.C.C.), Bastarache J.

101 *Antaios Cia Naviera SA v. Salen Rederierna AB (the Anteios)*, [1985] A.C. 91 at 201, Lord Diplock. See also *Mannai*, above note 25 at 771, Lord Steyn. See also *Sirius International Insurance*, above note 16.

102 Above note 25. And see *Rainy Sky SA v. Kookmin Bank*, 2011 UKSC 50.

103 See Chapter 15, Section C.

"so unreasonable that it must make me search for some other possible meaning of the contract."[104] He further observed: "The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear."[105]

Relying on provisions of the agreement relating to the ability of the manufacturer to require the distributor to "cure" material breaches, the court was able to conclude that, notwithstanding the use of the term "condition," the parties did not intend that any breach of the visitation requirement, however minor, would permit the manufacturer to terminate the agreement. Conversely, of course, the less unreasonable the meaning of the provision, the less likely it is that such heroics will be undertaken.[106] As these cases tend to illustrate, however, the open-textured nature of concepts such as "commercial absurdity" or "commercial unreasonableness" leave them, perhaps inescapably, to some extent in the eye of the beholder.

5) Construction *Contra Proferentum*

The principle of construction *contra proferentum* holds that provisions in agreements and other written documents that suffer from ambiguity are to be construed against the interest of the person who drafted or proferred the ambiguous provision. The doctrine was described by Estey J. in *McClelland & Stewart*[107] in the following terms: "That principle of interpretation applies to contracts and other documents on the simple theory that any ambiguity in the term of the contract must be resolved against the author if the choice is between him and the other party to the contract who did not participate in its drafting."[108]

The apparent rationale for the rule is that the author of the agreement, having had an opportunity to protect his or her interest, ought to be able to take advantage of such protections as have been inserted only to the extent that they are clearly communicated in the language of the agreement to the other party. The doctrine works against unfair surprise of the non-drafting party.[109] A further underlying concern may

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104 *L. Schuler A.G.*, above note 25 at 251.

105 *Ibid.*

106 See, for example, *Yorkwood Homes (Georgetown) Inc. v. Law Development Group Georgetown (No. 2) Ltd.* (1999), 45 O.R. (3d) 257 (C.A.).

107 Above note 82.

108 *Ibid.* at 15.

109 See *Arthur Andersen*, above note 23 at 395, Abella J.A.