ONCA weakens entire agreement clauses in contract interpretation

April 08, 2026

Entire agreement clauses are often treated as a contractual safety net: once the definitive agreement is signed, prior drafts, negotiations, and understandings are meant to fall away. Courts have long recognized limited exceptions to that rule, most notably the use of surrounding circumstances as part of the factual matrix to resolve genuine ambiguity in the contract's language.

In *Project Freeway Inc. v ABC Technologies Inc.*, 2025 ONCA 855, the Ontario Court of Appeal acknowledged the rule and the exceptions, but it endorsed reliance on a letter of intent as an interpretive aid even though the letter of intent was non-binding and specifically excluded by the entire agreement clause. The court treated the letter of intent as part of the factual matrix of the agreement.

The decision raises a pointed question: when a document is clearly identified as not forming part of the parties' agreement, how far can it be used to inform what that agreement means?

What you need to know

- Entire agreement clauses are strong evidence that the agreement is the final expression of the parties' agreement. They generally prevent the admission into evidence of other agreements, understandings or negotiations that may vary or contradict the express terms in a written agreement.[1]
- Entire agreement clauses are particularly important where there is extensive back and forth negotiations between parties. They help to ensure that terms that were previously considered and rejected do not override the final agreement.
- Historically, the factual matrix was broad, but "not unlimited". The factual matrix did not include evidence of negotiations "except perhaps in the most general of terms", because only the final document records the actual agreement between the parties.[2]
- Even when considering the factual matrix, negotiations have generally been inadmissible.

Facts of *Project Freeway*

The case centred on a dispute between a vendor, Project Freeway Inc., and purchaser, ABC Technologies Inc., over the amount of additional earn out payments following the close of a share purchase agreement.

In October 2022, the parties entered into a non-binding letter of intent to describe the terms of the eventual share deal (**Letter of Intent**). The Letter of Intent contained covenants, but not final terms, relating to an eventual Earn Out payment (as defined below), including:

- The purchaser would not take any action to intentionally impair the vendor's ability to earn Earn Out payments, including agreeing not to divert resources, contracts with customers, or direct business opportunities away from the business in a manner that materially impairs the ability to achieve the Contribution Margin Targets;
- The purchaser would not act in bad faith to intentionally impair the vendor's ability to earn Earn Out payments, provided that the purchaser not be prohibited in any way from closing, merging or consolidating any of the acquired facilities of the business with any of the purchaser or its affiliate facilities;
- The purchaser will maintain an adequate amount of working capital for the business consistent with the purchaser's other business units; and
- A sale of the business, or failure to follow the operating covenants in the eventual purchase agreement in a manner which materially impairs ability of seller to earn Earn Out payments, will result in the acceleration of the Earn Out payments.

On December 21, 2022, the purchaser and vendor entered into the final share purchase agreement (**SPA**). The purchaser paid a base purchase price of US$165,000,000, with an additional US$26,461,000 to be paid out in three tranches over two years based on financial performance (**Earn Out**). The SPA further provided for an acceleration of the Earn Out payment in specific circumstances, including if prior to the end of the Earn Out period:

> The Purchaser […] (B) **directly or indirectly, sells, transfers or licenses a material portion of the assets of the Business of the Target Companies in one or a series of transactions to any Person other than an Affiliate of the Purchaser.** For greater certainty, the Parties agree that the foregoing clause shall not limit the Purchaser's right to complete mergers, amalgamations or other internal reorganizations with or among the WM Group and Affiliates of the Purchaser, and shall specifically exclude a change of control of the Purchaser Guarantor; [Emphasis added.][3]

The SPA also included an Entire Agreement clause which specifically excluded the Letter of Intent:

> This Agreement […] constitute[s] the entire agreement among the Parties with respect to the transactions contemplated by this Agreement, and ***supersedes*** *all prior agreements,* ***understandings, negotiations and discussions****, whether oral or written, of the Parties with respect to such transaction,* ***including the Letter of Intent*** […]. [Emphasis added][4]

Following the SPA's close on March 1, 2023, the purchaser entered into two transactions:

- **The Sale Lease Back** Transaction: the purchaser sold lands and buildings to a third party, then entered into long-term leases for the properties.
- The **Factoring** Transaction: the purchaser sold customer accounts to HSBC. The purchaser had other existing factoring agreements with HSBC and joined this transaction to the existing agreements.

The vendor did not provide written consent for either transaction. However, two of the vendor's executives facilitated site visits for the Sale Lease Back transaction prior to the SPA's close.

In November 2023, the purchaser provided the vendor with the first Earn Out statement, indicating the requirements for the accelerated Earn Out had not been met. The vendor subsequently objected on the basis that the Sale Lease Back was material and triggered the accelerated Earn Out.

The decision of the trial court

The core issue on the application was whether the Sale Lease Back and Factoring transaction were "material" such that they triggered the accelerated Earn Out payment.[5] The SPA left a gap by failing to define "material." As a result, the Entire Agreement Clause, and the extent to which it restrained the use of the Letter of Intent as an interpretative tool, was considered by the Court.

The vendor argued that the Sale Lease Back transaction fell under a plain reading of "material" and triggered payment; the value or the transaction represented approximately 59 per cent of the SPA purchase price. The purchaser argued that "material" could not just mean "expensive", its meaning had to be tied to the Earn Out itself. They argued these were non-substantive, ordinary financing transactions which had no impact on the business beyond to generate on-hand cash. The purchaser further argued that the application judge should look to the Letter of Intent as "objective evidence of the parties at the time of the definitive agreement". The vendor argued that the entire agreement clause precluded consideration of the Letter of Intent.

The judge at first instance held that the Letter of Intent could be considered as "objective evidence" of the parties understanding at the time of the definitive agreement and that the entire agreement clause did not preclude her from considering "admissible evidence of the surrounding circumstances at the time of the contract formation".[6] This conclusion was reached even though the Letter of Intent was explicitly non-binding, the parties had only agreed on certain covenants related to the Earn Out, had not fully negotiated the terms, and the SPA was signed two month later. The application judge held that the covenants in the Letter of Intent supported the purchaser's interpretation of "material". The application judge found that the Sale Lease Back and Factoring transactions were ordinary course financing transactions with no impact on the operation of the business. Accordingly, the accelerated Earn-Out Payment was not triggered.

The decision of the Court of Appeal

In short reasons, the Ontario Court of Appeal dismissed the vendor's appeal.

The Court of Appeal held that reliance on the Letter of Intent did not offend the Entire Agreement Clause because it was part of the factual matrix and, thus, a permissible consideration. The application judge was entitled to use the Letter of Intent as an "interpretative aid to identify what the agreement between in the SPA was, so that she could apply the entire agreement in resolving the issue before her".[7]

Analysis

While courts are permitted to consider the factual matrix, or the surrounding circumstances, of a contract, evidence of negotiations has still been held by several Courts to be inadmissible. The most recent Supreme Court of Canada case on this issue, *Corner Brook (City) v Bailey,* did not decide the matter. Rather, the Supreme Court of Canada noted that the inadmissibility of negotiations "sits uneasily" in the factual matrix analysis, but left that issue "for another day", noting that there should be "a case where it has been fully argued."[8]

Project Freeway is one of the first appellate level decisions to endorse reliance on a document that was otherwise excluded by an Entire Agreement clause. While previous appellate decisions have bypassed limits on the use of broadly defined "negotiations" or "surrounding circumstances"[9], the Court's specific reliance on the Letter of Intent here goes further. This may have been driven by necessity due to the fact the term "material" was not defined. Had the court not used the Letter of Intent, it is not clear how the term "material" would have been interpreted.

In *Project Freeway*, it seems that the court has made a very fine distinction, suggesting that it is permissible to use a Letter of Intent to *interpret* the SPA without offending the Entire Agreement Clause, but it would be impermissible to *incorporate or add* a term. Even when considered through this lens, this distinction is interesting since the Entire Agreement clause superseded prior understandings, negotiations and discussions, including the Letter of Intent.

Key takeaways

- Pre-contract drafts that include draft provisions or terms that are, at the time, not intended to form part of the final agreement, may require exclusionary clauses indicating the point-in-time nature of the terms, and explicitly precluding the terms as drafted from intervening on the final agreement.
- When drafting final agreements, commonly used terms, such as "material", should be defined, even if their meaning seems obvious, to avoid subsequent disputes. Final agreements should also be evaluated within the context of any pre-contractual agreements, and where there are differences, the supremacy of the final agreement terms may require specific identification.
- Entire agreement clauses must be drafted with precision and specificity, and parties should consider explicit exclusions of all previous negotiations, pre-contract drafts, and agreements-in-principle.
- Parties may consider very clear exclusionary language to ensure prior negotiations or drafts are not subsequently used as interpretative aids for the final agreement. Whether that will withstand scrutiny, remains to be seen.

Footnotes

[1] *Whiteside v Celestica International Inc.,* 2013 ONSC 323 at para 107.

[2] Canadian Contractual Interpretation Law, 3rd edition, by Geoff Hall at s. 2. 3.4, p. 30. See also *Penn v Simmonds* [1971] 3 All E.R. 237 (H.L.)

[3] SPA s. 3.10(12)(a).

[4] SPA s. 14.11.

[5] The case was brought as an application under Rule 14.05(3)(d) and (h) of the *Rules of Civil Procedure*, RRO 1990, Reg. 194, not an action. This means at issuance, the applicant deemed that the relief claimed sought the determination of rights that depend on the interpretation of a contract, and it was unlikely that there would be any material facts in dispute requiring a trial.

[6] *Project Freeway Inc. v ABC Technologies Inc.*, 2025 ONSC 1048 at para 50, citing *Ontario First Nations (2008) Limited Partnership v Ontario Lottery and Gaming Corporation*, 2021 ONCA 592.

[7] *Project Freeway Inc. v ABC Technologies Inc*., 2025 ONCA 855 at para 14.

[8] *Corner Brook (City) v Bailey*, 2021 SCC 29 at para 56.

[9] See *Ontario First Nations (2008) Limited Partnership v Ontario Lottery and Gaming Corporation*, 2021 ONCA 592; *IFP Tehcnologies (Canada) v EnCana Midstream and Marketing,* 2017 ABCA 157.

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