Supreme Court defines use of exclusion clauses in Ontario sale contracts

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Sellers of products often attempt to exclude liability for implied warranties and conditions, including those implied into the contract of sale by virtue of sale of goods legislation. The analysis as to whether such exclusions clauses are enforceable has now been articulated by the Supreme Court of Canada in its May 31, 2024, decision in *Earthco Soil Mixtures Inc. v Pine Valley Enterprises Inc.*, 2024 SCC 20 (*Earthco*). While *Earthco* addressed a contract clause purporting to exclude an implied condition under Ontario's *Sale of Goods Act* (SGA), it has broader application given that most provinces contain similar statutory language.

Sections 14 and 15 of the SGA imply into every contract of sale certain implied conditions: fitness for purpose, merchantability and that the goods correspond with the description. While these conditions are implied, s. 53 of the SGA permits parties to contract out of these and other provisions of the SGA, provided they do so through one of several ways, one of which is an "express agreement".

The appeal concerned a seller's ability to contract out of an implied condition of sale under s. 14 of SGA that goods sold by description must correspond with their description. The court considered whether an exclusion clause in the contract was an "express agreement" to oust liability for the breach of this implied condition.

Writing for a 6-1 majority, Justice Martin held that an express agreement for the purposes of s. 53 of the SGA must comprise an agreement to oust a statutory implied condition and must be expressly set out in the contract. The paramount consideration is to determine the objective intention of the parties, which is determined by the words used and the surrounding factual circumstances.

Background

Pine Valley Enterprises Inc., a municipal parks contractor, was hired by the City of Toronto for a project to remediate basement flooding, which included the removal and replacement of topsoil to improve drainage. Pine Valley contracted Earthco Soil Mixtures Inc., a topsoil provider, to obtain topsoil with a specified composition.

Earthco provided Pine Valley with laboratory reports from different topsoil samples that had been taken about six weeks previously. Earthco warned Pine Valley to wait for updated test results of the topsoil before purchasing. Because Pine Valley was in a rush to meet its project deadlines to avoid paying liquated damages to the City, it waived its right to test the soil and insisted on immediate delivery.

Both parties agreed to add two clauses to the contract, one which allowed Pine Valley to test the soil before shipment and a second stated that if Pine Valley waived its right to testing, then Earthco "will not be responsible for the quality of the material once it leaves our facility".

The City of Toronto ultimately required Pine Valley to remove and replace the topsoil at the project site due to water ponding. Testing revealed there was substantially more clay in the topsoil than the previous test results had indicated. Pine Valley sued Earthco for damages, alleging that Earthco was liable for its loss because Pine Valley did not receive topsoil within the range of compositional properties that had been indicated in the earlier test results.

Lower court decisions

The trial judge dismissed Pine Valley's action, concluding that the exclusion clause was an express agreement pursuant to s. 53 of the SGA. Although the exclusion clauses did not explicitly state that they were added to the contract to oust the implied conditions of the SGA, the trial judge found that Pine Valley's waiver of its right to test the soil indicated that it deliberately assumed the risk that the topsoil would not meet the contract's specifications.

The Court of Appeal disagreed with the trial judge's ruling, unanimously finding that the exclusion clause did not oust liability under s. 14 of the SGA because it lacked wording that explicitly, clearly, and directly referred to any statutory "conditions" or to the "identity" of the goods. Instead, the exclusion clauses only referred to the "quality" of the soil.

The Supreme Court's majority decision

The Supreme Court restored the trial judge's ruling that the exclusion clause was an express agreement pursuant to s. 53 of the SGA. Justice Martin held for the majority that an express agreement for the purposes of s. 53 must comprise an agreement to negative or vary a statutorily implied right, duty, or liability, and that this agreement must be expressly set out in the contract.

However, Justice Martin emphasized that courts should use a flexible approach focused on the objective intention of the parties when interpreting exclusion clauses under s. 53. Case law has demonstrated a shift away from a strict, technical approach to contractual interpretation. Instead, a court must apply the principles of modern contractual interpretation previously established by the Supreme Court in *Sattva Capital Corp. v. Creston Moly Corp*, 2014 SCC 53 and *Tercon Contractors Ltd v British Columbia*, 2010 SCC 4. These principles include considering the words used, the surrounding circumstances, and the nature of the contracting parties and their level of contracting sophistication. Justice Martin stated that the paramount goal is to determine whether the

objective intention of the parties was to exempt one party from statutorily imposed liability.

Accordingly, Justice Martin concluded that express agreement does not mandate particular or explicit language. No “magic words” are required, but the agreement must be made in distinct and explicit terms and not be left to inference. The parties must have expressly and unambiguously used language in the agreement that signals their intention to override the statutorily implied obligation. Silence or omission will not suffice. Furthermore, a court cannot imply, impute, or infer an intention to oust the statute based on conduct.

Justice Martin explained that, in the present case, the parties purposefully inserted two expression written clauses into their contract that provided that if Pine Valley waived its right to test and approve the topsoil, then Earthco would not be responsible for the quality of the soil once it left Earthco’s facility. Therefore, the objective intention of the express agreement was for Pine Valley to accept the risk that the composition of the topsoil would not meet specifications if it failed to test the provided soil.

Justice Martin noted that a key surrounding circumstance was that the parties were free to choose how to negotiate and allocate the risk of not testing the soil before shipment. Pine Valley deliberately chose not to test the soil and assumed the risk that the soil would not meet the project requirements in favour of faster delivery. Pine Valley made this choice consciously and strategically to avoid financial penalty for project delay.

Moreover, Pine Valley was a commercial purchaser that had years of experience with purchasing large amounts of topsoil, which it knew was an organic and changing material. The parties reasonably understood the word “quality” to describe and include all the properties of the topsoil, including its percentage-based composition. Pine Valley and Earthco used the word “quality” in its ordinary sense and not in its legal sense.

The majority of the Supreme Court rejected the Court of Appeal’s conclusion that the exclusion clauses needed to explicitly refer to “conditions” or “identity” to oust the SGA because the clauses contained direct, clear, and expressive language that demonstrated the parties’ objective intention for Pine Valley to waive its right to pursue Earthco for liability related to the soil.

Implications and key takeaways

The Supreme Court previously held in *Sattva* and *Tercon* that contractual interpretation is guided by what the parties objectively intended when forming the contract and what they reasonably understood their words to mean. In the present case, the Supreme Court clarified that these principles extend to contracts for the sale of goods. Modern contractual interpretation requires courts to consider the factual circumstances surrounding contract formation, in addition to the contractual words, in order to discern the objective intention of the parties.

The Supreme Court noted that the “gold standard” is for parties to use language that explicitly, clearly, and directly ousts statutory protections to ensure such terms are enforced. The absence, however, to use such explicit language is not (no longer) fatal;

rather, a full analysis of the factual circumstances and language used is required to determine whether the parties objectively intended to oust statutory protections.

For more information on the interpretation and enforceability of exclusion clauses, please contact the author listed below.

The author would like to thank Victoria Chen, Summer Law Student, for her contributions to this article.

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