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RECENT DEVELOPMENTS & TRENDS IN CASE LAW

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Can a Court Imply Terms in a Commercial Agreement?

As a general rule, Canadian Courts do not like implying terms in a commercial contract. The Courts do their utmost to avoid rewriting the agreement between the parties. In very limited circumstances, however, a Court may feel compelled to imply certain words or obligations to "fill in the gaps" in a contract. When this happens, the Court emphasizes that it is not rewriting the contract, but simply articulating what the parties intended to include or ought to have included in their agreement.

Such was the Ontario Court of Appeal's position in the decision *Energy Fundamentals Group Inc. v. Veresen Inc.*, 2015 ONCA 514, per Pardu J.A. ("*Energy Fundamentals*"). In *Energy Fundamentals*, the Court implied a disclosure obligation in an option agreement; this was done in order to give "business efficacy" to the contract.

The Facts

The plaintiff investment bank, Energy Fundamentals Group Inc. ("EFG"), entered into a two-and-a-half page letter agreement (the "Letter Agreement") with the Defendant, Veresen Inc. ("Veresen"). Under the Letter Agreement, EFG agreed to assist Veresen in developing a natural gas terminal in Oregon (the "Project").

The Letter Agreement gave EFG the option to acquire up to a twenty per cent interest in the Project, depending on successful financing (the "Option"). In order to exercise the Option, EFG had to pay a proportionate share of all development equity contributed by Veresen, as well as a return on Veresen's development equity. If EFG became a partner, it also had to pay a proportionate share of future project costs. In short, EFG had to pay several hundred million dollars in order to take advantage of the Option.

Because EFG was Veresen's financial advisor, EFG was privy to confidential information about the Project. However, once EFG indicated its intention to exercise the Option, one of its

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representatives who sat on the board of the Project's general partner was terminated.

As a result of changes in the price of natural gas, Veresen decided that it would build an export facility, rather than import facility. Veresen argued that this fundamental change to the nature of the Project was of such significance, that EFG's Option no longer applied.

Ultimately, Veresen represented to EFG that the cost of exercising its Option would outweigh the economic benefit of doing so. Critically, Veresen then refused to provide EFG with the documents to verify the pricing of the Option or its economic value.

Accordingly, EFG brought an application to the Ontario Superior Court (the "Application"). On the Application, the judge implied a contractual duty on the part of Veresen to disclose information in order to allow EFG to determine whether to exercise the Option. The Applications Judge held that EFG's right to value and price disclosure was needed to give "business efficacy" to the contract between the parties.

Veresen appealed.

Veresen took the position that EFG chose not to bargain for a contractual right of disclosure with respect to the Option and therefore, as a sophisticated commercial party, EFG was not entitled to the benefit of an implied contractual term requiring disclosure.

EFG took the position that it would not have invested millions of dollars if it did not have a right to verify Veresen's calculation of the Option price and to review Veresen's records in order to assess the value of the Option.

Ultimately, the Court of Appeal upheld the Application Judge's ruling and implied a disclosure obligation with respect to the Option.

When Will a Court Imply Terms in a Contract?

The Court of Appeal canvassed the law regarding the limited circumstances in which a Court will imply the terms in a contract.

First, the Court held that a contractual term can be implied "on the basis of the presumed intentions of the parties where necessary to give business efficacy to the contract".

Second, the Court held that a contractual term could be implied where the "officious bystander test" is met. The "officious bystander test", long part of the common law governing contracts, derives from the United Kingdom and provides as follows:

> …that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying. Thus, if while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common: 'Oh, of course'.

The Court further noted that in order to imply a term in a contract, it did not have to make a finding that the parties actually thought about a term or expressly agreed to it: "Often terms are implied to fill gaps to which the parties did not turn their minds". This principle notwithstanding, the Court held that it will not imply a term that contradicts the express language of the contract or is unreasonable.

In this case, the Letter Agreement was clearly not intended to be a comprehensive iteration of the contract between the parties. The Option would have been "illusory" unless EFG had a right to disclosure. Thus, the implied term was necessary to give "business efficacy" to the agreement. EFG would not "blindly exercise the [O]ption without knowing whether it would make economic sense to do so".

Is the Implied Term based on the Intentions of Reasonable Parties?

Veresen further argued that in implying a disclosure term with respect to the Option, the Applications Judge was required to focus on the intention of the *actual* parties, rather than the intentions of *reasonable* parties.

The Court of Appeal held that the Applications Judge did not err in

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concluding that no reasonable person would have entered into the Option without a right to financial disclosure.

Citing John D. McCamus, *The Law of Contracts*, 2nd ed. (Toronto: Irwin Law, 2012) at 781, the Court held that it is "inescapable" that the Courts will apply a reasonable intentions standard when implying a term in a contract. Courts presume that the intent of contractual parties is reasonable. Courts assume that parties will behave reasonably and will agree to reasonable terms.

Accordingly, in this case, a reasonable term is that the Option could only be exercised upon EFG obtaining disclosure from Veresen.

Does "Good Faith" Matter When Implying a Term in a Contract?

The Court of Appeal further held that the Applications Judge made no error when he relied on the principle of "good faith" to fill in the gaps in the contract between EFG and Veresen. Specifically, Veresen had initially agreed that it would provide pricing information to EFG.

To maintain Veresen's good faith obligation to EFG, it was necessary to imply a term in the contract whereby EFG would not be blindly accepting Veresen's calculation of the Option price.

Implications of the *Energy Fundamentals Group* Decision

Energy Fundamentals does not represent a radical departure from the common law regarding when a Court will imply a term in a commercial agreement.

The Court's reasoning appears to have been driven by two considerations: (i) the desire to do what was fair and equitable in order to allow EFG to meaningfully exercise its Option; and (ii) the need to require Veresen to act reasonably and in good faith, according to its contractual obligations.

In this sense, the Court's willingness to imply a contractual term was motivated by the equities of the case; the principle of giving "business efficacy" to the agreement allowed the Court to achieve this end.

For more information on the implications of *Energy Fundamentals* to your commercial agreements, contact the author, Marco P. Falco, at mfalco@torkinmanes.com.

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