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Does a terminated contract "cease to exist"?

Introduction

On April 19, 2022, we released an article on the Divisional Court's decision in *SOTA Dental Studio Inc. v. Andrid Group Ltd.*[1] to dismiss an application for judicial review because of the applicant's failure to comply with the adjudicator's determination.

While the Divisional Court's decision was a great one for Andrid Group Ltd. (*"Andrid"*) and for the enforceability of the new prompt payment provisions of the *Construction Act*, R.S.O. 1990, c. C.30 (the "*Act*") generally, the underlying merits of SOTA Dental Studio Inc.'s ("*SOTA*") application were not addressed.

A decision based on the merits of the application itself—would have provided the construction industry with important insight into a number of legal issues related to the new prompt payment and adjudication provisions of the "*Act*", legal issues that will likely find themselves before the Divisional Court in the future.

This article provides the industry with insight on these underlying merits, focused on the critical question of: "Does a construction contract cease to exist upon termination?".

Factual Background

The facts are straight forward. SOTA, the owner, hired Andrid, the contractor, to build out a dental wellness clinic in a commercial building.

In February 2021, Andrid delivered two invoices to SOTA. In mid-March 2021, Andrid delivered two revised invoices which complied with the requirements for a proper invoice pursuant to s. 6.1 of the *Act*, following which a paralegal representing SOTA sent a letter to Andrid purporting to terminate the contract. Despite the purported termination, no notice of non-payment was given by SOTA to Andrid, nor did SOTA pay the proper invoices within 28 days as required by s. 6.4(1) of the *Act*.

As a result of SOTA's failure to pay the proper invoices, Andrid commenced an adjudication, during which SOTA did not argue that the termination of the contract rendered adjudication unavailable. Andrid received a favorable determination from the adjudicator, finding the invoices to be proper invoices and enforcing s. 6.4(1) of the *Act.* The determination was simple: because SOTA failed to deliver a notice of non-payment in accordance with s. 6.4(2) of the *Act*, SOTA was required to make payment.

SOTA thereafter sought and was granted leave to bring an application for judicial review of the adjudicator's decision.

[1] 2022 ONSC 2254.

The Issues

SOTA's application to set aside the adjudicator's determination centered on two arguments:

1. That the determination ought to be set aside in accordance with s 13.18(5) of the *Act* because the contract "ceased to exist" once terminated, which was prior to the commencement of the adjudication.

2. The adjudicator's decision was unreasonable in that it contained a fundamental error with respect to whether the invoices met the requirements of a proper invoice pursuant to s. 6.1 of the *Act*.

The second argument is not addressed in this article, other than to point out that s. 13.18(5) of the *Act* contains a specific list of grounds for setting aside an adjudicator's determination, none of which include reasonableness or errors in the underlying determination. Further, interim adjudication is intended to be a form of rough justice and in accordance with the UK jurisprudence, the adjudicator has the right to be wrong. While s. 13.18(5) sets out grounds for setting aside a determination, judicial review is not intended to enable a party to relitigate its case, especially since s. 13.15 of the *Act* provides for the parties' rights to have the matter determined by the courts, by arbitration, or by written agreement, notwithstanding the determination.

On the first issue, Andrid argued that a contract does not cease to exist simply because it has been terminated. Accordingly, the issue that the Divisional Court would have been required to address is a statutory interpretation issue. Both parties agreed with the application of the principles of statutory interpretation as set out by the Supreme Court of Canada in *Re Rizzo & Rizzo Shoes Ltd*.[2] That is, words of a statute are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the *Act,* the object of the *Act,* and the intention of the Legislature. The resulting issues before the Divisional Court, which are discussed in this article, are as follows:

1. Does the plain language of the *Act* necessitate an interpretation that termination results in a contract ceasing to exist?
2. Does the common law support a finding that a terminated contract ceases to exist?
3. Did the Legislature intend for adjudications to be available after the termination of a contract, having regard for the scheme and object of the *Act*?
4. Does making adjudication available after termination of a contract result in an absurdity in the *Act?*

(1) Does the plain language of the *Act* necessitate an interpretation that termination results in a contract ceasing to exist?

The plain language of the *Act* does not support an interpretation that termination results in a contract ceasing to exist. Simply put, s. 13.5(3) of the *Act* which provides that an adjudication may not be commenced if the notice of adjudication is given after the date the contract or subcontract is "completed". It does not deny the right to adjudication after a contract has been "terminated".

[2] *Re Rizzo & Rizzo Shoes Ltd*., [1998] 1 SCR 27 (SCC) at para. 21.

Further, the *Act* enumerates the grounds for setting aside an adjudicator's determination on an application for judicial review under s. 13.18(5). The relevant ground that SOTA relied upon was that the "contract or subcontract is invalid or has ceased to exist". The provision does not state "the contract or subcontract is terminated".

Although the Supreme Court of Canada has cautioned that this principle must be used with care, the well-known principle of statutory interpretation referred to as *"expressio unius est exclusio alterius"*, more easily understood in English as "implied exclusion" supports this reasoning. This principle was discussed in *SRK Woodworking Inc. v. Devlan Construction Ltd. et al.*[3]*:*

> 57 In R. v. Boyle, 2019 ONCJ 11, the court commented beginning at para. 15:
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> **The principle of statutory interpretation known as "expressio unius est exclusio alterius" does not support the defendant's position**
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> [15] This principle of interpretation is more easily understood, for those who do not understand Latin, by the English term of "implied exclusion", as expressed by Professor Ruth Sullivan in her text "*Sullivan on the Construction of Statutes*" (6th edn., 2014, LexisNexis). As Professor Sullivan writes at page 248, **an implied exclusion argument lies whenever there is reason to believe that if the legislature had meant to include a particular thing within its legislation, it would have included that thing expressly. [emphasis added]** This expectation results in the conclusion that the failure to mention the thing becomes grounds for inferring that it was deliberately excluded.
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> [16] Professor Sullivan writes at page 248:
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> > The force of the implication depends on the strength and legitimacy of the expectation of express reference. The better the reason for anticipating express reference to a thing, the more telling the silence of the legislature.
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> **[17] The particular form of the implied exclusion argument relied on by the defendant is called by Professor Sullivan "failure to follow an established pattern". [emphasis added]** The defendant submits that because service of the application record for a s. 278.4 hearing for the production of third party records is expressly provided for in s. 278.3(5), and there is no such provision for an application to determine the admissibility of evidence of other sexual activity under s. 276(2), Parliament must have intended that the latter application records not be served on the complainant.
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> [18] One way in which the implied exclusion argument may be rebutted is by offering an alternative explanation of why Parliament expressly mentioned something in one section and excluded it in another. (Sullivan, p. 255) In my view, there is such an alternative explanation in this case.

Importantly, the words "terminate", "terminated", and "termination", used in reference to the termination of a contract, are found throughout the *Act* but not in the two provisions that SOTA relied upon.[4]

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[3] *SRK Woodworking Inc. v. Devlan Construction Ltd. et al*., 2022 ONSC 1038 at para. 57.

[4] See for example: s. 31(2), s. 31(2.1), s 31(3), s. 31(6), s. 31(7) and s. 72 of the *Act.*

In fact, the word "terminated" was included in some provisions added to the *Act* by Bill 142, the same bill that added prompt payment, adjudication and s. 13.18(5) to the *Act*. For example, Bill 142 introduced s. 31(6) of the *Act* which requires the publication of a notice of termination if a contract is terminated. Similarly, s. 31(7) was introduced by Bill 142 and provides that the publishing of the notice in s. 31(6) does not prevent a person from contesting the validity of a termination.

Therefore, the use of the word "terminated" in portions of the Act, but not in the two relevant sections, supports the "implied exclusion" argument. That is, "terminated" was intentionally excluded from s. 13.5(3) and s. 13.18(5)2.

Simply, a plain reading of the *Act* does not support the finding that a terminated contract ceases to exist.

(2) Does the common law support a finding that a terminated contract ceases to exist?

Settled law on the concepts of rescission and repudiation do not support a finding that a terminated contract ceases to exist. Rescission and repudiation are two distinct legal concepts. The difference between the two concepts was outlined by the Supreme Court of Canada in *Guarantee Co of North America v Gordon Capital Corp.*:[5]

> *39 A fundamental confusion seems to exist over the meaning of the terms "rescission" and "repudiation". This confusion is not a new one, as it has plagued common law jurisdictions for years.* ***Rescission is a remedy available to the representee, inter alia, when the other party has made a false or misleading representation*** **[emphasis added].** *A useful definition of rescission comes from Lord Atkinson in Abram Steamship Co. v. Westville Shipping Co., [1923] A.C. 773 (H.L.), at p. 781:*
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> > *Where one party to a contract expresses by word or act in an unequivocal manner that by reason of fraud or essential error of a material kind inducing him to enter into the contract he has resolved to rescind it, and refuses to be bound by it, the expression of his election, if justified by the facts, terminates the contract,* ***puts the parties in status quo ante and restores things, as between them, to the position in which they stood before the contract was entered into*** **[emphasis added].**
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> See similarly G. H. L. Fridman, The Law of Contract in Canada (3rd ed. 1994), at p. 807.
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> *40 Repudiation, by contrast, occurs "by words or conduct evincing an intention not to be bound by the contract. It was held by the Privy Council in Clausen v. Canada Timber & Lands, Ltd. [[1923] 4 D.L.R. 751], that such an intention may be evinced by a refusal to perform, even though the party refusing mistakenly thinks that he is exercising a contractual right" (S. M. Waddams, The Law of Contracts (4th ed. 1999), at para. 620). Contrary to rescission, which allows the rescinding party to treat the contract as if it were void ab initio, the effect of a repudiation depends on the election made by the non-repudiating party. If that party treats the contract as still being in full force and effect, the contract "remains in being for the future on both sides. Each (party) has a right to sue for damages for past or future breaches" (emphasis in original): Cheshire, Fifoot and Furmston's Law of Contract (12th ed. 1991), by M. P. Furmston, at p. 541.* ***If, however, the non-repudiating party accepts the repudiation, the contract is terminated, and the parties are discharged from future obligations. Rights and obligations that have already matured are not extinguished*** [emphasis added]. Furmston, supra, at pp. 543-44.[6]

[5] *Guarantee Co. of North America v. Gordon Capital Corp*. (1999), 39 C.P.C. (4th) 100 (S.C.C.).
[6] *Guarantee Co. of North America v. Gordon Capital Corp*. (1999), 39 C.P.C. (4th) 100 (S.C.C.) at para 39-40.

Rescinding a contract will lead to a contract ceasing to exist. On the other hand, a repudiated contract, while terminated, has not ceased to exist. In other words, a rescinded contract "ceases to exist" but a repudiated contract does not because rights and obligations that have already matured are not extinguished.

The Ontario Court of Appeal has also clarified that just because a contract has been terminated, it does not mean it has ceased to exist:

> *Although the Court does say that accepted repudiation "terminates" the contract, the context reveals that only future obligations under the contract are extinguished. Accrued obligations under the contract continue to exist, at least in the form of a secondary obligation to pay damages.* ***To the extent that there remain in existence contractual obligations, it cannot be said that the contract ceases to exist*** [emphasis added].[7]

The argument that a contract "ceases to exist" once it is terminated, was also raised in another adjudication with ODACC. In that determination, the adjudicator found that the "*Contract between the Claimant and the Respondent has not ceased to exist for the purpose of subsection 13.18(5)2 even if it has been terminated or abandoned*."

In rendering its decision, the adjudicator referred to *Heyman v Darwins*, the seminal House of Lords case regarding the availability of arbitration in circumstances where a contract has been terminated. The decision discussed the concept of repudiation:

> ***I am, accordingly, of opinion that what is commonly called repudiation or total breach of a contract, whether acquiesced in by the other party or not, does not abrogate the contract, though it may relieve the injured party of the duty of further fulfilling the obligations which he has by the contract undertaken. The contract is not put out of existence, though all further performance of the obligations undertaken by each party in favour of the other may cease*** **[emphasis added].** *It survives for the purpose of measuring the claims arising out of the breach, and the arbitration clause survives for determining the mode of their settlement. The purposes of the contract have failed, but the arbitration clause is not one of the purposes of the contract.*

Simply put, following the accepted repudiation of a contract, the contract is terminated. However, the parties to the contract remain bound by the obligations within the contract to the extent arising prior to the termination and, in many cases, may be governed by the contract following its termination as well. These obligations include, but are not limited to, the obligation to pay money due under a contract, certain warranties, and even the obligation to pay damages.

If SOTA's position were correct, it would mean that for the purposes of the *Act*, a contract ceases to exist when terminated, but for the purposes of the law of contracts, it does not. This would be an absurd result.

Another useful example of an obligation that parties to a contract remain bound by following termination, can be found within the well-known CCDC contracts. For example, in the CCDC 2 Stipulated Price Contract 2020, General Condition 7.2 "Contractor's Right to Suspend the Work or Terminate the Contract" states as follows at Paragraph 7.2.5:

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[7] *1394918 Ontario Ltd. v. 1310210 Ontario Inc.*, [2002] O.J. No. 18 at para. 22.

> *7.2.5 If the Contractor terminates the Contract by giving a Notice in Writing to the Owner under the conditions set out above, the Contractor shall be entitled to be paid for all work performed including reasonable profit, for loss sustained upon Products and Construction Equipment, and such other damages as the Contractor may have sustained as a result of the termination of the Contract.*

If a contract ceases to exist upon termination, then a provision such as Paragraph 7.2.5 of the CCDC 2 could not be applied or enforced. Beyond just the CCDC 2, many modern construction contracts outline extensive processes that survive termination. If termination of a contract meant that it ceased to exist, these processes would be superfluous.

It would be unfair, unjust, and an absurd result if the mere fact that a contract has been terminated could result in a party being absolved of: (a) contractual obligations that arose prior to termination or, (b) contractual obligations that survive termination.

(3) Did the Legislature intend for adjudications to be available after the termination of a contract, having regard for the scheme and object of the *Act*?

A review of the scheme and object of the *Act* demonstrates that the legislature intended for adjudications to be available after the termination of a contract. Certainly, the discussion above relating to the plain reading of the *Act* and the principle of *"expressio unius est exclusio alterius"* supports this legislative intent argument, particularly as the Legislature used the term "terminated" in its updates to the *Act* while excluding it from the relevant sections relied upon by SOTA. Therefore, the Legislature turned its mind to the use of "terminate" or "terminated" but chose to exclude it from the relevant sections.

Nonetheless, a useful starting point for ascertaining the scheme and object of the *Act*, especially in the context of prompt payment and adjudication, is a review of the recommendations made by Bruce Reynolds and Sharon Vogel in their report, *Striking the Balance: Expert Review of Ontario's Construction Lien* ("*Striking the Balance*") which led to the updates to the *Act*.

The recommendations in *Striking the Balance* related to prompt payment and adjudication are framed by two important and related concerns identified therein:

> *Two important and related concerns that were identified by a number of stakeholder groups are: (1) timeliness of payment, and (2) the efficiency of the mechanisms for the enforcement of payment for work performed. Some commentators are of the view that the Act does not sufficiently protect contractors, subcontractors or suppliers from payment delays, and that proceeding to litigation to secure payment is too protracted and too costly. As a result, many have indicated that there is a need for a more practical solution*.[8]

The recommendations from *Striking the Balance* also make clear that adjudication is concerned primarily with avoiding payment delays and ensuring the flow of funds down the contractual pyramid. These recommendations made their way into debate at the Legislative Assembly of Ontario where it was made clear that prompt payment is concerned primarily with ensuring that workers are paid, or in other words, ensuring that funds continued to flow down the construction pyramid, and have nothing to do with whether a contract has been terminated.

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[8] Bruce Reynolds, Sharon Vogel, *Striking the Balance: Expert Review of Ontario's Construction Lien Act*, April 30 2016, pg. 153.

> *I would like to talk about the real reason why we are here addressing the issue of prompt payment with this piece of legislation.* ***It's about workers—workers who go to work every day and perform a job, whether they be electricians, plumbers or labourers*** **[emphasis added].** *They give up their time, Mr. Speaker, and you can relate to this; they work hard and they do their best all the time, yet, when Friday comes, they don't get paid."* [9]

The legislature went on further to say the following:

> *I think it's important that we are all reminded why acting on prompt payment is essential to protect working people in the province of Ontario, because, really, at the end of the day I hope we can all agree that workers deserve to be paid for the work they perform. Nobody— and I mean nobody— should go to work and work for free. It's only fair, isn't it? It's really the most basic level of protection a worker can receive, to be paid for the work they perform. I know that some of you may say that in most cases this is a contractor or a subcontracting company that is not being paid for work, not the worker. But, as I previously stated, it always seems to fall back on the worker.*[10]

Even if a contract is terminated, parties deserve to be paid promptly.

At the end of the day, adjudication is the enforcement mechanism for prompt payment and without adjudication and, importantly, certainty of payment following adjudication, prompt payment is meaningless. As stated in by the legislature "*if you don't have enforcement, it's not worth the paper its written on*."[11]

This interconnection between prompt payment and adjudication was also articulated in *Construction, Builders' and Mechanics' Liens in Canada:*

> *The enactment of statutory prompt payment obligations along with a companion adjudication regime now fill this gap. Prompt payment obligations buttressed by summary adjudication processes now allows a quick determination of entitlement issues associated with payment, binding on an interim basis and enforceable as if by order of the court, facilitating orderly cash flow and striking a balance among competing interests.*[12]

There can be no reasonable doubt that the primary purpose of prompt payment and adjudication under the *Act* is to enforce payment obligations, and to enforce them promptly.

An interpretation of the *Act* that prevented a party from commencing an adjudication after a contract was terminated would be incompatible with the legislative intent of prompt payment and adjudication. This interpretation would allow a party to unilaterally terminate a contract to prevent the other party from benefiting from the streamlined process of adjudication afforded by the legislature. This cannot be the correct outcome. As found by the Court in *Rizzo*, an interpretation can be considered absurd if it leads to ridiculous or frivolous consequences, if it is extremely unreasonable or inequitable, if it is illogical

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[9] Ontario, Legislative Assembly, Official Report of Debates (Hansard), 41st Parl, 2nd Sess, No 92 (13 September 2017) at pg. 4951.

[10] Ontario, Legislative Assembly, Official Report of Debates (Hansard), 41st Parl, 2nd Sess, No 92 (13 September 2017) at pg. 4932.

[11] Ontario, Legislative Assembly, Official Report of Debates (Hansard), 41st Parl, 2nd Sess, No 92 (13 September 2017), at page 4955.

[12] David I Bristow et al., *Construction, Builders' and Mechanics' Liens in Canada*, 8th ed. (Toronto: Thomson Reuters Canada), § 13:2; § 13:10.

or incoherent, or if it is incompatible with other provisions or with the object of the legislative enactment.[13]

(4) There is no absurdity

Finally, SOTA argued that allowing a party to commence an adjudication after a contract has been terminated leads to an absurdity. The argument was that (a) a party to a terminated contract would be afforded additional time to preserve its liens than a party to a completed contract, due to the extension language in s. 34(10) of the *Act* which pauses the lien expiration period during an adjudication and (b) that allowing adjudication to commence after a contract is terminated will enable a party to circumvent the *Limitations Act*, 2002, S.O. 2002, c. 24, Sched. B ("*Limitations Act*"). Both arguments are flawed.

(a) The Extended Lien Preservation Period Argument

Pursuant to s. 34(10) of the *Act*, the commencement of an adjudication pauses the expiration of unpreserved liens. As a result, while the lien expiration period will begin to run following termination, a party to a terminated contract could pause that time period by commencing an adjudication after termination. However, a party to a completed contract is afforded no such right.

This, however, is not an absurdity. Rather, it is simply the nature of the *Act* as contemplated by the Legislature. The Legislature specifically added s. 34(10) of the *Act* in order to extend the lien preservation period for parties to an adjudication. Of course, this will only apply to liens which have not already expired. But it also ensures that issues which can be addressed and resolved through adjudication need not proceed into a lien action.

Importantly though, no prejudice is suffered by the party to a completed contract. That party knows, prior to completion, that the contract is nearing completion. If there are issues which require adjudication, the party may commence an adjudication and benefit from s. 34(10) of the *Act* before it completes the contract. A party to a terminated contract, however, likely has no advance warning of termination, and therefore has no such benefit.

(b) The *Limitations Act* Argument

Under s. 13.5(3) of the *Act*, an adjudication can be commenced until the contract has been completed. SOTA argued that, given that a terminated contract will in most cases be an incomplete contract, allowing a party to commence an adjudication after a contract has been terminated allows a party to, in effect, avoid the basic two-year and ultimate fifteen-year limitation periods under the *Limitations Act.* The argument is based on the fact that s. 2 of the *Limitations Act* identifies the claims for which it applies, which are limited to "court proceedings". Because an interim adjudication is not a "court proceeding", it is not subject to the *Limitations Act.*

SOTA argued that this apparent absurdity is resolved by virtue of s. 13.5(3) of the *Act* which prevents adjudications from being commenced after a contract or subcontract is "complete". However, s. 13.15(3) is not the solution to this *Limitations Act* issue. Rather, the *Limitations Act* issue is resolved by virtue of s. 13.15(1) of the *Act*, which states that a determination of a matter by an adjudicator is binding on the parties to the adjudication only until, among other things, a determination of the matter by a court or

[13] *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 SCR 27 (SCC) at para. 27.

arbitrator. Consequently, the courts (or an arbitrator) ultimately have jurisdiction over the matter and therefore a party may always seek relief under the *Limitations Act* through the courts. Adjudication does not determine liability; it simply determines interim entitlement to payment.

Even if the Court were to agree that allowing a party to commence an adjudication after a contract has been terminated may lead to an absurdity, such absurdity is unlikely ever to materialize; a party entitled to payment under a terminated contract would need to sit on its claim for more than two years. Further, where the party entitled to payment wishes to pass non-payment down to its subcontractors, s. 6.5(5) of the *Act* requires that an adjudication be commenced within 21 days of the notice of non-payment to the subcontractor.

Finally, if there is a gap in the legislation, the matter should be referred to the legislature. The Court of Appeal has found that the courts should not remedy gaps in legislation by redrafting, even if such gaps are inadvertent.[14] At the end of the day, "*[i]t is up to the legislature rather than the courts to effect any desired change*".[15] Such change could be made by adding a provision to the *Act* akin to that at s. 52(1) of the *Arbitration Act*, 1991 S.O. 1991, c. 17 which states that the law with respect to limitation periods applies to an arbitration as if the arbitration were an action.

Conclusion

As a result of the success that we had with dismissing SOTA's application, the Divisional Court missed the opportunity to provide some much-needed clarity to the *Act.* However, had the Divisional Court made a decision on the underlying merits, they would likely have adopted the analysis above which provides strong support to the conclusion that a contract does not "cease to exist" when it is terminated.

The full decision from the Divisional Court can be found here.

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[14] *Beattie v. National Frontier Insurance Co.*, 2003 CarswellOnt 4465, [2003], at para 18.
[15] *Beattie v. National Frontier Insurance Co.*, 2003 CarswellOnt 4465, [2003], at para 18.