COURT OF APPEAL FOR ONTARIO

CITATION: 1298417 Ontario Ltd. v. Lakeshore (Town), 2014 ONCA 802
DATE: 20141117
DOCKET: C56585

Feldman, MacFarland and Epstein JJ.A.

BETWEEN

1298417 Ontario Ltd.

Plaintiff (Respondent)

and

The Corporation of the Town of Lakeshore

Defendant (Appellant)

William V. Sasso, Werner H. Keller and Jacqueline A. Horvat, for the appellant

Claudio Martini, Myron Shulgan and Maria Marusic, for the respondent

Heard: February 11, 2014

On appeal from the judgment of Justice A. Duncan Grace of the Superior Court of Justice, dated January 7, 2013, with reasons reported at 2013 ONSC 99, 6 M.P.L.R. (5th) 227.

Feldman J.A. (Concurring):

[1] I have had the benefit of reading the reasons of Epstein J.A. I agree that the appeal should be allowed and the action dismissed because the damages claimed by the respondent, 1298417 Ontario Ltd. ("129"), the developer of the St. Clair Shores Subdivision, and awarded by the trial judge, are too remote and not compensable for the breach of contract that was alleged.

[2] However, I would not uphold the trial judge's interpretation of the contract. I do not agree that the town entered into an *ultra vires* contract. In my view, the trial judge erred in interpreting the contract and finding that Lakeshore breached it.

A. Article 3.1 does not grant 129 a monopoly over sewer capacity

[3] The Supreme Court of Canada recently discussed the standard of review in cases involving the interpretation of contracts in *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, 373 D.L.R. (4th) 393. At para. 50, Rothstein J. began by stating that "[c]ontractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix." To the extent that the process of contractual interpretation involves fact-finding and mixed questions of fact and law, the reasons that favour deference on such issues, set out in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, are applicable, particularly in cases where "[t]he legal obligations arising from [the] contract are…limited to the interest of the particular parties": *Sattva*, at para. 52.[1]

[4] However, "it may be possible to identify an extricable question of law from within what was initially characterized as a question of mixed fact and law",

[1] I note that in this case, where one of the parties is a public body, that principle may have a somewhat more limited application.

though courts should be cautious in doing so: *Sattva*, at paras. 53-54. Examples of extricable legal errors include "the application of an incorrect principle, the failure to consider a required element of a legal test, or the failure to consider a relevant factor", as well as the failure to construe the contract as a whole: *Sattva*, at paras. 53, 64.

[5] The provision at issue is article 3.1 of the Supplementary Agreement between Lakeshore and 129, which states:

> The Municipality hereby grants and approves the allocation of additional capacity in the Existing System so as to allow for full development of the St. Clair Shores Subdivision, in compliance with the existing zoning provisions for the said Subdivision. For greater certainty, said additional capacity shall be deemed to have been expressly reserved for the benefit of the St. Clair Shores Subdivision, and the Municipality shall not, prior to completion of full development and build out of residential and commercial buildings in the St. Clair Shores Subdivision, grant and/or approve additional capacity in the Existing System for lands outside of the St. Clair Shores Subdivision. [Emphasis added.]

[6] The trial judge read the second half of the second sentence (underlined above) as Lakeshore effectively granting 129 an exclusive right or monopoly over sewer capacity until the St. Clair Shores Subdivision was completed. I agree with my colleague, that if the trial judge's interpretation of article 3.1 is correct, then article 3.1 is *ultra vires* the authority of Lakeshore because it conflicts with Lakeshore's obligation under s. 86(1)(c) of the *Municipal Act, 2001*, S.O. 2001, c. 25.

[7] In my view, however, the trial judge made extricable legal errors when interpreting article 3.1, most importantly by reading the words that appear to grant a monopoly in isolation, rather than construing the clause as a whole. Reading article 3.1 as a whole, the proper interpretation that gives full effect to the words used, the surrounding circumstances, and the intention of the parties, is that article 3.1 does not grant 129 a complete monopoly over sewer capacity pending the completion of the St. Clair Shores Subdivision. Rather, Lakeshore contracted to provide 129 with only sufficient sewer capacity *required for the full development of the St. Clair Shores Subdivision*. Lakeshore merely promised not to grant another development any of the capacity *required for the full development of the St. Clair Shores Subdivision* before that subdivision was completed.

[8] Read in isolation, the clause underlined above may well bear the meaning attributed to it by the trial judge. However, it is an extricable error of law to read a provision of a contract in isolation rather than construe the contract as a whole. In *Sattva*, Rothstein J. stated at para. 64:

> I accept that a fundamental principle of contractual interpretation is that a contract must be construed as a whole (McCamus, at pp. 761-62; and Hall, at p. 15). If the arbitrator did not take the "maximum amount" proviso into account, as alleged by Creston, then he did not construe the Agreement as a whole because he ignored a specific and relevant provision of the Agreement. This is a question of law that would be extricable from a finding of mixed fact and law.

[9] When reading article 3.1 as a whole, one looks first at the first sentence, in which Lakeshore grants “the allocation of additional capacity in the Existing System so as to allow for full development of the St. Clair Shores Subdivision”. In other words, the grant of sewer capacity is not unqualified or unlimited; it is a grant given for the stated purpose of allowing for the full development of the St. Clair Shores Subdivision.

[10] The second sentence of article 3.1 is a further explanation of the first sentence. It begins with the words “For greater certainty”, indicating that it is intended to provide a fuller understanding of the first sentence. The second sentence refers to “said additional capacity”, that is, the capacity that will “allow for full development of the St. Clair Shores Subdivision”. That “said additional capacity” is deemed to be reserved for the benefit of the St. Clair Shores Subdivision. Finally, the second half of the second sentence says that Lakeshore shall not grant “additional capacity in the Existing System” – i.e., the capacity referred to in the first sentence that is required for full development of the St. Clair Shores Subdivision – to other lands prior to completion of the buildings in the St. Clair Shores Subdivision.

[11] When interpreting the second half of the second sentence, the trial judge failed to consider that the first sentence is the operative portion of the grant, and the second sentence is there only “[f]or greater certainty.” Therefore, by its plain language, the second sentence cannot change the meaning and intent of the first

sentence. The first sentence grants only the amount of additional capacity necessary for the full development of the St. Clair Shores Subdivision, but not more. The disputed clause that appears to grant a monopoly must be interpreted in that context.

[12] The trial judge's interpretation also failed to give effect to the intent of the parties, which the Supreme Court has emphasized is the overriding concern in contractual interpretation. Rothstein J. wrote at para. 47 of *Sattva*:

> …the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" (*Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744, at para. 27 *per* LeBel J.; see also *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 S.C.R. 69, at paras. 64-65 *per* Cromwell J.) To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract.

[13] One of the key surrounding circumstances was that any contract that Lakeshore entered into had to comply with the *Municipal Act, 2001*. The trial judge erred in law in his conclusion that granting the sewer capacity monopoly to 129, to the exclusion of all other developers, was not *ultra vires* an Ontario municipality, because it is contrary to s. 86 of the *Municipal Act, 2001*. Having made this error, he failed to take into account, in interpreting the second half of

the second sentence, the fact that the interpretation he gave would result in an illegal, and therefore unenforceable contract, which could not have been the intention of Lakeshore. Nor would 129 have intended that a provision granting it additional sewer capacity in fact be unenforceable.

[14] In addition, when interpreting contracts, courts prefer to give the contractual provisions a meaning that will make them legal, rather than illegal and unenforceable. As this court observed in *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust*, 2007 ONCA 205, 85 O.R. (3d) 254, at para. 57:

> It is well accepted that "where an agreement admits of two possible constructions, one of which renders the agreement lawful and the other of which renders it unlawful, courts will give preference to the former interpretation": John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005), at 729.

[15] Because the trial judge failed to recognize that his interpretation of the contract made article 3.1 *ultra vires*, he failed to prefer an interpretation of article 3.1 that rendered it legal and enforceable rather than illegal and unenforceable.

[16] To summarize, in article 3.1, Lakeshore agreed to grant 129 sufficient sewer capacity to allow for the full development of the St. Clair Shores Subdivision. To that end, Lakeshore also agreed not to grant any of the capacity that 129 needed to fully develop the St. Clair Shores Subdivision to any other development before the St. Clair Shores Subdivision was completed.

[17] This interpretation is the result of reading article 3.1 as a whole. It recognizes that the phrases “additional capacity in the Existing System” and “additional capacity” are used in the first sentence and consistently and in the same way in the second sentence of article 3.1, and are therefore both modified by the important qualification, “so as to allow for full development of the St. Clair Shores Subdivision”. This interpretation recognizes the context of the municipality’s obligations under s. 86(1) of the *Municipal Act, 2001*. It gives full effect to the intent of the parties and fully complies with the applicable principles of contract interpretation.

B. Lakeshore did not breach the contract

[18] The trial judge observed that the issue of breach “seems obvious.” He interpreted article 3.1 as giving 129 an effective monopoly over sewage capacity until the St. Clair Shores Subdivision was completed. Lakeshore violated the monopoly by allocating sewage capacity to another developer before the St. Clair Shores Subdivision was completed. The trial judge found that, therefore, Lakeshore “did the very thing it promised not to do.”

[19] The trial judge nevertheless also examined whether there was sufficient capacity in the enhanced sewage system to accommodate full development of both the St. Clair Shores Subdivision and the Tecumseh Golf lands and found

that there was not. On that analysis, Lakeshore would have been in breach of the contract, even as properly interpreted.

[20] My colleague used the doctrine of severance to effectively reach the same result that I have regarding the proper interpretation of article 3.1. Based on that interpretation, under Issue 5, she discusses whether Lakeshore breached the agreement by allocating sewer capacity to the Tecumseh Golf lands development. I agree with her analysis and conclusion under Issue 5 that, on the record, the future sewer requirements of the developments could not be known in 2005, and consequently, there was no evidence of a breach of article 3.1, properly interpreted.

C. There are no damages

[21] I also agree with my colleague that the damages claimed and awarded by the trial judge are too remote from the alleged breach and are not compensable. On that basis alone, the judgment would be set aside and the action dismissed.

D. Conclusion

[22] For these reasons, I would allow the appeal and grant judgment dismissing the action.

"K. Feldman J.A."

"I agree. J. MacFarland J.A."

Epstein J.A.:

INTRODUCTION

[23] The appellant, the Town of Lakeshore, and the respondent, 1298417 Ontario Limited, a developer, entered into a Subdivision Agreement in which Lakeshore undertook to provide capacity in its sewage system to the respondent's proposed development. Subsequently, the parties entered into a Supplementary Agreement that provided for an enhancement to the town's sewage system that would increase the capacity available to the respondent's proposed development. When Lakeshore provided another developer access to the enhanced sewage capacity prior to the completion of the respondent's development, the respondent sued Lakeshore for breach of contract. The respondent claimed damages stemming from the loss of commercial tenancies to the competing developer.

[24] The trial judge found that by providing the other developer access to the sewer system, Lakeshore breached the Supplementary Agreement. He awarded the respondent damages of $2,423,860, based on the profits that the other developer purportedly realized from certain commercial tenancies.

[25] Lakeshore appeals. Lakeshore argues that the trial judge erred in interpreting the Supplementary Agreement, specifically article 3.1, as prohibiting it from allocating sewage capacity to anyone else pending completion of the respondent's subdivision. Lakeshore's position is that, properly interpreted,

article 3.1 requires it to provide the respondent with sufficient capacity to complete its subdivision. Lakeshore argues that the respondent failed to prove any breach, since the evidence does not establish that the capacity in the system is insufficient to allow for the completion of the respondent's subdivision. Lakeshore submits in the alternative that, if the trial judge's contractual interpretation is correct, the Supplementary Agreement is *ultra vires*. Lakeshore further contends that even if it did breach the Supplementary Agreement, the trial judge's assessment of damages cannot stand.

[26] For the reasons that follow, I would allow the appeal, set aside the judgment below and dismiss the action. In my view, the last portion of article 3.1 is *ultra vires* as it imposes a blanket restriction on Lakeshore's ability to provide sewage capacity to others, regardless of the availability of unallocated capacity. Such a restriction conflicts with Lakeshore's statutory obligation under s. 86(1) of the *Municipal Act, 2001*, S.O. 2001, c. 25 (the "Act"), which provides that where there is sufficient capacity, a municipality shall, upon request, supply a building lying along a supply line with a sewage public utility.

[27] My conclusion that a portion of article 3.1 of the Supplementary Agreement is *ultra vires* does not end the analysis. In the circumstances, it is appropriate, in my view, to sever the *ultra vires* portion, particularly having regard to the fact that the Supplementary Agreement contains a "severability clause".

[28] In article 3.1, as revised after severance, Lakeshore promises 129 sufficient sewage capacity to enable it to complete St. Clair Shores. This promise is enforceable. However, as of the trial date, the evidence does not establish that Lakeshore will be unable to honour that promise. As a result, the action must fail.

[29] For completeness, I have also considered Lakeshore's appeal with respect to damages. In my view, the trial judge erred in his determination of damages. The type of damages 129 sought was too remote.

THE FACTS

The Subdivision Agreement

[30] In 1998, 1298417 Ontario Limited ("129") purchased 170 acres of land (the "Lands") for $6.5 million. At the time, the Lands were vacant, undeveloped and unserviced. 129 proposed to build a subdivision known as St. Clair Shores on the Lands. To this end, on January 4, 2000, the parties entered into a Subdivision Agreement.

[31] Under the terms of the agreement, 129 promised to design and install, at its expense, all required services including sanitary sewers. In the Subdivision Agreement, Lakeshore stated its intention to construct a new trunk main. The Subdivision Agreement provided that, pending completion of the new trunk main, 129 would have access to a specified amount of capacity (0.8 cubic feet per

second or “cfs”) in the existing downstream system that serviced that part of the town in order to outlet St. Clair Shores’ sewage. If it turned out that there were additional capacity in the downstream system, such capacity would be allotted to 129. 129 agreed to pay for any works necessary to take advantage of any additional capacity.

[32] 129’s consulting engineers, Hanna, Ghobrial and Spencer Ltd. (“Spencer”), designed the sewer system for the new subdivision. The system, ultimately approved by the required public authorities, including Lakeshore, was designed to service St. Clair Shores and the existing uses on two neighbouring properties. The system would outlet into Lakeshore’s existing downstream system, as set out in the Subdivision Agreement. One of the neighbouring properties was a golf driving range on the Tecumseh Golf Lands (the “TGL”).

The Supplementary Agreement

[33] By 2003, the sewage system Spencer designed had been installed underneath the Lands and 129 had completed the first phases of commercial and residential development. 129 asked Lakeshore to approve further phases of development. However, Lakeshore had not constructed the new trunk main and became concerned about the sufficiency of sewer capacity as development of the subdivision progressed. 129 took the position that there was ample sewage capacity in the existing downstream system to permit further residential and

commercial development. Lakeshore therefore asked its engineer, Stantec Consulting Ltd., to examine and report on the matter.

[34] In a report dated August 22, 2003, Stantec recommended that improvements to be made to the downstream system to increase its capacity, such that 1.5 cfs of sewage capacity could be allocated to St. Clair Shores. In a further report, dated September 12, 2003, Stantec proposed that the improvements, estimated to cost $730,000, be shared roughly equally between Lakeshore and 129. 129 agreed. On September 22, 2003, Lakeshore's council approved the report's recommendations.

[35] During the next 12 months, 129 through its lawyer, Jeffrey Slopen, and Lakeshore through its planner, Cindy Prince, negotiated a supplement to the Subdivision Agreement in order to incorporate Stantec's recommendations. Following passage of an enacting by-law on October 25, 2004, the parties entered into a Supplementary Agreement. The Supplementary Agreement set out, among other things, the parties' responsibilities relating to the enhancement of the downstream system.

[36] Article 3.1 of the Supplementary Agreement, the interpretation of which is the focus of this appeal, reads as follows:

> The Municipality hereby grants and approves the allocation of additional capacity in the Existing System so as to allow for full development of the St. Clair Shores Subdivision, in compliance with the existing

> zoning provisions for the said Subdivision. For greater certainty, said additional capacity shall be deemed to have been expressly reserved for the benefit of the St. Clair Shores Subdivision, and the Municipality shall not, prior to completion of full development and build out of residential and commercial buildings in the St. Clair Shores Subdivision, grant and/or approve additional capacity in the Existing System for lands outside of the St. Clair Shores Subdivision.

The Golf Lands Development

[37] In the summer of 2005, Manning Developments Inc. ("MDI") sought access to sewage capacity to develop a two-acre portion of the TGL. Counsel for Lakeshore advised MDI as follows:

> It is our understanding that you are concerned that the Supplementary Agreement ... as amended ... excludes [the TGL] from available sanitary sewage capacity. In our view, you[r] conclusion is not correct. [The TGL] are clearly described as [B]enefiting [L]ands in the Agreement and therefore will have access to additional sewage capacity not required by St. Clair Shores upon paying the costs as outlined in the agreement. Having regard to all of the circumstances, the agreement was not intended to prevent the [B]enefiting [L]ands from developing prior to the completion of St. Clair Estates but rather to ensure sufficient capacity for that development. We have been assured that there is sufficient capacity to complete St. Clair Estates as well as to service [the TGL].

[38] As part of the original design of the subdivision, 129 retained a one-foot reserve on the north side of the Lands. This one-foot reserve blocked TGL's access to the sewer line. To allow MDI to connect the TGL to the existing sewage system, Lakeshore asked 129 for a transfer of the one-foot reserve.

Lakeshore took the position that it was entitled to the conveyance pursuant to the Subdivision Agreement. 129 refused.

[39] Mr. Slopen wrote a letter to Lakeshore's counsel dated November 3, 2005, asserting that Lakeshore had agreed that the TGL would not be serviced until 129 had completed St. Clair Shores. He indicated that Lakeshore granted this concession in consideration of 129's commitment to spend in excess of $10,000,000 to service the subdivision and the resulting tax benefit to Lakeshore.

[40] Through its counsel, Lakeshore responded by confirming that it intended to comply with its contractual obligations. However, Lakeshore disagreed with 129's interpretation of the parties' obligations under the Supplementary Agreement. Lakeshore asserted that it could not withhold capacity from the TGL because sewage is a municipal service and there was sufficient capacity in the system to service both the TGL and St. Clair Shores. Lakeshore argued that it would be unreasonable to interpret the agreement as promising 129 a market advantage over others.

[41] In 2007, over 129's objection, Lakeshore expropriated the one-foot reserve. In the expropriation proceeding, 129 and Lakeshore filed an agreed statement of facts in which 129 took the position that there was adequate capacity in the system for St. Clair Shores and the two-acre portion of the TGL that was being developed by MDI.

[42] Ultimately, Lakeshore allowed MDI to connect to the sewage system that ran underneath the Lands. The TGL were developed. By March 2007, MDI had leased 17,265 square feet of commercial space to tenants including Boston Pizza, Pizza Pizza and Bulk Barn.

[43] In proceedings commenced in July, 2007, 129 sued Lakeshore for breach of contract, claiming damages stemming from the loss of these commercial tenancies to MDI.

THE TRIAL DECISION

[44] In analyzing the "scope of the parties' agreement", at para. 133, the trial judge identified the issue as being "*when* [Lakeshore] was permitted to allocate sewage capacity to someone other than 129 in light of the provisions of the Supplementary Agreement" (emphasis in original).

[45] The determination of that issue rests on the interpretation of article 3.1.

[46] The trial judge summarized the parties' positions. According to Lakeshore, while it promised that 129 would have sufficient sewage capacity to complete St. Clair Shores, it did not promise that 129 would have a monopoly, exclusivity or priority over development in that part of the town until the subdivision was fully developed. According to 129, it was promised such a priority as Lakeshore had agreed not to allocate sewage capacity in the existing system to anyone else until St. Clair Shores was fully developed.

[47] The trial judge accepted 129's interpretation. It followed that by allocating sewage capacity to MDI prior to the completion of St. Clair Shores, Lakeshore did the very thing it promised not to do. Lakeshore was therefore in breach of the Supplementary Agreement.

[48] The trial judge went on to reject the reasons Lakeshore advanced for why it should not be found to have breached the Supplementary Agreement.

[49] The only issue relevant to this appeal is the trial judge's rejection of Lakeshore's *ultra vires* defence. Lakeshore argued that its statutory duty to supply sewage public utility, under s. 86(1) of the Act, prevented it from denying access to MDI: as a result, any agreement that purported to prevent it from honouring its statutory obligations is *ultra vires* and therefore unenforceable.

[50] Upon hearing expert evidence from both sides, the trial judge found that the sewage capacity that ultimately will be required for the full development of St. Clair Shores and the TGL will exceed 1.5 cfs, which was the capacity in the enhanced downstream system allocated to St. Clair Shores. As a result, the trial judge concluded that Lakeshore was not obligated to provide sewage capacity to MDI under s. 86(1) of the Act. In addition, he found that s. 86(1) "did not affect [Lakeshore's] contractual obligations to 129" (para. 198).

[51] In awarding 129 damages, the trial judge referred to the evidence as limited, but sufficient to support the following findings, at para. 222:

> [F]irst, if the Supplementary Agreement had not been breached, sewage capacity would not have been allocated to MDI; second, without the allotment, [the TGL] would not have been developed; third, there was precious little alternative commercial space in the vicinity of the Lands before completion of the MDI and Spidrock developments and fourth, income 129 otherwise would have generated was lost.

[52] Based on these findings, the trial judge was satisfied that there was a "reasonable probability" that 129 would have leased commercial space on the Lands had Lakeshore not breached the Supplementary Agreement and allowed MDI to develop. After considering the evidence relevant to the specific leases upon which 129 relied, as well as the costs of developing the commercial space, and then applying a contingency allowance to reflect a degree of uncertainty, the trial judge concluded that 129 sustained damages of $2,423,860 as a result of Lakeshore's breach.

[53] The trial judge dismissed 129's claim for punitive damages.

ISSUES ON APPEAL

[54] This appeal raises the following issues:

1. Did the trial judge err in interpreting article 3.1 of the Supplementary Agreement?
2. What is the proper interpretation of s. 86(1) of the Act?
3. Is article 3.1, or a portion of the provision, *ultra vires* as a result of Lakeshore's obligations pursuant to s. 86(1)?

4. If article 3.1, or a portion of the provision, is *ultra vires*, should the offending words be severed?

5. If severance is permitted, do the facts demonstrate that Lakeshore breached article 3.1, as revised?

6. If Lakeshore, in providing sewage capacity to MDI, breached an enforceable agreement, what remedy is 129 entitled to?

ANALYSIS

ISSUE ONE – Did the trial judge err in interpreting article 3.1 of the Supplementary Agreement?

[55] The trial judge accepted 129's interpretation of article 3.1 of the Supplementary Agreement. He found that Lakeshore had promised not to provide sewage capacity in the existing downstream system to anyone other than 129 until the completion of St. Clair Shores.

[56] The trial judge set out his reasons for accepting 129's interpretation at para. 136:

> I make this finding because:
>
> a. First, 129 sought - and was given - priority from the outset of its relationship with [Lakeshore]. As noted previously, the existing system's known capacity (0.8 cfs) was allotted to 129 in its entirety in article D.4 of the Subdivision Agreement. If additional capacity was identified, 129 was to receive that allotment too;
>
> b. Second, the reason for the inclusion of article D.4 in the Subdivision Agreement still existed. Capacity in the existing/downstream system was limited. Construction of a new trunk line would have eliminated the problem. However, that work had

never been undertaken. While the existing/downstream system was to be enhanced, capacity was still limited;

c. Third, the Supplementary Agreement was a product of discussions following delivery of Stantec's August 22, 2003 report. It identified 1.5 cfs of capacity in the existing system if enhancements were made. Stantec did not discuss the capacity needed to complete development of the Lands or [the TGL]. 129's plans for developing vacant parcels were not yet fully known. [Lakeshore] seeks to ascribe to Stantec an opinion it did not form. I should add here that the author of Stantec's report - Mr. Manzon - did not testify. He is no longer employed by Stantec. Donald Joudrey of Stantec did testify both as a fact and, ultimately with the consent of 129's counsel, expert witness. In cross-examination Mr. Joudrey fairly acknowledged that he assumed 1.5 cfs was sufficient to allow completion of development of 129's lands but could point to nothing as a foundation for it;

d. Fourth, sewage capacity was of continuing concern to 129. Article 3.1 included a qualification from the first draft: [Lakeshore] was prohibited from allocating sewage capacity to others *if* the downstream system would no longer be able to accommodate full development of the Lands. [Lakeshore's] March 31, 2004 request for significant changes left the qualification untouched;

e. Fifth, the final version of article 3.1 reflected revisions made by Mr. Slopen to make 129's position - and hence priority - even more clear. The qualification was deleted. In its place was a prohibition: sewage capacity could not be allocated by [Lakeshore] to MDI or anyone else until 129's development was complete. [Lakeshore] signed the Supplementary Agreement in that form. [Italics in original; underlining added.]

[57] In *Sattva Capital Corp. v. Creston Moly Corp*., 2014 SCC 53, 373 D.L.R. (4th) 393, Rothstein J. set out the standard of review for contractual interpretation. He wrote for the court, at para. 50:

> Contractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix.

[58] *Sattva* directs that an appellate court should defer to a trial judge's contractual interpretation unless it was based on an extricable error of law.

[59] With respect, I am of the view that, in interpreting the Supplementary Agreement, the trial judge may have erroneously taken into account the factors found in parts of subparagraphs d. and e. in para. 136 (underlined above). These factors involve the subjective intentions of the parties when drafting the agreement, as largely inferred from the evolution of the drafts. The trial judge may have erred in taking these factors into account as the Supreme Court has held that, (1) subjective intentions of the parties are not relevant to contractual interpretation: *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, at paras. 54, 58-59; and, (2) prior drafts are inadmissible as evidence of subjective intentions: *Indian Molybdenum Ltd. v. The King*, [1951] 3 D.L.R. 497 (S.C.C), at pp. 502-3; Geoff R. Hall, *Canadian Contractual Interpretation Law*, 2nd ed. (Markham, Ontario: LexisNexis Canada, 2012), at pp. 64-65, 79-81. I also note that the Supplementary Agreement contains an "entire agreement clause" (article

6.10) expressly stating that the written contract "supersedes all prior understandings, agreements, negotiations and discussions, whether oral or written, among the parties".

[60] I have somewhat qualified my assessment of whether, by taking the above-noted factors into account, the trial judge erred, as *Sattva* does not appear to limit what courts may look at to interpret a contract. At para. 47, Rothstein J. says:

> [T]he interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding"... To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning... [Emphasis added.]

[61] In *Sattva*, the Supreme Court appears to direct an appellate court to defer to the trial judge's findings concerning the relevant antecedent facts.

[62] In this regard, at para. 136 of his reasons, reproduced above, the trial judge sets out a number of different grounds, derived from the text of the agreement and the factual matrix, for reaching his conclusion as to how the Supplementary Agreement should be interpreted. With the guidance from *Sattva*

in mind, the trial judge's interpretation is consistent with the "ordinary and grammatical meaning" of article 3.1. Indeed, I am unable to read the second half of the second sentence of article 3.1, underlined below, as promising anything less than a monopoly over the existing system pending the completion of St. Clair Shores. For convenience I set out article 3.1 again. It reads:

> The Municipality hereby grants and approves the allocation of additional capacity in the Existing System so as to allow for full development of the St. Clair Shores Subdivision, in compliance with the existing zoning provisions for the said Subdivision. For greater certainty, said additional capacity shall be deemed to have been expressly reserved for the benefit of the St. Clair Shores Subdivision, and the Municipality shall not, prior to completion of full development and build out of residential and commercial buildings in the St. Clair Shores Subdivision, grant and/or approve additional capacity in the Existing System for lands outside of the St. Clair Shores Subdivision. [Emphasis added.]

[63] Lakeshore submits that article 3.1 contains no promise of a monopoly, but merely prescribes the terms and conditions for enhancement of the downstream system.

[64] With respect, Lakeshore has not persuaded me that the monopoly is contrary to sound commercial principles or the business purpose of the whole agreement. Further, such considerations cannot overcome the unambiguous words underlined above. The following passage from *Novopharm*, at para. 56, encapsulates my view on this issue:

> [I]t would be absurd to adopt an interpretation which is clearly inconsistent with the commercial interests of the parties, if the goal is to ascertain their true contractual intent. However, to interpret a plainly worded document in accordance with the true contractual intent of the parties is not difficult, if it is presumed that the parties intended the legal consequences of their words. [Emphasis added.]

[65] I note that Lakeshore also stressed that the provisions in the Supplementary Agreement in which it promised to collect development charges from third parties and remit them to 129 to defray the up-front costs of the enhancements were not consistent with the trial judge's interpretation of article 3.1. But, I also note that these terms could apply after the promised monopoly came to an end upon completion of St. Clair Shores.

[66] In short, I am not convinced that the trial judge's interpretation is so contrary to commercial sense that the parties must have intended something other than what is expressed by the plain words of article 3.1. As stated by Hall, at p. 39:

> [S]eeking a commercially sensible interpretation is not a policy goal in and of itself. The purpose of the commercial efficacy principle is not to protect business people from absurd results of their own contracts. Instead, the commercial efficacy principle relates to the overall goal of contractual interpretation, which is to give an accurate meaning to the parties' intentions.

[67] Lakeshore also contends that the trial judge's interpretation of article 3.1 made it *ultra vires*: thus, this court should reject his interpretation. I am aware

that "[c]ourts will avoid a contractual interpretation which results in rendering the agreement unlawful": *Unique Broadband Systems, Inc.(Re),* 2014 ONCA 538, 121 O.R. (3d) 81, at para. 87. But, there is no ambiguity in article 3.1 to resolve by way of that principle.

[68] There were, however, two related aspects of the Supplementary Agreement that initially gave me some pause as they might be interpreted as demonstrating an intention to create sewage capacity sufficient to allow for the full development of St. Clair Shores *and* the TGL. First, in article 2.1, the agreement gave effect to the cost-sharing arrangement set out in the September 12, 2003, Stantec report. Lakeshore's contribution was based on the premise that "[u]ltimate development in the service area **not including** St. Clair Shores would create peak flows higher than the existing pumping system can handle" (emphasis in original). Second, the Supplementary Agreement contains a recital stating that the enhancements "are necessary not only to accommodate the St. Clair Shores Subdivision, but in order to accommodate ultimate expected flows from the existing service area". The recital goes on to state that the enhancements will be to the benefit of the "Benefiting Lands", which included the TGL and undeveloped portions of St. Clair Shores. The entire recital reads:

> **AND WHEREAS** it has been determined by way of engineering studies and consultation between [Lakeshore and 129] that certain enhancements to [Lakeshore's] existing sanitary sewer system (the **"Existing System"**) are necessary not only to

> accommodate the St. Clair Shores Subdivision, but in order to accommodate ultimate expected flows from the existing service area of the Existing System, and which enhancements will be to the benefit of the lands described in Schedule "B" attached hereto (the **"Benefiting Lands"**), being that portion of the St. Clair Shores Subdivision which is undeveloped as of the date of this Supplementary Agreement, as well as other lands abutting the St. Clair Shores Subdivision to the north;... [Emphasis in original.]

[69] The trial judge interpreted the words "existing service area" in the first part of the recital as pertaining to parts of Lakeshore lying to the east of St. Clair Shores and the TGL. This interpretation is a finding of mixed fact and law to which deference must be given. It follows from this finding that Lakeshore's share of the enhancements in the cost-sharing arrangement was to provide, at least in part, for the ultimate development of areas of Lakeshore unrelated to the Lands. The trial judge went on to find that, although the TGL are included in the Benefiting Lands, there was no representation in the recital that the enhancements would accommodate the "ultimate expected flows" from the TGL. All that was represented was that TGL would "benefit": the extent of that benefit was unstated and could have been anticipated as capacity's being available following full build-out of St. Clair Shores. Based on the trial judge's analysis, in which I detect no error, I do not think that the cost-sharing arrangement and the related recital are so contradictory to the plain words of article 3.1 that effect should not be given to their ordinary meaning.

[70] In concluding my analysis of the issue of whether the trial judge erred in interpreting article 3.1, I return to *Sattva*. Specifically, I note para. 55, where Rothstein J. reinforces the reviewing court's obligation to defer to the trial judge's interpretation of a contract by saying that "the circumstances in which a question of law can be extricated from the interpretation process will be rare."

[71] In the light of the clear direction in *Sattva*, and the trial judge's interpretive exercise, both reviewed above, I would not interfere with the trial judge's finding that, in article 3.1 of the Supplementary Agreement, Lakeshore promised not to provide sewage capacity in the existing system to anyone other than 129 until full build-out of St. Clair Shores had been completed.

ISSUE TWO - What is the proper interpretation of s. 86(1) of the Act?

[72] Lakeshore submits that article 3.1, as interpreted by the trial judge, is *ultra vires*, because the provision would prevent Lakeshore from meeting its obligations under s. 86(1) of the Act. Before addressing the *ultra vires* argument it is necessary to understand a municipality's obligations under that provision.

[73] Section 86(1) governs the municipality's obligation to supply water or sewage. It provides:[2]

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[2] Section 19 concerns the geographic application of a municipality's powers. For instance, section 19(1) states, "By-laws and resolutions of a municipality apply only within its boundaries, except as provided in subsection (2) or in any other provisions of this or any other Act." There is no need to consider s. 19 here.

> 86. (1) Despite section 19, a municipality shall supply a building with a water or sewage public utility if,
>
> (a) the building lies along a supply line of the municipality for the public utility;
>
> (b) in the case of a water public utility, there is a sufficient supply of water for the building;
>
> (c) in the case of a sewage public utility, there is sufficient capacity for handling sewage from the building; and
>
> (d) the owner, occupant or other person in charge of the building requests the supply in writing.
>
> (2) Subsection (1) does not apply if the supply of the public utility to a building or to the land on which the building is located would contravene an official plan under the *Planning Act* that applies to the building, land or public utility. [Emphasis added.]

[74] The subsection at issue is s. 86(1)(c), specifically, what is meant by "sufficient capacity". The question is what a municipality is required to take into account in deciding whether there is "sufficient capacity" to trigger its obligation under s. 86(1). Must it take into account capacity currently being used or capacity currently being used as well as capacity that has been previously allocated into the future?

[75] In *John Doe v. Ontario (Finance)*, 2014 SCC 36, 373 D.L.R. (4th) 601, at para. 18, Rothstein J. repeated Driedger's modern principle that governs the approach to statutory interpretation:

> The modern approach to statutory interpretation requires the words of s. 13(1) to be read in their entire context and according to their grammatical and ordinary sense, harmoniously with the scheme and object of the

> Act and the intention of the legislature (R. Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at p. 1; *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21).

[76] With respect to legislative intent, an overriding object of the Act was to provide "more authority, accountability and flexibility so that municipal governments would be able to deliver services as they saw fit": *Croplife Canada v. Toronto (City)* (2005), 75 O.R. (3d) 357 (C.A.), at para. 6. The Act moved away from the prescriptive approach of earlier municipal legislation, which had set out itemized lists of what municipalities could do, toward providing municipalities with greater flexibility and independence: John Mascarin and Christopher J. Williams, *Ontario Municipal Act & Commentary*, 2014 ed. (Markham, Ontario: LexisNexis Canada, 2013), at pp. 6-13. Part II of the Act sets out general municipal powers, including natural person powers and the power to pass by-laws within broad spheres of jurisdiction: Mascarin and Williams, at p. 19. One of these spheres is public utilities: s. 11(3)4 of the Act.

[77] Section 8(1) of the Act expressly states that municipal powers are to be interpreted broadly:

> 8. (1) The powers of a municipality under this or any other Act shall be interpreted broadly so as to confer broad authority on the municipality to enable the municipality to govern its affairs as it considers appropriate and to enhance the municipality's ability to respond to municipal issues.

[78] I start from the premise, therefore, that s. 86(1)(c) should be interpreted broadly, meaning so as not to unnecessarily restrict a municipality from allocating and promising sewage capacity into the future.

[79] Policy considerations are also important here. In *Statutory Interpretation*, 2nd ed. (Toronto: Irwin Law, 2007), at pp. 218-19, Ruth Sullivan identifies policy analysis as "an essential and appropriate part of the interpretative process.... [I]t is a legitimate part of statutory interpretation in so far as the values and preferences relied on are rooted in legislation or the common law or in the evolving legal tradition."

[80] An interpretation of s. 86(1)(c) that prevents a municipality from allocating sewage capacity into the future has the potential to stymie development and to create unfairness. In Lakeshore itself, the trial judge found that capacity allotted to one developer for future development would not ordinarily be given to another (para. 151). This is because, as the facts of this case demonstrate, municipal development is forward-looking. Providing for orderly development requires a municipality to be able to allocate public utilities going forward in order to prevent future shortages, avoid conflicts, and facilitate growth. A developer would be far less willing to invest the resources necessary for a building project if access to sewage services were uncertain.

[81] It would follow from these considerations that s. 86(1)(c) should also be interpreted as allowing municipalities to contract with developers in a manner that allows allocations of future sewage supply.

[82] Furthermore, as the facts of this case demonstrate, such contracts provide municipalities with a means of funding the extension of services into a new development. This is a policy preference rooted in legislation. Through the Act and related legislation, the legislature has provided municipalities with tools to secure contributions from developers for the provision of services to new developments. For instance, under ss. 51(25) and 51(26) of the *Planning Act*, R.S.O. 1990, c. P.13, subdivision of land can be made conditional on entry into an agreement with a municipality to provide services. Similarly, under ss. 44 and 45 of the *Development Charges Act*, 1997, S.O. 1997, c. 27, a municipality can enter into a "front-ending agreement" in which a developer that agrees to contribute to the upfront costs of providing certain services can be reimbursed by third parties who later develop land within the service area, as was contemplated in the Supplementary Agreement.

[83] Interpreting s. 86(1)(c) as providing that sufficiency of capacity be assessed without regard to any previous allocation of future supply, contractual or otherwise, has the potential of exposing developers who rely on the allocated capacity to be co-opted by another developer who finishes their building first. The resultant uncertainty risks interfering with a municipality's ability to secure

contributions from developers for the upfront costs of sewage services. As I have noted, there is also an obvious potential for unfairness and conflict.

[84] These factors lead me to conclude that, properly interpreted, under s. 86(1)(c) a municipality, in assessing whether a sewage system's remaining capacity is sufficient to grant a request for supply, must take into account both capacity that is currently being used as well as capacity that has been reasonably allocated into the future.

[85] I say *reasonably* allocated into the future because it would be contrary to the intent of s. 86(1) for a municipality to be in a position to avoid its obligations under that provision by promising a favoured developer an unreasonable amount of future capacity.

[86] First and foremost, s. 86(1) creates a duty on the municipality. It obliges a municipality to supply a sewage public utility if three conditions are met: the building lies upon a supply line, there is "sufficient capacity" and a person in charge of the building makes a written request.

[87] The jurisprudence on s. 86(1), and its predecessor, s. 55 of the *Public Utilities Act*, R.S.O. 1990, c. P.52, is limited. But, the courts have interpreted these provisions generously so as to prevent a municipality from using its control over public utilities to pursue its objectives at the expense of those requesting supply. In *St. Lawrence Rendering Co. v. Cornwall (City)*, [1951] O.R. 669

(H.C.), a city council passed a resolution that the water supply to a rendering plant should be discontinued. Council members frankly admitted that the purpose of the resolution was to drive the plant out of Cornwall because of the foul odours it was emitting. The trial judge held that the resolution was contrary to the city's duty under s. 55. In *Holmberg v. Sault Ste. Marie Public Utilities Commission*, [1966] 2 O.R. 675 (C.A.), the commission refused to supply the applicants' house with water. The applicants had purchased land in a subdivision and built a home. The original developer of the subdivision had failed to test the water main it had installed, as required by a subdivision agreement. The commission demanded that the applicants pay for the testing of the water main before it would supply water to their home. Writing for this court, Laskin J.A. relying on s. 55, upheld the order for *mandamus* requiring the commission to supply water to the applicants.

ISSUE THREE - Is article 3.1, or a portion of the provision, *ultra vires* as a result of Lakeshore's obligations pursuant to s. 86(1)?

[88] In the words of Ian MacF. Rogers, *The Law of Canadian Municipal Corporations*, loose-leaf (2012-Rel. 6), 2d ed. (Toronto: Carswell, 2009), at p. 1049, "[i]t is clear that a municipality can set up the defence of *ultra vires* and is not debarred as an individual person would be from showing and relying on its incompetency to make the agreement in question" (footnote omitted). A person contracting with a municipality is bound at its peril to take notice of the limits

within which the council has the power to contract: *Pacific National Investments Ltd. v. Victoria (City)*, 2000 SCC 64, [2000] 2 S.C.R. 919, at para. 68; Rogers, at pp. 1035-36.

[89] Lakeshore submits that, as interpreted by the trial judge, article 3.1 is *ultra vires*.

[90] The trial judge, based on his finding that the existing downstream system was inadequate to accommodate development of the TGL, rejected this argument, saying, at para. 198:

> For the purposes of this dispute, I am not satisfied that the Town was obligated to allocate sewage capacity to MDI under section 86 (1) of the *Municipal Act*. That section did not affect the Town's contractual obligations to 129. The Supplementary Agreement was not *ultra vires*. The Town was bound by and breached its terms.

[91] For the reasons that follow, I am of the view that the trial judge erred in concluding that article 3.1 was *intra vires*. Properly interpreted, article 3.1 of the Supplementary Agreement is *ultra vires*, as it requires Lakeshore to make a promise that is directly contrary to its obligations under s. 86(1) of the Act. Lakeshore does not have the jurisdiction to make such a promise.

[92] In explaining my reasoning on this issue, it may be best to start with what I have not concluded.

[93] First, it is not my opinion that any promise of future sewage capacity is *ultra vires*. Given my interpretation of s. 86(1), a contractual promise to reserve a

specific and reasonable amount of sewage capacity for future development, to the exclusion of all others, may well be *intra vires*.

[94] Second, it is not my opinion that a promise of future sewage capacity is necessarily *ultra vires* if it has the effect of creating a *de facto* monopoly over development. Such a *de facto* monopoly may well be acceptable under s. 86(1), as interpreted, if the municipality promises a specific and reasonable amount of future sewage capacity to a developer and that specific amount is equal to all of the remaining capacity in the sewage system.

[95] The offending portion of article 3.1 is the wording at the end of the article – wording, as found by the trial judge - in which Lakeshore promises that, pending completion of St. Clair Shores, it will not allocate sewage capacity in the existing system to anyone else. The promise is absolute. It is not qualified. The promise ties Lakeshore's hands until some unknown date when St. Clair Shores is fully built out. Significantly, even if capacity becomes available before the completion of St. Clair Shores, Lakeshore is prevented from allocating it to building owners otherwise entitled to sewage supply under s. 86(1).

[96] What distinguishes the monopoly promised to 129 and the hypothetical *de facto* monopoly, set out above, is that the *de facto* monopoly would end in the event sufficient capacity becomes available for others, allowing the municipality

to meet its obligations under s. 86(1). However, article 3.1 does not allow for this.

[97] The parties disagreed over whether, at the time Lakeshore allocated capacity to MDI, there was capacity in the downstream system to enable St. Clair Shores to be fully developed and for the TGL. After an extensive analysis, the trial judge concluded, at paras. 194-97, that the full development of St. Clair Shores alone would require sewage capacity in excess of the 1.5 cfs the enhancements created in the downstream system. That is, there was insufficient capacity to grant MDI's request in 2005 because, at some point prior to the build-out of St. Clair Shores, the downstream system would run out of capacity. Although one may question whether this fact will prove to be accurate to the completion of St. Clair Shores, particularly given the expert evidence about how malleable the determination of available sewage capacity is, deference is owed to this finding and I would not interfere with it.

[98] However, I disagree with the trial judge's conclusion that this conclusion saves article 3.1 from being *ultra vires*. I note that s. 86 is located in Part III of the Act. As Mascarin and Williams opine, at p. 33, "The structure of the *Municipal Act*, 2001 requires that the general powers in Part II co-exist with and be supplemented, or restricted by, the specific powers in Part III" (emphasis added). In my view, s. 86(1) does not just require a municipality to provide sewage supply if certain conditions are met. By implication, the section also

restricts a municipality's powers to enter into an agreement that would have the effect of preventing it from providing sewage supply if the conditions are met.

[99] Accepting that an agreement to exclude all others from a sewage system could be justified by proof that sufficient capacity for others never was (or never will be) available over the duration of the contract, such that an obligation under s. 86(1) never arises, would be contrary to the intention of s. 86(1), which is to provide fair and predictable access to public utilities. Such a holding would also create uncertainty because the enforceability of such an agreement would be contingent on the availability of sewage capacity, which is subject to constant change and which, at any given time in the life of the contract, may or may not be known to the parties. The agreement could flicker in and out of legal existence as the sewage system changed. With respect to subdivision agreements, which are publicly available documents upon which third parties rely for their own decision-making, such uncertainty is particularly objectionable.

[100] Furthermore, the connection between a municipality's obligation to supply sewage under s. 86(1) and its lack of jurisdiction to make a promise to exclude all others from a sewage system, is supported by the trial record. The evidence in this case was that a municipality cannot be completely certain when it makes such a promise that a s. 86(1) obligation will not arise in the future. Even if, at the time of contracting, there is only enough capacity in the system for the

property owner who receives the promise to exclude all others, “sufficient capacity” to grant other requests may well arise.

[101] In saying that it may “well” turn out that additional capacity will become available, I rely on the expert evidence of both parties - Donald Joudrey, called by Lakeshore, and David Archer, called by 129. Their evidence demonstrates that, in any one or more of a number of ways, capacity may become available in Lakeshore’s downstream system beyond that needed for the full build-out of St. Clair Shores.

[102] First, and most obviously, further enhancement of the downstream system might generate additional capacity. Lakeshore may still build the trunk main contemplated by the Subdivision Agreement.

[103] Second, different developments lying to the east of St. Clair Shores, also connected to the downstream system, might be completed without using all of their previously allocated capacity. Theoretical calculations form the basis for a municipality’s allocation of future capacity to a developer. The experts agreed that it is difficult to compute, with precision, the amount of sewage capacity a development will ultimately require.

[104] Third, buildings connected to the downstream system might reduce or stop altogether their production of sewage, freeing up capacity for others. Businesses change. They also shutter and move.

[105] Fourth, the means by which a municipality determines if there is “sufficient capacity” in a sewage system is subject to change. The evidence revealed that determining whether a sewage system has available capacity is a question on which reasonable experts can disagree. For instance, a municipality may have guidelines for calculating capacity that are more or less stringent. In addition, as the evidence in this case demonstrates, experts differ on what indicates that a sewage system is overcapacity.

[106] The issue of surcharging (i.e. overflow) provides an example. At para. 195 of his reasons, the trial judge appears to interpret s. 86(1) as providing that there will not be “sufficient capacity” in a sewage system if there is any level of surcharging. With respect, I see nothing in the Act that limits s. 86(1) to such a technical definition of “sufficient capacity”. To the contrary, as discussed above, the Act was meant to empower municipalities to manage their own affairs. Mr. Joudrey testified that a small amount of surcharging in a sewer system would have no consequences (e.g. no basement flooding). Thus, another means by which additional capacity can be found within a sewage system is if a municipality’s standards are relaxed (e.g. to allow for more surcharging).

[107] These examples, identified in the evidence, about how additional capacity might yet be found in Lakeshore’s downstream system, are only meant to illustrate the many ways a conflict can arise between a contractual promise to exclude all others and a municipality’s s. 86(1) obligation. However, my

conclusion that article 3.1 is *ultra vires* is not dependent on any of these examples' occurring. More generally, my conclusion that article 3.1 is *ultra vires* is not dependent on whether or not additional capacity has been or ever will be found in Lakeshore's downstream system. Rather, it is dependent on the wording of s. 86(1) of the Act and its clear intention to restrict, in at least this one way, a municipality's power to contract.

ISSUE FOUR - If article 3.1, or a portion of the provision, is *ultra vires*, should the offending words be severed?

[108] An *ultra vires* contract is void *ab initio*. But, based on the above analysis, I am of the view that only the words at the end of article 3.1 are *ultra vires*; namely, ". . . and the Municipality shall not, prior to completion of full development and build out of residential and commercial buildings in the St. Clair Shores Subdivision, grant and/or approve additional capacity in the Existing System for lands outside of the St. Clair Shores Subdivision."

[109] This conclusion begs the following questions. What should be done about an agreement that contains a term that is void? Can severance be used to preserve the remainder of the parties' bargain?

[110] Under the common law doctrine of severance, a court can excise or even reword an illegal or *ultra vires* contractual term so as to give effect to the remainder of the agreement. By eliminating or rewording a contractual term a court is making a new agreement: *Transport North American Express Inc. v.*

New Solutions Financial Corp., 2004 SCC 7, [2004] 1 S.C.R. 249, at para. 30. As a result, as stated by Rothstein J. in *Shafron v. KRG Insurance Brokers (Western) Inc.,* 2009 SCC 6, [2009] 1 S.C.R. 157, at para. 32, "courts will be restrained in their application of severance because of the right of parties to freely contract and to choose the words that determine their obligations and rights."

[111] Notwithstanding the courts' cautious approach to severance, I am of the view that, here, severance is appropriate and I would excise from article 3.1 the above-quoted words in which Lakeshore promises 129 that it will not grant sewage capacity to any other lands until completion of St. Clair Shores.

[112] In concluding that severance is warranted, I start with the important observation that, in this case, the parties expressly put their minds to the possibility that a provision in the Supplementary Agreement may be unenforceable and agreed that severance could be used to remedy the problem. I refer to article 6.5 that reads:

> If any provision of this Supplementary Agreement shall be held to be invalid, illegal or unenforceable, the validity, legality and enforceability of the remaining provisions of this Supplementary Agreement shall not in any way be affected or impaired thereby.

[113] The clause indicates the parties' clear intention that they did not want their rather complex agreement impaired by a finding that a specific provision is invalid. In determining whether the doctrine of severance should be applied,

substantial weight should be given to a severability clause: see e.g. *Miller v. Convergys CMG Canada Limited Partnership*, 2014 BCCA 311, 2014 CarswellBC 2260, at para. 44.

[114] Turning to the jurisprudence surrounding the issue of severability, I note that courts typically conduct a two-step analysis: McCamus, p. 510. First, it is determined whether severance would radically change the purport and substance of the original contract. Here, in *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011), at pp. 412-13, G.H.L. Fridman describes the "true test" as being "whether the subtraction of the void part of a contract affects the meaning of the remainder, or merely the extent." Second, it is determined whether severance would be contrary to public policy, particularly that underlying the law infringed by the offending contractual term.

[115] No radical change is required here. All that is needed to remedy article 3.1 is the deletion of the offending words. This application of the doctrine of severance would meet the traditional "blue-pencil test": McCamus, pp. 515-22. This revision renders article 3.1 *intra vires* and enforceable. Under the article, as revised, Lakeshore promises to 129 a specific and reasonable amount of sewage capacity; namely, that amount required for full build-out of St. Clair Shores. Significantly, upon receiving a third party request for sewage supply, if there is sufficient capacity to meet both the promise to 129 and the third party request, Lakeshore will be able to meet its obligations under s. 86(1).

[116] Revising article 3.1 in this manner does not offend public policy. In *New Solutions*, at paras. 42-46, a majority of the Supreme Court applied "four considerations relevant to the determination of whether public policy ought to allow an otherwise illegal agreement to be partially enforced rather than being declared void *ab initio*". These considerations were identified by this court in *William E. Thomson Associates Inc. v. Carpenter* (1989), 69 O.R. (2d) 545 (C.A.), leave to appeal refused, [1989] S.C.C.A. No. 398, at para 17 as:

> 1. whether that object and policy of the provision, in this case s. 86(1) of the Act, would be subverted by a partial performance of the agreement;
>
> 2. whether one or both parties intended to break the law;
>
> 3. whether the parties were in an equal bargaining position; and
>
> 4. whether one party would be unjustly enriched if the contract was not enforced.

[117] In my view, the *Thomson* considerations support severance. First, severing the offending words would not, in my view, subvert the purpose or policy of s. 86(1) of the Act – as provision that, as previously indicated governs a municipality's orderly allocation of water and sewage services. The essence of the parties' bargain is that 129 would benefit from its investment in the downstream sewage system and be in a position to complete St. Clair Shores. It is a bargain in keeping with the purpose of the Act. Severance would not subvert that purpose. Second, there is no evidence that supports a finding that either

party intended to circumvent s. 86(1) of the Act. Third, both parties were sophisticated and had extensive resources. The trial judge's description of the bargaining process indicates that it was chaotic but not patently unfair. Fourth, voiding the entirety of article 3.1 might create a windfall in that Lakeshore would no longer be liable if the development of St. Clair Shores is halted due to lack of sewage capacity.

[118] I am mindful of the fact that we received no submissions on severance. In my view, this is not an impediment to assist the parties by severing of what amounts to several lines of a lengthy agreement. It is clear that neither party would have reason to find severance objectionable. From 129's perspective, without severance, Lakeshore would have no obligations under article 3.1. From Lakeshore's perspective, severance gives effect to its consistent interpretation of article 3.1, namely that Lakeshore "guarantee[d] that [129] would have sufficient sewer capacity for full build-out of the Subdivision": see trial reasons, at paras. 114 and 132.

[119] Finally, I return to the fact that the parties expressly agreed to severance by including a severability provision in their agreement.

ISSUE FIVE - If severance is permitted, do the facts demonstrate that Lakeshore breached article 3.1, as revised?

[120] Following the decision to sever the offending portion of article 3.1, the issue that must be addressed is whether Lakeshore breached the revised provision.

[121] The trial judge had no reason to turn his mind to this question. However, given the fullness of the record, this court is in a position to exercise its broad jurisdiction under s. 134 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, jurisdiction that includes drawing inferences of fact from the evidence and determining this issue.

[122] Based on the analysis that follows, I conclude that 129 has not proven that Lakeshore breached article 3.1, as revised, when it allocated sewage capacity to MDI.

[123] Lakeshore has promised to provide enough sewage capacity to 129 to allow for full build-out of St. Clair Shores. As of the time of trial, St. Clair Shores remained only partially developed. There was no evidence that the amount of sewage capacity available to that point in time had had any negative impact on the development of St. Clair Shores.

[124] As discussed, in his reasoning on *ultra vires*, the trial judge found that full-build out of St. Clair Shores will require more than 1.5 cfs, which was the amount

of additional capacity in the downstream system that was purportedly created by the enhancements. But, it does not follow that Lakeshore breached article 3.1, as revised, by providing capacity to MDI. This is because the trial judge's finding is merely a prediction of future events that, as of the time of trial, had yet to be proven accurate.

[125] I would not find that the trial judge's prediction is inaccurate, only that it lacks sufficient certainty to prove breach on a balance of probabilities. I reiterate that the trial judge never had to consider whether breach of the revised article 3.1 was proven by his prediction. The trial judge's prediction lacks sufficient certainty for at least two reasons.

[126] First, even as of the trial date, it was not known whether St. Clair Shores will ever be fully built-out or, if it is, whether the final flows will exceed 1.5 cfs. The trial judge himself acknowledged this uncertainty, writing at para. 168, "Ultimate flow would depend on the nature of the businesses occupying the Lands. The mix was – and still is - unknown."

[127] Second, even as of the trial date, it was not known whether St. Clair Shores would only have access to 1.5 cfs by the time of full-build out. As the four examples provided earlier in these reasons demonstrate, the available capacity in a sewage system is subject to change.

[128] It may be argued that Lakeshore's allocation to MDI amounted to an anticipatory repudiation of the revised article 3.1, as the allocation would make performance impossible: McCamus, at p. 693.

[129] In my view, however, Lakeshore's allocation to MDI was not conduct that demonstrated an intention to repudiate the revised article 3.1.

[130] In 2005, when 129 expressed concern over the town's plans to provide sewage access to the TGL, Lakeshore expressly confirmed its intention to adhere to the Supplementary Agreement, or at least its interpretation of the agreement, which, as discussed, is the promise remaining in the revised article 3.1. As stated in *Standard Precast Ltd. v. Dywidag Fab Con Products Ltd.* (1989), 56 D.L.R. (4th) 385 (B.C.C.A.), at p. 386, "[r]epudiation is not lightly to be inferred from a party's conduct, particularly where, as here, prior to the time for performance that party has repeated its intention to carry out the contract". See also *McBride v. Johnson*, [1962] S.C.R. 202, at pp. 207-8.

[131] Furthermore, in my view, the allocation of capacity to MDI does not meet the test for anticipatory repudiation; namely, depriving 129 of "substantially the whole benefit" of the revised article 3.1: McCamus, pp. 693-94; *Place Concorde East Ltd. Partnership v. Shelter Corp. of Canada Ltd*., [2006] O.J. No. 1964, 270 D.L.R. (4th) 181 (C.A.), at para. 51. For the reasons discussed above, it is impossible to know whether the allocation to MDI will have a major, minor, or

insignificant effect on when, in the development of St. Clair Shores, sewage capacity becomes limiting (assuming the trial judge's prediction comes true). As the effect of the allocation to MDI was highly uncertain at the time – and, in fact, remains uncertain - Lakeshore's conduct in 2005 could not have been reasonably interpreted as depriving 129 of "substantially the whole benefit" of article 3.1, as revised.

[132] In summary, article 3.1, as revised through severance, is enforceable. However, I conclude that the evidence does not support a finding that Lakeshore is in breach of its obligations or a finding that Lakeshore has repudiated its promise. As a result, 129's action for breach of contract must fail.

ISSUE SIX - If Lakeshore, in providing sewage capacity to MDI, breached an enforceable agreement, what remedy is 129 entitled to?

[133] While my conclusion that the revised article 3.1 has not been breached or repudiated disposes of the matter, for completeness, I will briefly explain why I am of the view that the trial judge erred in determining damages.

[134] The $2,423,860 that the trial judge awarded 129 for breach of contract was calculated based on lost profits arising out of certain leases that MDI was able to secure for commercial space on the TGL.

[135] In assessing whether this loss of income flowed from the breach of contract, the trial judge cited, at para. 202, the following passage in *Hadley v. Baxendale* (1854), 156 E.R. 145, at p. 151:

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

[136] The trial judge accepted 129's claim that it was entitled to damages for rental income that was lost when prospective tenants chose to lease commercial space in MDI's new development on the TGL. The trial judge summarized his conclusions at para. 222, which, for convenience, I will set out again:

> I recognize the evidence is limited. However, four things are clear: first, if the Supplementary Agreement had not been breached, sewage capacity would not have been allocated to MDI; second, without the allotment, [the TGL] would not have been developed; third, there was precious little alternative commercial space in the vicinity of the Lands before completion of the MDI and Spidrock developments and fourth, income 129 otherwise would have generated was lost.

[137] Although correctly noting at the start of the section on damages, at para. 202, that the relevant legal principle was remoteness, the trial judge provided no analysis as to whether the loss of commercial leases to otherwise lawful

competition was the type of loss that fell within the parties' reasonable contemplation. Instead his analysis is devoted to causation and quantifying the loss.

[138] In *RBC Dominion Securities Inc. v. Merrill Lynch Canada Inc*., 2008 SCC 54, [2008] 3 S.C.R. 79, at paras. 63-64, Abella J. (dissenting in part) summarized the test for remoteness of damages following a breach of contract:

> The defining explanation of the contractual breach principles of reasonable foreseeability and remoteness is found in *Hadley v. Baxendale*... A court must therefore ask itself "what was in the reasonable contemplation of the parties at the time of contract formation" (*Fidler v. Sun Life Assurance Co. of Canada*, [2006] 2 S.C.R. 3, 2006 SCC 30, at para. 54).
>
> The principle of remoteness "imposes on damage awards reasonable limits which are required by fairness" *(Matheson (D.W.) & Sons Contracting Ltd. v. Canada (Attorney General)* (2000), 187 N.S.R. (2d) 62, 2000 NSCA 44, at para. 69, per Cromwell J.A.). It aims "to prevent unfair surprise to the defendant, to ensure a fair allocation of the risks of the transaction, and to avoid any overly chilling effects on useful activities by the threat of unlimited liability" (Jamie Cassels and Elizabeth Adjin-Tettey, *Remedies: The Law of Damages* (2nd ed. 2008), at p. 352). This principle will be informed by the nature and culture of the business in question, and the particular contractual relationship between the parties... [Emphasis added.]

[139] In Angela Swan and Jakub Adamski, *Canadian Contract Law*, 3d ed. (Markham, Ontario: LexisNexis Canada, 2012), at p. 480, the authors' helpfully

frame the issue as “the determination of the extent of the risk that a promisor assumes when he makes a promise.”

[140] In my view, the nature of the damages 129 claimed and the trial judge awarded was not in the reasonable contemplation of the parties when the contract was executed.

[141] The problem is not with rental income *per se* as a type of loss. The type of loss that was not reasonably contemplated is rental income that was lost as a result of ordinary, commercial competition. It only indirectly related to Lakeshore’s purported breach: the actions of a third party were also involved. It does not follow in the “usual course of things” that a grant of sewage capacity to a third party will result in a competing commercial development. Even if, as MDI did, a third party chose to compete with 129 for the same commercial tenancies, the loss of rental income depends on a myriad of commercial vagaries. Vacancy rates, profit margins, business relationships, and the relative attractiveness of the lots must be factored in. For instance, Mr. Valente acknowledged under cross-examination that, at least for Bulk Barn, the location of MDI’s development on the TGL was preferable to that of 129’s proposed development.

[142] Significantly, 129 points to no evidence that, prior to execution of the Supplementary Agreement, it alerted Lakeshore that the town would be liable for rental income lost as a result of commercial competition stemming from a breach.

Thus, the “second branch” of *Hadley v. Baxendale* does not come into play. To the contrary, the evidence was that there was risk to 129’s success with commercial tenancies that was entirely independent of Lakeshore. The evidence was that 129 also lost tenancies to a commercial development across the road from St. Clair Shores in the Town of Tecumseh. Thus, at the time of executing the contract, the parties had knowledge that spoke against Lakeshore’s liability for the loss of rental income to ordinary, commercial competition; namely, that this competition might arise in Tecumseh regardless of Lakeshore’s decisions.

[143] I conclude that even if article 3.1, as written, were enforceable and Lakeshore breached it, the damages 129 claimed in this proceeding are too remote.

[144] In such circumstances 129 would be entitled only to nominal damages that I would have fixed at $1: see e.g. *Southcott Estates Inc. v. Toronto Catholic School Board*, 2010 ONCA 310, 104 O.R. (3d) 784, at para. 30, aff’d 2012 SCC 51, [2012] 2 S.C.R. 675.

DISPOSITION

[145] For these reasons, I would allow the appeal. I would set aside the judgment below and dismiss the action.

[146] Further to counsel’s agreement, Lakeshore is entitled to its costs of the appeal fixed in the amount of $40,000, including disbursements and applicable

taxes. Failing resolution of the issue of costs below, I would ask the parties to make submissions with respect to the costs of the trial within 15 days of the receipt of these reasons.

Released: “KF” November 17, 2014

“G.J. Epstein J.A.”