A STUDY IN CERTAINTY

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On January 27, 1959, the Supreme Court of Canada brought down a decision which could have far reaching effects throughout the Common Law provinces. The case was *Calvan Consolidated Oil and Gas Company Ltd.* v. *M. E. Manning.*[1]

This case is important not only for what was specifically decided between the parties, but also for the principle which may be derived from it. Mr. Justice Judson spoke for the Court and was not embarrassed by dissenting judgments, or by what is often more troublesome, concurring judgments which remind one of Stephen Leacock's legendary character who mounts his horse and rides off in all directions leaving counsel and the lower courts completely unenlightened.

This case arose out of a very simple set of facts. The Respondent Manning and the Appellant Calvan were both holders of petroleum and natural gas permits issued by the British Columbia government. Manning held permit 153 and Calvan permit 120. Early in 1953 the parties entered into negotiations with regard to their respective permits with a view to exchanging partial interests. On the 20th of February 1953, Manning made a written offer to Calvan in which he proposed to transfer a 20% interest in permit 153 to Calvan in exchange for a transfer of a 20% interest in permit 120 to Manning. Calvan was to retain the right to deal with permit 120 and three possible situations were envisioned and provided for.

First, in the case of a sale the owner of the permit would account to the other for 20% of the proceeds. Secondly it was provided that if the permit was to be farmed out to a third party Calvan was to have full power of decision over the terms of the farmout of permit 120 subject to its duty to preserve Manning's 20% interest as a working interest. Both Manning and Calvan's interest would abate according to the extent of the third party's interest. The third situation contemplated was the development of permit 120 by Calvan and in that case both parties would mutually agree to the terms of the operating agreement and if they could not agree on any particular clause, then the clause in question would be arbitrated by a single arbitrator pursuant to "The Arbitration Act of Alberta". It was also agreed that each party would keep its permit in force for three years, and that a formal agreement would be drawn up as soon as possible.

This offer was in the form of a letter from Manning to Calvan and was signed by Manning. Four days later on the 24th of February, 1953 the following clause was added:

> "It is agreed that the terms of the formal agreement are to be subject to our mutual agreement and if we are unable to agree, the terms of the agreement are to be settled by arbitration by a single arbitrator, pursuant to 'The Arbitration Act of the Province of Alberta'."

This offer with the amendment was accepted by Calvan.

Both parties carried on under this agreement for a considerable time.

[1] [1959] S.C.R. 253.

Manning sold permit 153 accounting to Calvan for 20% of the proceeds. From the evidence at trial, there appeared to be no difficulty over this transaction.

Later Calvan arranged a farmout of permit 120 to Imperial without Manning's knowledge or acquiescence and at this point the disagreement arose which ripened into action. Manning claimed that in their farmout agreement with Imperial Oil, Calvan had derogated from Manning's 20% working interet, and thus were in breach of their fiduciary duty towards him. Calvan brought action to have the court declare that the above quoted letter with amendments did not, nor ever had, constituted a contract. Mr. Justice Egbert at trial in the Supreme Court of Alberta,[2] declared that there never had been a contract.

In the interests of clarity before discussing the various questions arising out of this case on its journey through the courts, it is necessary to label two particular terms of the agreement. The arbitration clause which appeared in the letter of February 20, 1953 referring to the operating agreement will hereinafter be called the first arbitration clause. The arbitration clause referring to the drafting of a formal agreement which appeared in the amendment of February 24th, 1953 will be referred to as the second arbitration clause.

The first question to be decided in the action was a familiar one in the courts of both England and Canada, and it is fair to say that the principle to be applied is or should be the same in both jurisdictions.

This question arises where the parties have drawn up an informal agreement and expressed their desire that it be cast in more formal terms. Does this reference to a more formal agreement contemplate a new contract and new terms or does it mean that the formal contract is merely to give a more regular and complete expression to the terms already agreed upon? There are a great number of cases on this point and fortunately they all seem to express the same principle.[3] This principle is perhaps best stated *in Hatzfeldt-Wildenburg* v. *Alexander* where Mr. Justice Parker says:[4]

> "It appears to be well settled by the authorities that if the documents or letter relied on as constituting a contract contemplate the execution of a further contract between the parties, it is question of construction whether the execution of the further contract is a condition or term of the bargain or whether it is a mere expression of the desire of the parties as to the manner in which the transaction already agreed to will in fact go through. In the former case there is no enforceable contract either because the condition is unfulfilled or because the law does not recognize a contract to enter into a contract. In the latter case there is a binding contract and the reference to the more formal document may be ignored."

At trial Mr. Justice Egbert took the view that the second arbitration clause contemplated settlement of the terms not only of the informal agreement as it stood on February 24, 1953 but also of any farmout agreement which Calvan

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[2]*Calvan Consolidated Oil and Gas Company Limited* v. *M. E. Manning* (1957) 22 W.W.R. (NS) 433.

[3]*Chinnock* v. *Ely* (*Marchioness*) 46 E.R. 1066.
Winn v. *Bull* (1877) 7 Ch.D. 29.
Rossiter v. *Miller* (1879) 3 A.C. 1124.
Hatzfeldt-Wildenburg v. *Alexander* 1912 1 Ch. 284.
Branco v. *Cobarro* 1947 K.B. 854

[4]*Hatzfeldt-Wildenbury* v. *Alexander* 1912 1 Ch. 284.

might negotiate. On Mr. Justice Egbert's view of the meaning of this clause, it was asking too much of the arbitrator to settle the terms of both agreements.

Leaving for the moment Mr. Justice Egbert's view on the operation of the second arbitration clause, and narrowing our view to the question whether the parties contemplated that they would not be bound until a formal contract was signed, we find that both the Alberta Court of Appeal[5] and the Supreme Court of Canada decided the second arbitration clause operated only to embody the precise terms of the formal agreement, if the parties failed to agree on how this was to be done. Mr. Justice Judson put this proposition forcefully when he said:[6]

> "Only two questions remain to be considered and these arise from the provision in the amending agreement for arbitration on the terms of the formal agreement. The questions are first: whether this indicates an intention not to be bound until the formal agreement is executed and second: what terms may be incorporated in the formal agreement by the arbitrator. My opinion is that the parties were bound immediately on the execution of the informal agreement, that the acceptance was unconditional and that all that was necessary to be done by the parties or possibly by the arbitrator was to embody the precise terms and no more, of the informal agreement in a formal agreement."

The next and more important point decided in the Calvan Case was the function and operation of the first arbitration clause. In order to analyze the reasons for the judgment on this clause it is necessary to examine the earlier case law thoroughly. This necessitates close scrutiny of three English cases which succeeded in baffling a very competent judge of this English Court of Appeal.

May and Butcher v. *The King*[7] is the first case in this series. The parties were the crown and a dealer in war surplus equipment. By means of successive letters there emerged an agreement wherein the price was not agreed, but was left for the future agreement of the parties. The last term was in the form of an arbitration clause and appeared as follows:[8]

> "It is understood that all disputes with reference to or rising out of this agreement will be submitted to arbitration in accordance with the provisions of The Arbitration Act, 1889."

It was held both at trial and on appeal that there was no contract. The dissent of Lord Justice Scrutton was important for he was to play a leading part in the other two cases. He felt that the case was one where the unagreed price could be settled by the operation of the Sale of Goods Act. When appealed to the House of Lords, the Law Lords were unanimous in finding that this section provided for a reasonable price to be fixed by the courts where there had been no mention of price by the parties, but where the parties had stated how the price was to be arrived at, the act could not apply to make certain this uncertain term.

Then the House of Lords had to consider whether the arbitration clause could serve to make certain what the parties had neglected. Lord Buckmaster deals with the clause as follows:[9]

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[5](1957) 22 W.W.R. (NS) 433.

[6][1959] S.C.R. 253 at 260.

[7][1934] 2 K.B. 17 (Case decided in the House of Lords in 1929).

[8]*Ibid.*

[9]*Ibid.*, at 20.

"The next question is about the arbitration clause, and there I entirely agree with the majority of the Court of Appeal and also with Rowlatt, J. The clause refers 'disputes with reference to or arising out of their agreement' to arbitration, but until the price has been fixed, the agreement is not here. The arbitration clause relates to the settlement of what ever may happen when the agreement has been completed and the parties are regularly bound. There is nothing in the arbitration clause to enable a contract to be made which in fact the original bargain had left quite open . . . . ."

The second case is *W. N. Hillas Company* v. *Arcos Limited.*[10] In this case the parties made an agreement in the most ambiguous terms using expressions meaning little to the layman or even to the courts. This most inartistic language did not prevent the parties from performing the original agreement for a period of a year. At the end of this year however, when the Hillas Company attempted to enforce an option provided for in the original contract, the Arcos Company resisted and as a result the Hillas Company sued them for breach of contract. At trial the Hillas Company was successful, but this judgment was reversed in the Court of Appeal, where the selfstyled impenitent Lord Justice Scrutton still felt that he had been right in *May and Butcher* v. *The King,* but found for the Arcos Company, feeling that he was obliged to do so by the decision of the House of Lords in *May and Butcher* v. *The King.*

This case was then appealed to the House of Lords where the trial judgment was restored. The Law Lords stated that Lord Justice Scrutton had mistaken their meaning in *May and Butcher* v. *The King,* and the correct view was that where an agreement could be found despite the difficulty of construing vague language there would be a contract binding the parties.

Third and last in the series is *Foley* v. *Classique Coaches Limited.*[11] The parties, a bus company and a garage owner, entered into an agreement whereby the bus company would puchase certain property from the garage owner for a cash consideration and certain added conditions. One of these conditions was that the bus company would purchase all the petrol they required for their operations from the garage owner at a price to be agreed by the parties in writing from time to time. As this term stands it is clear from the cases already discussed that it is void for uncertainty. There was in the agreement, however, an arbitration clause as follows:[12]

"If any dispute or difference shall arise on the subject matter or construction of this agreement the same shall be submitted to arbitration in the usual way in accordance with the provisions of the Arbitration Act, 1889."

At trial judgment was found for the garage operator. The Court of Appeal confirmed this finding, Lord Justice Scrutton holding with the rest of the court that the arbitration clause related to the subject matter of the agreement and could serve to cure the omission in the clause as to price. In reaching this conclusion Lord Justice Scrutton considered that he was applying the law in accordance with the judgment of the House of Lords in the Hillas case.

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[10](1932) 38 Comm. Cases 23. Also contained in Milner *Wright's and Materials on the Law of Contracts.* (University of Toronto, 1954) 117.

[11][1934] 2 K. B. 1.

[12]*Ibid.,* at 4.

May and Butcher v. *The King* and *Foley* v. *Classique Coaches Limited* may be classified together. In both cases the terms were unambiguous, and it is evident that no contract could have arisen from the unsettled terms for the parties had left something to be agreed. The question to be answered is, did the arbitration clause operate to cure the obvious omissions? *In May and Butcher* v. *The King* it was held that the arbitration clause could not operate until there was a concluded agreement since its terms provided only for settling disputes with reference to or arising out of the contract. In *Foley* v. *Classique Coaches Limited* however, it was found as a fact by Lord Justice Scrutton that on construction the arbitration clause did not depend on concluded terms of agreement, but was by its language a term of a complete agreement which could serve to cure the obvious unsettled term as to price. The principle is readily apparent, that where there is an unsettled term and there is an arbitration clause which can be construed as providing for the settlement of this term as distinguished from mere disputes arising out of the contract, such an arbitration clause can operate to make a contract.

Hillas Company v. *Arcos Limited* presents a very different situation. There was great ambiguity here, but no question of an unsettled term. The question was could certainty be found in the loose terms of trade usage and the performance of the parties? The court by the use of expert witnesses and patient examination was able to find an agreement.

It is submitted that the Calvan Case falls within the *May and Butcher* v. *The King*, and *Foley* v. *Classique Coaches Limited* category and there is no need to consider *Hillas Company* v. *Arcos Limited*. Mr. Justice Judson puts this point almost beyond argument when he states:[13]

> "My conclusion therefore, is that this contract is not void for uncertainty. There is no need here to invoke the principles of a 'fair' and 'broad' construction of this contract as mentioned by Lord Wright in *Hillas and Company* v. *Arcos Limited supra*. The parties knew what they were doing and they expressed their intention with certainty and a complete lack of ambiguity."

Looking at the first arbitration clause in the Calvan Case and comparing it with those in *May and Butcher* v. *The King* and *Foley* v. *Classique Coaches Limited* the Calvan clause stands out as a model of clarity. It might well be said that Lord Justice Scrutton erred in *Foley* v. *Classique Coaches Limited* in finding that the arbitration clause in that case came within the orbit of the contract. But be that as it may, this question is one of construction and in no way derogates from the principle.

Mr. Justice Egbert at trial felt strongly that an arbitrator could not do what the parties had failed to do and he based his opinion on the mistaken principle that arbitrators are subject to the same rules as are judges in a court of law. Both Mr. Justice Porter in the Alberta Court of Appeal and Mr. Justice Judson in the Supreme Court of Canada took the directly opposite view, holding that, if properly empowered by the parties, an arbitrator can make a contract for them. In support of this they both cite the same authority:[14]

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[13][1959] S.C.R. 253 at 260.

[14]*Russell on Arbitration*, (17th ed.) at 10.

"Since an arbitrator can be given such powers as the parties wish, he can be authorized to make a new contract between the parties. The parties to a commercial contract often provide that in certain events their contract shall be added to or modified to fit the circumstances then existing, intending thereby to create a binding obligation although they are unwilling or unable to determine just what the terms of the new or modified agreement shall be. To a court such a provision is ineffective as being at most a mere 'agreement to agree' but a provision that the newer modified terms shall be settled by an arbitrator can without difficulty be made enforceable."

As his authority Mr. Justice Egbert quotes *Scammell* v. *Ouston*[15] where it is stated that a judge cannot make a contract for the parties where they have not reached agreement on essential terms, or in other words the court cannot invent a contract for the parties. This case is an excellent authority for the definition of the powers of a court in construing the terms of a purported contract, but it says nothing as to the powers of arbitrators.

The trial judge also felt that even if an arbitrator could fix one term as in *Foley* v. *Classique Coaches Limited* the drafing of what might amount to an entire operating agreements would be asking far too much of him. It seems to the contrary that if one term can be made certain by arbitration then why not two or three . . . . . ad infinitum. If this were not so it would put a strait jacket on business men preventing them from entering into contracts which a rapidly expanding country needs in order to continue its development. Mr. Justice Judson expresses this view in the clearest terms in the following passage:[16]

"The only remaining contingency was the retention, exploration and development of the property by the parties themselves. In an agreement of this kind, where the lands may be first of all sold or made subject to a farmout agreement, it seems to me virtually impossible for the parties at that stage of the proceedings to set out in full what the terms of operation would be if Calvan were to develop the land itself. Here are two co-owners who do not know at the point of time when co-ownership is established what they will do with the land. They realize that they may eventually have to develop it themselves. It is a situation that all co-owners may have to face and if nothing more is said between them, they must agree on the terms of the development. If they cannot agree they are at a standstill and must put up with this situation or wind up their association in some way. There is every reason, therefore, why the parties here introduced an arbitration clause into their agreement to deal with this particular point."

To sum up it is submitted that the decision in the Calvan Case will be most welcome in the business world, for it seems no exageration to say that business development was being seriously hampered by a too great respect for the superficial formalities in contracts. Business men were precluded or thought they were precluded from entering into many contracts which required commitments far into the future, and by this decision they will be enabled to take bolder steps forward with certainty. But to take advantage of this decision, they must insert an adequate arbitration clause within the contract.

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[15][1941] A.C. 251.

[16][1959] S.C.R. 253 at 259.

GIFTS OF LAW BOOKS TO UNIVERSITY

For several years, the Law Library has received *Canadian Bankruptcy Reports* as a gift from Sem Field, Q.C. The subscription is being continued by his firm following Mr. Field's retirement.

In this connection, the Law Librarian wishes to bring to the attention of the profession that gifts of the more frequently used reports are always most welcome, as constant use makes periodic replacement necessary, particularly of those volumes that contain leading cases. Volumes currently sought by the Library include: *Supreme Court Reports,* vols. 23, 27, 69; [1925], and [1929]-[1938]; *Alberta Law Reports,* vols. 21-26; and *Territories Law Reports,* vols. 5 and 7.

In addition, some of the classic texts which have not been re-edited are now very difficult to obtain. In particular, the Library is most anxious to procure a copy or copies of *Remedies of Vendor and Purchaser* by C. C. McCaul.